

## Fiscal Burden as Factor of the Business Climate

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**Abstract.** A conceptual approach to the ongoing reform of the state's control and supervision activity involves the identification and elimination of administrative barriers with the active participation of the business community. The paper examines the impact of the fiscal burden on business climate, identifies the main reasons for tax evasion by entrepreneurs in the Russian Federation and proposes ways of creating adequate tax relations between the state and enterprises, thus increasing business activity. The current research bases on the systematization and analysis of the results carried out annually over three years from 2016 to 2018 surveys of managers of enterprises. The surveys initiated by the regional business ombudsman and the business community. An analysis of the opinions of entrepreneurs suggests that business representatives call the high fiscal burden and falling profits due to the deteriorating economic situation as key negative factors that have a devastating effect on the business. There is an interdependence of subjective perception of the magnitude of the fiscal burden by business representatives and the objective characteristics of the business climate, which have a significant impact on the motivation and objective results of business entities.

### 1. Introduction

Tax relations between business and the state are an important mechanism that, on the one hand, systematizes tax revenues to budgets of all levels and stimulates business activity, on the other hand. At the same time, the norms of financial and tax law aim at ensuring the protection of public property interests and act as an institutional regulator and a tool for harmonizing interests.

Entrepreneurial activity determines by the characteristics of the business climate, including the conditions for the creation and conduct of business, as well as barriers and restrictions for doing business. It is obvious that the role of the state in regulating the conditions for carrying out economic activities and creating a favorable business environment is associated not only with the establishment of rules for obtaining licenses, registration of enterprises, but also with the policy of paying taxes and the current tax burden.

Note that that the tax system bases on the principle of dependence of the state on all taxpayers, and taxation inevitably leads to a conflict of private and public interests.

At present, the Russian Federation characterizes by a large share of shadow and informal economic relations, while the imperfection of the tax system prevents taxes from performing their main functions, including the fiscal function, which would provide the financial support for the activities of the state.

The share of tax revenues in the revenues of the Russian Federation federal budget is significantly lower than this figure in the budgets of developed countries. In the federal budget of the Russian

Federation, tax revenues estimate from 40% to 50%, while this indicator is much higher in the revenues of the budgets of developed countries. At the same time, non-tax revenues mainly provide for the budget of the Russian Federation.

In addition, there is a huge total debt of taxpayers into the budget of the Russian Federation, estimating about 5–6% of the total federal budget revenues.

## 2. Literature review

The influence of behavioral and psychological factors on the behavior of entrepreneurs, their relationship with tax authorities and compliance with tax laws have been actively studied since the 1950s. Günter Schmolders [1] examined the problems of fiscal psychology as a separate branch of public finance research. Later, Michael G. Allingham and Agnar Sandmo [2] evaluated the actual level of compliance with tax legislation, examining the specifics of interaction between various parties involved in taxation (taxpayers, legislators, tax authorities, etc.).

Over the following decades, researchers developed new approaches based on experiments and mathematical modeling that allowed evaluating the influence of behavioral dynamics on stimulating or preventing tax evasion. In his studies on various aspects of the theory describing the planned behavior of parties in economic relations and their intentions, Icek Ajzen [3] proved that the subjective norms of entrepreneurial behavior and their perception of the state control bodies are associated with certain sets of basic behavioral, regulatory and control attitudes. In the study, he obtained empirical data confirming the role of psychological factors in tax relations.

Erich Kirchler, Stephan Muehlbacher, Erik Hoelzl, Paul Webley [4] claim that the experience entrepreneurs have in dealing with tax authorities and the consequences of tax audits are an important factor in their compliance with tax obligations.

Research on the tax behavior of entrepreneurs in different countries conducted by various scientists, including Chris W. Chan, Coleen S. Troutman, David O'Bryan [5], James Alm, Jorge Martinez-Vazquez, Friedrich Schneider [6], Klarita Gërxhani, Arthur Schram [7], Benno Torgler and Friedrich Schneider [8] and others, highlights the importance of social and ethical norms. The publications confirm national differences in tax relations and prove that moral values have a strong influence on the behavior of taxpayers and their compliance with tax laws.

