

INCREASING PROGRESSION IN THE RUSSIAN TAX SYSTEM



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INEXPLICIT ISSUES OF AN INCREASE IN TAX PROGRESSION

MAIN CONCLUSIONS

- **The Russian tax system will become more progressive in 2025:** it is most likely that the tax burden on relatively wealthier citizens will increase. Additional budget revenues will be used to finance the programs announced by the president during his address to the Federal Assembly.
- **Tax reform possibilities may include adjusting the personal income tax (PIT) scale, social contributions, rates and tax bases of property taxes, as well as corporate income tax (CIT) and other measures.** It is most likely that the reform will affect the PIT scale and CIT. In the event of an increase in tax rates, ACRA expects a change in the norms for the distribution of income between budgets in favor of the federal budget.
- **The vast majority of countries have their own PIT, and most often, income tax scales are progressive.** Such countries often have a five-bracket scale, but everything depends on the general spread of rates on the tax scale. The PIT scale in Russia will not be entirely standard even after the reform. In a global context, it will gravitate toward the flatter end of the spectrum of tax systems. At the same time, if the minimum rate remains unchanged post-reform, the beginning of the scale in Russia, by world standards, will be relatively high.
- **Depending on the chosen parameters, additional budget revenues related to the reform may amount to up to 2.5 pps of GDP.** Theoretical growth of CIT may generate additional income in the amount of around 0.2 pps of GDP per percentage point increase of the tax rate. Increasing the PIT rate by one percentage point may generate additional income of up to 0.15 pps of GDP, depending on the income group of the population targeted by the rate increase. Similar assessments apply to changes in the scale of social contributions.
- **The growth of progression in the tax system touches on many related topics, and the technical implementation of this initiative will significantly impact the effect of the reform.** The fairness of taxation and the level of tax burden on labor are determined not only by PIT, but also by other taxes and obligatory payments, as well as by the social support system. The importance of indexing the boundaries of income brackets depends on what level of income the progression begins at. Increasing the progression and discreteness of the tax scale can create new incentives for companies and workers to switch to informal — so-called gray — practices.

POSSIBLE DECISIONS

On February 29, 2024, the President of Russia delivered an **address to the Federal Assembly containing a wide range of initiatives**, part of which involve changing Russia's tax system.

What changes were announced?

According to the president, the tax system “must ensure the flow of resources to address national goals and to implement regional programs. It is designed to **reduce inequality not only in society, but in the socioeconomic development of the regions of the Federation as well**, and to take into account individual incomes and corporate revenues”.

The president also suggested developing approaches to modernizing Russia's fiscal system and more fairly **distributing the tax burden toward those with higher individual incomes and corporate revenues**, and proposed locking in key tax parameters until 2030 to ensure a **stable and predictable environment** for implementing any, including long-term, investment projects.

What options for changing taxes that do not contradict what was stated above are theoretically possible?

Further differentiation of taxpayers by income in order to reduce inequality is feasible using the following measures¹:

- 1) Changing rates and boundaries of brackets on the PIT scale, as well as its tax base;
- 2) Changing the list and amounts to tax rebates;
- 3) Changing the rates and boundaries of brackets on the scale of social contributions;
- 4) Changing the profit tax rate for organizations;
- 5) Changing rates or the tax base of property taxes for individuals and/or organizations;
- 6) Adjusting the income tax scale for bank deposits.

According to ACRA's estimates, the most likely tax reform is changing the parameters of PIT combined with adjusting CIT rates².

RUSSIA'S PERSONAL INCOME TAX SCALE IN THE GLOBAL CONTEXT

The vast majority of countries have their own PIT. They are generally paid by individuals, although there are examples of taxes being calculated at the household level.