Stimulation of entrepreneurial activity is seen as a key factor in ensuring sustainable growth of the economy, reducing unemployment and increasing prosperity. At the same time, according to María Soledad Castaño, María Teresa Méndez, Miguel Ángel Galindoc [9], the state economic policy, including taxation, determines economic activity and its growth. Sharing the views of many politicians and researchers, Doaa Mohamed Salman [10] claims that the state should develop a system of special measures to support business development that would imply creating an attractive tax and stable monetary policy, promoting business education, and stimulating research and development.

Malcolm J. Beynon, Paul Jones, David Pickernell [11] claim that the established business climate or institutional environment influence the self-perception of business and its social status, opportunities to open new businesses, current risk levels and intentions of entrepreneurs. Pekka Stenholm, Zoltan J. Acs, Robert Wuebker [12] carried out a study of the business environment which shows that differences in institutional mechanisms affect both the level and type of business activity. The authors assess the level of country's development according to its ability to support highly efficient entrepreneurship. In their opinion, the differences in institutional mechanisms connect with the rate of companies' economic growth and differences in business types that different countries have.

Apart from the level of the development of the country and its welfare, business behavior is greatly influenced by its national mentality, culture, entrepreneurial attitudes and attitude to risk. According to Silvia Stroe, Vinit Parida, and Joakim Wincent [13], entrepreneurs' assessment of their business performance, their perception of risk and the combination of these largely determine the logic of decision making in the business environment. Weiqi Dai and Steven Si [14] argue that the positive attitude of businesspersons towards economic policy and their political connections, along with the level of institutional development of the country, stimulate economic activity.

However, David L. Poole [15] argues that, fairly often under the cover of developing measures to boost the SME sector, presented as the effective cure for countries with low per capita income, politicians act on the basis of unsaid claims and are influenced by a wide range of people, for example, microloan providers, management consultants or economists who adhere to different theories.

Moreover, according to Petra Dickel and Peter Graeff [16], corruption and non-compliance with laws is all the more likely, the higher the expected economic profit is. Entrepreneurs' neglect of legal norms and their tendency to take such actions caused by expected economic benefits and the high probability that they will get away with these illegal actions.

In this context, considering the legal framework and business environment, Ashantha Ranasinghe [17] focuses on the unavailability of unofficial payments, various forms of cash back or extortion that reduce the capital profitability and increase business costs. Here note that internal self-restraints in behaviour and ethical norms are much more difficult to represent in theoretical terms than informal restrictions that maximize personal gain.

According to Jose Joaquin Lopez [18], such phenomena as tax evasion and the informal sector are more common in developing countries. At the same time, increasing tax burden and unavailability of tax evasion may cause officially registered companies to move into the informal sector.

### 3. Materials and methods

At the initiative of the regional business ombudsman and with the active participation of business associations for three years from 2016 to 2018 surveys conducted annually among the managers of enterprises of various types of economic activity and legal forms. Surveys aimed at assessing the state of the business climate and identifying key factors affecting the business environment in the perception of entrepreneurs. Such studies conducted regularly over the past three years, which makes possible to assess the dynamics of changes in the conditions of doing business.

Thus, 502 respondents interviewed in 2016, 287 business representatives - in 2017, and 384 entrepreneurs participated in the 2018 survey. The respondents' opinions were collected in an anonymous survey with the note that all data will be generalized.

The sample structure corresponds to the average Russian characteristics of the business community according to the unified register of small and medium-sized enterprises of the Federal Tax Service.

Most of the respondents are enterprises that have existed on the market for more than 10 years (their share is more than 40% of the total number of respondents) and enterprises that exist from 5 to 10 years (about a third of respondents). Note that the rich experience in conducting business activities that most respondents possess allows them more objectively assess changes in business conditions and factors of the business climate.

Methods of systemic, logical and comparative analysis of scientific publications have applied in the study. The descriptive statistics have analyzed, and the hierarchical and correlation dependencies between the empirical data have determined.

## 4. Results

### 4.1. Perception of fiscal burden by Russian entrepreneurs

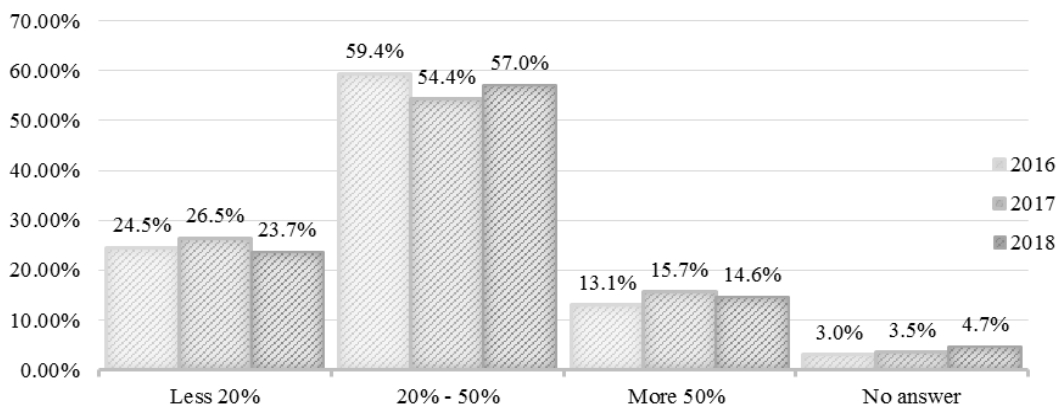
In the Russian Federation, a significant number of types of payments charges from business entities that ensure the performance of public functions, taxes and fees.

Respondents noted a high share of mandatory payments, taxes and non-tax fees. They have a negative or critical attitude to the size of the cadastral value and anticipate the further growth of tax burden. To establish the real boundaries of the burden for business, respondents were asked to assess the amount of mandatory payments (see Table 1, Figure 1).

Over the past three years, more than half of the respondents estimate the share of all obligatory payments (taxes and fees, customs payments, compulsory insurance expenses, etc.) in the company's expenses in the range from 20% to 50%; every fourth respondent determined a share of the fiscal burden on the business is about 20%.

**Table 1.** Respondents' assessment of the share of all obligatory payments (taxes and fees, customs payments, expenses for compulsory insurance, etc.) in the company expenses (percentage of the total number of respondents).

Answer Options	2016	2017	2018
<b>Less 20%</b>	24.5%	26.5%	23.7%
<b>20% - 50%</b>	59.4%	54.4%	57.0%
<b>More 50%</b>	13.10%	15.7%	14.6%
<b>No answer</b>	3.00%	3.5%	4.7%
<b>Total</b>	100.0%	100.0%	100.0%



**Figure 1.** Respondents' assessment of the share of all mandatory payments in company expenses (percentage of the total number of respondents).

Respondents believe that their actions, with a possible increase in taxes and non-tax fees and charges, will either be compensation for additional costs at the expense of the consumer - 54.7%, or - liquidation of the business 30.2% and only 10.7 % of respondents are ready to reduce their own profits to compensate for additional expenses.

In dynamics, the share of those willing to liquidate a business is declining, and to compensate for additional costs at the expense of the consumer is growing (see Table 2).

**Table 2.** Respondents' opinions on their actions in the event of a possible increase in taxes and non-tax fees and charges (percentage of the total number of respondents).

Answer Options	2016	2017	2018
<b>I will shift the costs to consumers</b>	47.4%	41.1%	54.7%
<b>I will liquidate my business</b>	37.6%	41.5%	30.2%
<b>I will compensate for my profit</b>	14.9%	11.5%	10.7%
<b>No answer</b>	0.1%	5.9%	4.4%
<b>Total</b>	100%	100.0%	100.0%

High fiscal burden and falling profits associated with the deterioration of the economic situation in the perception of entrepreneurs are the key negative factors that have a devastating effect on the business. Moreover, new tax administration practices and increased fiscal control have led to the fact that the high fiscal burden and its impact on the financial results of enterprises are more worrying for business representatives than the unfavorable market conditions.