Most countries have a progressive income tax scale, meaning that as annual or monthly income increases, the ratio of the amount of tax paid to income increases

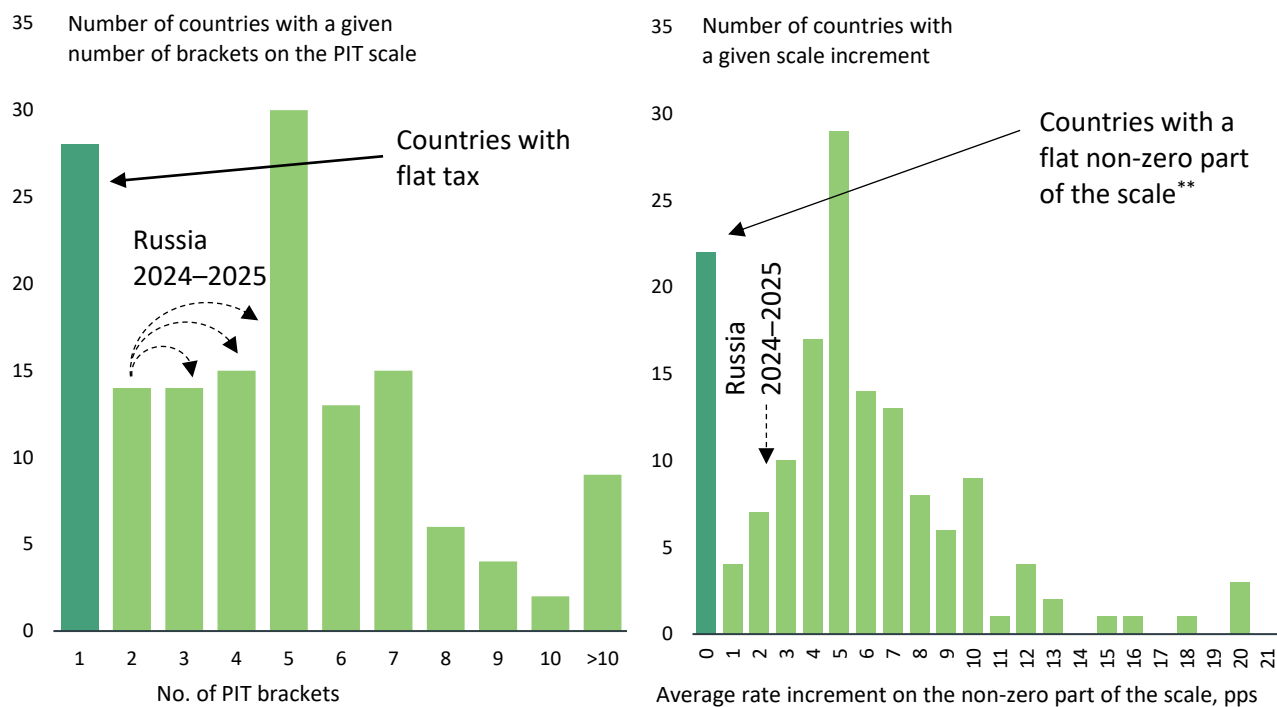
¹ The technical level of tax reporting in Russia theoretically allows the implementation of non-standard scenarios, such as a more progressive value added tax (VAT): Rita de la Feria, Artur Swistak (2024). *Designing a Progressive VAT*. Working Paper WP/24/78, IMF. However, ACRA assumes that such measures are much less likely.

² In particular, the Agency refers to the **comments** made by Anatoly Aksakov, Chairman of the State Duma Committee on the Financial Market, to *Parlamentskaya Gazeta* and other media outlets. He mentions the discussed options for changing the PIT scale: increased rates at 15 and 20% for undefined income ranges. In addition, Finance Minister Anton Siluanov mentioned existing proposals on PIT and corporate taxes in an **interview** with Interfax.

(the average rate increases). A flat tax rate currently exists in about 30 countries around the world³.

Russia had this sort of tax regime from 2001 to 2020, with a flat rate of 13%. The return to progression began in 2021 with the tax rate being hiked to 15% for taxpayers with an annual income of more than RUB 5 mln. Therefore, the scale now has two brackets. The impact of changes to the tax system announced in 2024 on the PIT scale may include its lengthening to three to five brackets with an average increment of 2–3 percentage points.

Figure 1. Parameters of the PIT scale in different countries*



* For Russia, the dynamics shown are speculative and not based on any information about the options being discussed.

** (Countries with a flat non-zero part of the scale) = (countries with a completely flat tax rate) – (countries with zero rates for everyone) + (countries with a zero rate for very low incomes and a flat non-zero rate for everyone else).