Table 3 presents the most dangerous risks and threats to business over the course of three years, ranked in descending order of importance for business representatives in 2018.

**Table 3.** The most dangerous risks and threats to business (percentage of the total number of respondents).

	Answer Options	2016	2017	2018
1	Raising taxes and excise taxes	45.2%	54.0%	71.1%
2	Deterioration in the general economic situation and falling demand	74.1%	59.2%	68.2%
3	Tariff increase	39.0%	39.4%	61.2%
4	Tighter controls and increased fines	22.1%	19.5%	21.1%
5	The growth of the dollar / euro	15.7%	14.3%	19.3%
6	Increase in credit costs due to higher rates of banks on commercial loans	18.7%	7.3%	19.0%
7	The arrival of a major Russian and foreign competitor. including retail chains	13.9%	12.5%	15.6%
8	Growth in rental payments	12.2%	16.7%	15.1%
9	The complexity of bureaucratic procedures	20.5%	7.3%	13.0%
10	Administrative pressure from authorities	11.6%	4.5%	7.8%
11	Extortion by criminal groups	0.8%	0.3%	4.9%
12	Refusal to renew the lease	5.0%	5.9%	4.4%
13	Sanctions Restrictions by European Union Countries	7.8%	3.8%	3.4%
14	Russian response (anti-sanctions)	2.6%	1.7%	2.6%
15	Cancellation of benefits and preferences	5.8%	4.2%	2.6%
16	Attempts to seize business. raiding	3.4%	2.1%	1.0%
17	Supervisory pressure	12.2%	12.5%	0.0%
18	Difficult to answer	3.0%	3.1%	9.6%

The fears of entrepreneurs are primarily associated with financial problems and providing sufficient income to continue entrepreneurial activity and the existence of a business. Political problems and administrative pressure are less worrying for entrepreneurs.

It is worth noting that the respondents' opinion on increasing the tax burden is largely due to the policy conducted by the Federal Tax Service of Russia that aims at increasing the transparency of payments, strengthening tax administration and countering shadow economic relations. This refers to the use of online cash desks, following the adoption of the Federal Law No. 290-FZ on July 3, 2016 which increased the requirements for cash registers when making cash payments.

In the opinion of entrepreneurs, these measures aimed at improving tax administration and transparency of economic relations contribute to an increase in the tax burden. Therefore, the surveyed entrepreneurs said that the state should reduce the tax burden and consider the economic situation and the level of demand when changing tax rates. They also see it viable to introduce tax incentives for enterprises that have been in business for a long time and have a good record, to reduce pension and insurance contributions, not to introduce online cash registers, etc.

In addition, it is fairly challenging for individual entrepreneurs and small enterprises to calculate taxes and monitor legislative changes in taxation by themselves.

Talking about problems that arise during the interaction with tax authorities, directors of the companies also mention controversial and vague recommendations of tax authorities, the Ministry of Finance of the Russian Federation on accounting and economic feasibility of expenses when calculating the tax base for income tax and value-added tax. They also note that it is difficult to challenge the claims of the tax office, regulatory authorities, etc. in court. In addition, it is almost impossible to opt for tax incentives at the design stage of the project that precedes the implementation stage due to the absence of the taxation objects.

#### *4.2. State interests in tax relations with business and position of tax authorities*

Financial and tax law are of public nature. The financial and legal science and legislative practice are to a large extent determined by the idea that implies the dominance of the state interest in the regulation of financial relations. The norms of financial law provide the mechanism for protecting public property interests. Therefore, in this aspect, financial and tax law act as an institutional regulator and a tool for coordinating interests [19].

In recent years, the Federal Tax Service of Russia (FTS) has been reforming tax control over business, which has a great influence on the activities of tax authorities. Modern information and telecommunication systems, software and big data technology used in the tax control procedures enable to reduce the human factor. Tax authorities conduct far fewer on-site inspections. Value chains, taxes payment and desk audits monitor without direct contact with the taxpayer. Application of special information systems makes it possible to prevent tax evasion and attempted fraud in the reimbursement of taxes paid. Using cash registers to transfer information to the tax authorities helps control financial and commodity flows and eliminates the possibility of tax evasion. Marking of certain types of products (such as drugs or tobacco products) ensures greater transparency of business operations and allows identifying behavior patterns of economic entities and their possible attempts at tax evasion.