Sources: EY, OECD, ACRA

All the graphs and calculations in this section have been made for the scale applied in each individual country for the labor income of residents from the largest population group, at central budget level (if there is differentiation).

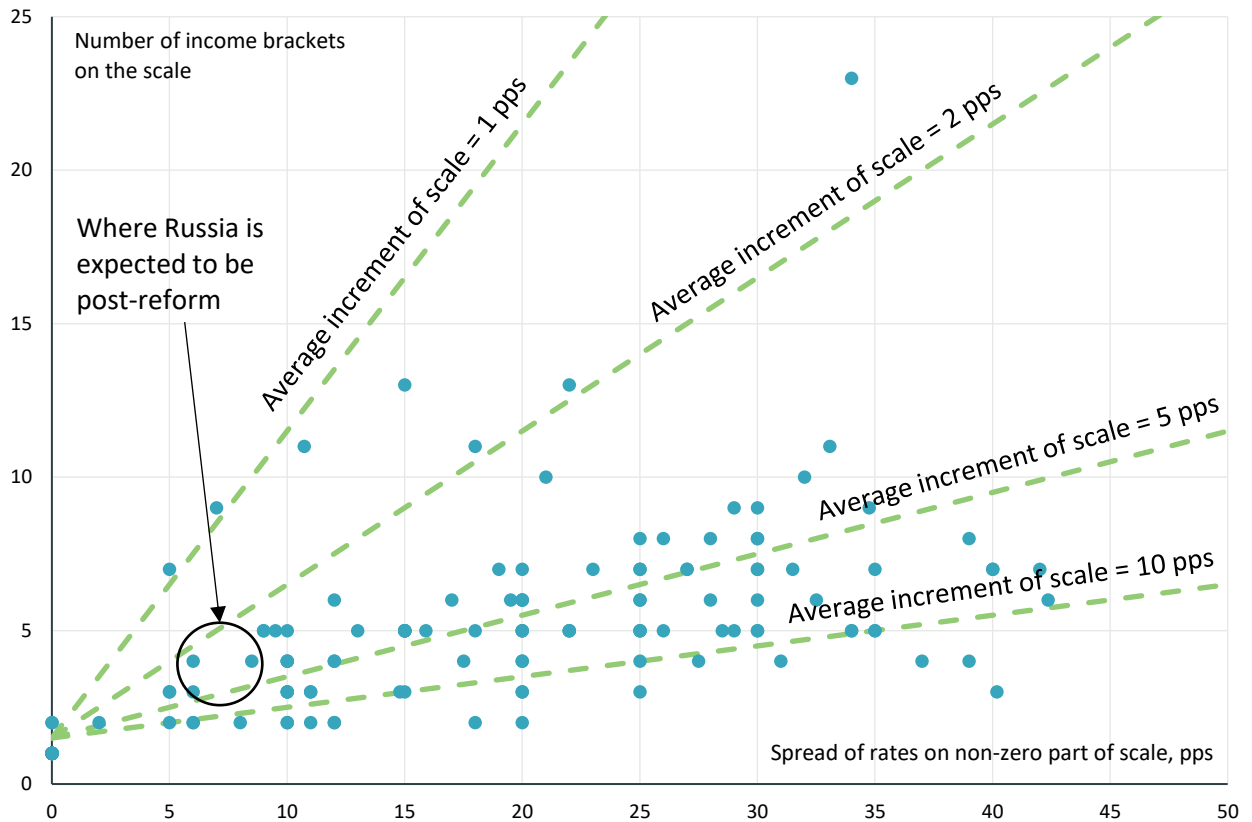
In countries with a progressive tax scale, the most common scale has five brackets, while other options ranging from two to seven brackets equally common (Fig. 1, left). Countries generally gravitate towards the average increment of the scale of about 5 percentage points — this is approximately how much the tax rate changes when moving to the next bracket, but the spread around the average is large (Fig. 1, right). In addition, the scale increments, as a rule, are not the same at the lower and upper parts.