The measures taken by the FTS contributed to the situation when for five years tax revenues were growing at a significantly faster pace than the revenues of the consolidated budget of the Russian Federation. According to D.K. Grunina [20], further improvements carried out by the tax authorities should include creating an environment for taxpayers which is more comfortable for fulfilling their tax obligations and that would provide favorable conditions for doing business and increasing business activity.

However, at present the most acute problems of tax administration in Russia are the schemes for profound tax minimization developed by taxpayers. This violates the balance of interests in competition: companies that do not use such schemes are in less favorable financial conditions, which makes it necessary for them to either switch to the shadow economy or apply the same or similar schemes.

In Russia, tax evasion is a common practice, which seriously undermines the economic security of the state.

Companies use various methods of tax evasion, including:

- fraudulent misrepresentation in accounting documents,
- cash operations without appropriate reporting in financial statements;
- unreasonable allocation of various expenditures to production costs,
- fraudulent misrepresentation of economic indicators,
- underreporting of the volumes of purchased and sold products,
- taxable entity concealment (substitution, false export),
- fraud carried out through one-day firms or intermediary affiliates.

At the same time, most representatives of the business community do not have negative attitude towards tax evasion or shadow companies. Replying to the question whether business feels negative influence of shadow companies that do not pay taxes, 26.8% of the respondents gave an affirmative answer, 30.3% said that it was not so. Moreover, almost half of the respondents did not answer the question.

The current imperfections of the tax system have a significant impact on public opinion and the attitude to paying taxes, respectively. In the Russian Federation, in comparison with developed countries, taxes have the opposite effect on stimulating the efficiency and initiative of individuals and legal entities. The analysis carried out in this article revealed the negative influence of the tax system on promoting entrepreneurial activity and the working efficiency of people. Thus, the tax system can name the main cause of tax evasion for individuals and entrepreneurs.

The reasons for both individuals and legal entities to evade taxes can be very different, from the hopeless situation due to the insolvency of business and people or breaches in tax legislation to the psychological aspects of people's behavior.

One should not forget about the tax culture of society, which also determines the extent of tax payment to the budget. Not all Russians consider paying taxes their civic debt. In addition, in many cases it is possible to evade taxes because government agencies do not have total control over all accounting and financial information of legal entities.

Aloys Prinz, Stephan Muehlbacher, and Erich Kirchner [21] name two ways of increasing tax collection: avoiding tax evasion through audits and fines, on the one hand, and creating trusting relationships with taxpayers by providing additional services and consulting support, on the other. They substantiate the importance of both instruments for collecting taxes and see them as a compulsory and efficient incentive for complying with tax laws. The researchers point out that constraint and persuasion measures can substitute or complement each other depending on the reaction of taxpayers, given that the behavior of taxpayers forms by the behavior norms prevailing in society.

At the same time, as Jose Joaquin Lopez [18] claims, in a developing economy the informal sector is shrinking, whereas the volume of tax evasion in officially registered enterprises is increasing, which reduces the potential collection of tax payments.

Small businesses and individual entrepreneurs tend to evade taxes by doing unreported business activities, while large officially registered enterprises evade taxes on a much larger scale. Economies in which tax evasion is carried out on a large scale and it is possible to dramatically increase tax revenues by eliminating the informal sector have to compromise between tax collection and the cumulative efficiency of tax revenue collection. This is due to the fact, that increasing tax collection from officially registered enterprises that evade taxes, the state may push them into the informal sector.

Jose Joaquin Lopez notes that if we consider a certain permissible share of the informal sector as a by-product of development, and not vice versa, tax authorities can create a reliable tax base by minimizing tax evasion of officially registered enterprises [18].

In a broad sense, protection of taxpayers' rights implies political, socio-economic, legal and organizational guarantees. In a narrow sense, this refers to the appeals to certain government agencies to consider the legality and validity of actions or inaction of tax authorities for each particular taxpayer.

The fact that the state represented by tax authorities has broad powers to limit the constitutionally guaranteed private ownership of a taxpayer leads to unjustified prevalence of public interests over private ones. At the same time, in some cases, taxpayers do not believe that their appeal to a higher tax authority may be successful and deliberately do not disclose all their arguments in the complaint, withholding them until investigation in court. This results in a situation when the tax authority cannot fully prepare and substantiate its position on all the arguments of the taxpayer before court proceedings.

#### *4.3. Reconciling the interests of the state and business in tax relations*

At present, the procedures for handling tax disputes monitors by the legislative and judicial systems of Russia. This includes taking certain measures, for instance, in 2009 a mandatory pre-trial procedure introduces for appealing against the decisions of the tax authorities based on the results of tax audits. In 2014, the pre-trial settlement of all tax disputes became mandatory; there were changes in the rules for consideration of tax disputes in court; taxpayers received an opportunity to appeal against private letter rulings of the Federal Tax Service of Russia [22, 23].

The Federal Tax Service of Russia currently faces the task of further improving pre-trial resolution of tax disputes, preferential resolution of out-of-court tax disputes by tax authorities, reducing the burden on the judicial system. One of the principles to promote pre-trial resolution of tax disputes is the customer-focused approach simplifying taxpayer's interaction with the tax authorities.

To ensure the balance of private and public interests, it may be viable to introduce into the practice of pre-trial settlement of tax disputes the possibility of providing compensation for the taxpayer's expenses for the services of tax advisers incurred during the administrative appeal in case the taxpayer's complaint is satisfied by a higher tax authority.

In most countries with developed market economies, tax legislation contains a fiscal rescript procedure that ensures the observance of tax rights and reduces tax risks. It seems relevant to consider the possibility of introducing this procedure into the Russian tax legislation. This procedure implies receiving a written statement of tax authorities that the planned actions and transactions of the taxpayer do not violate the law or not aim at any illegal tax optimization.

The fiscal rescript allows the taxpayer to obtain the preliminary assessment of their planned transactions. This procedure presents an explanation of the tax authorities that signifies their approval of the way of doing business or disapproval if there are signs of abuse.

Creating within the tax authority a mechanism for approving the planned business operations of the taxpayer, in which their approval or disapproval will be mandatory for both the tax authority and the taxpayer, will eliminate the risk of cases when a conscientious taxpayer may be held accountable and requested to pay arrears, penalties and fines.

In addition, the fiscal rescript can perform the function of preventing tax offenses and counteract the development of the shadow economy. The taxpayer that did not receive approval of the planned business operations will not commit an offense to avoid being held accountable.

It should be noted that in the case of a large number of such requests, the FTS, which has recently experienced a significant staff reduction, might not be able to cope with the deluge of appeals. In addition, the fiscal rescript has a significant drawback associated with the likelihood of increased corruption, since decisions, as international experience shows, are most often taken on the individual basis.

## **5. Conclusion**

In the perception of entrepreneurs, the fiscal burden appears to be a key factor in the business climate. The decrease in business activity and the opinion of entrepreneurs on the current system of business taxation in the Russian Federation suggest that the material interests of fiscal authorities should not always prevail over other interests.

It should be mentioned that the relations arising between private and public actors associated with the financial activities of the state and regional or local governments are multidimensional and complex. There is initial conflict of their social, political and legal aspects, which results in a large number of tax disputes.

At the same time, considering the problem from the perspective of the state interests, the expansion of the shadow economy manifesting itself through tax evasion can lead to the loss of significant financial resources and undermine the economic stability of the state.

To improve the situation, it seems reasonable to develop a set of organizational and legal measures controlling and preventing tax evasion and to carry out regulatory improvements, which will minimize the legal ways of tax evasion. At the same time, increasing accessibility of financial information on the activities of a company, the formation of tax culture and morality in society remain crucial issues.

## **6. Acknowledgments**

Research grant of Russian Foundation for Basic Research (project № 19-010-00032 A).

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