In terms of these parameters, **even after the tax reform, the PIT scale in Russia will most likely not be very conventional. In a global context, it will still be close to the flatter part of the spectrum of tax systems** — the spread of rates from maximum to minimum, according to publicly discussed options, will be less than 10 percentage points. This is due to the relatively small expected number of brackets in the new scale, as well as their relatively small increment (Fig. 2). At the same time, in approximately 30 countries the spread of rates on the non-zero part of the scale exceeds 30 percentage points. Such a large spread and a large degree of progression of the scale are, on average, characteristic of relatively rich countries and countries with strong socialist traditions (for example, Luxembourg, Chile, Greece). On the

³ Including some Persian Gulf countries and offshore companies that do not levy tax or have a zero rate for residents.

other side of the spectrum are flat scales, which today are characteristic of countries that were previously part of the Eastern Bloc and have experienced a transition period (for example, Uzbekistan, Bulgaria, Georgia).

Figure 2. Countries with a greater degree of tax progression are, on average, characterized by more fractional scales and larger average rate increments



Sources: EY, ACRA

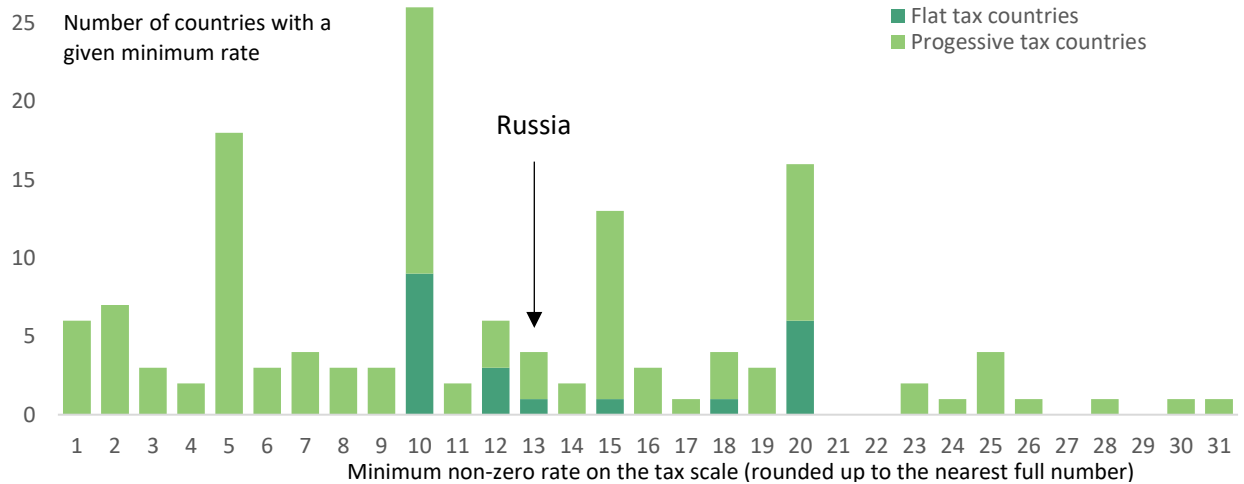
In Fig. 2, each dot indicates the parameters of the income tax scale of a particular country. The non-zero part of the scale refers to all levels of income for which the tax rate is greater than zero.

Countries with a flat tax rate for personal income often have rates of 10% and 20%, so the Russian 13% is close to the lower part of the distribution. With the transition to a progressive scale, Russia's position will change considerably: among such countries, approximately 40% have a minimum non-zero rate on the scale of less than 10%, and 60% of countries have less than 13% (Fig. 3). Thus, **if the minimum rate remains unchanged after the reform, the beginning of the scale in Russia, by world standards, will already be relatively high.**

In addition to differences in the degree of progression of the main PIT scale, countries around the world differ quite significantly in terms of alternative scales and features of regional taxation. At least about 10 countries have differentiated income tax scales depending on the marital status of the taxpayer (presence of a spouse, number of children, etc. are taken into account). Typically, in such cases, an increase in the number of dependents and a larger household will lead to a reduction in the tax burden at all or almost all levels of the scale. In several countries, rate differentiation is also related to the industry that is the source of income for the taxpayer (for example, Azerbaijan, Italy).

At least 15 countries, in addition to taxes at the central budget level, have various regional taxes with the same or similar tax base (for example, Canada, the USA, the UK). Moreover, this is relevant not only and not so much for large countries with significant regional income differentiation, but for countries with strong traditions of federalism or urban self-government. In a number of countries, the main part of the progression in the tax system is formed by regional taxes.

Figure 3. PIT scale parameters



Sources: EY, ACRA

In some countries with a recent history of high inflation (for example, Colombia and Venezuela), the boundaries of income brackets are specified not in nominal monetary units, but in conditional tax units, which change their value in monetary terms from year to year. This is one of the possible options for maintaining the stability of tax conditions as it allows the scale to be adapted to new conditions by changing only one parameter.

If the boundaries of the brackets are not indexed for inflation, the tax burden in the progressive system grows automatically since income distribution drifts quite quickly to the right, that is, into the zone of increased rates⁴. However, indexation of boundaries can be carried out directly if they are expressed in monetary terms (this is described in more detail in the section Inexplicit Issues of an Increase in Tax Progression).

The issue of indexation is discussed once a year or more in two thirds of the OECD countries⁵. Around half of the OECD countries have an automatic indexation rule, which does not require political decisions to be made.

ASSESSMENTS OF THE BUDGET EFFECT OF TAX REFORM

Corporate income tax

At current rates and collection levels, CIT annually generates revenues equal to approximately 4% of GDP for Russia's consolidated budget. Consequently, theoretical growth of CIT may add additional revenues of just under 0.2 percentage points of GDP for each percentage point of growth of the tax rate. For example, if the tax rate grows from 20% to 25%, then budget revenues will grow by around 1% of GDP.

Currently, out of the 20 percentage points of the total tax rate, 3 percentage points are paid to the federal budget, but if the tax rate grows then it is most likely that the norms of distribution between budgets will change. It is reasonable to expect that in this case, additional percentage points of the rate will be paid to the federal budget, which will mainly bear the additional costs announced in the president's address to the Federal Assembly.

Personal income tax and social charges

⁴ In international terminology, this phenomenon is called fiscal drag. There is a distinction between nominal fiscal drag — the increase in the tax burden due to inflation, and real fiscal drag — growth due to a real increase in income.

⁵ "Taxing Wages 2023. Indexation of Labour Taxation and Benefits in OECD Countries", OECD

Given the current interest rates and tax collection rates, PIT generates about 3.5–3.8% of GDP annually for the consolidated budget of Russia.

The estimation of the budget effect of the increase in PIT rates largely boils down to a correct assessment of the distribution of the Russian population by income (in its taxable portion). There are two main obstacles in this approach:

1. Information on income distribution is fuzzy. It is believed that the methodology used by the Federal Service for State Statistics (Rosstat) in its assessments reflects the real distribution for the low- and middle-income population quite well, while the high-income group (the main group for which taxes should be calculated with an increase in progression at the right end of the scale) is described relatively poorly by the model⁶. For example, in 2022, according to Rosstat, about 50,000 people have annual income in excess of RUB 5 mln, but according to the Federal Tax Service of Russia, 100,000 people declared annual income over RUB 10 mln, and the number of tax assessment notices with a tax rate of 15% (for those whose incomes exceed RUB 5 mln per year) amounted to about 275,000. Even taking into account the incomplete coincidence of the term ‘income’ in the two sources of information, the existence of tax rebates, as well as the incomplete correspondence of income distribution by taxpayer and by individual, it can be concluded that model statistical data would rather underestimate additional tax revenues⁷.
2. Changes in the tax system will come into force no earlier than 2025, while the latest data on income distribution relate to 2023, therefore, a forecast of income distribution on at least a two-year horizon is necessary.

Taking these facts into account, the distribution of 2023 modeled by Rosstat is used by ACRA as a base for estimating the lower limit of possible additional revenues, while the entire distribution is shifted 15% to the right for 2024–2025 (inflation plus real income growth). The estimated upper boundary of the effect was obtained using the data of the Federal Tax Service of Russia, with the assumption that the number of taxpayers in the upper income groups differs from the data of Rosstat by a fixed number of times, while the tax collection rate does not change.

According to the Agency’s calculations, a 1 pp increase in the PIT rate can generate budget revenues of up to 0.15 pps of GDP at each conditional income level (*Fig. 4*). The more low-income groups are affected by the growth of progression, the more noticeable the effect of an increase in the tax rate.

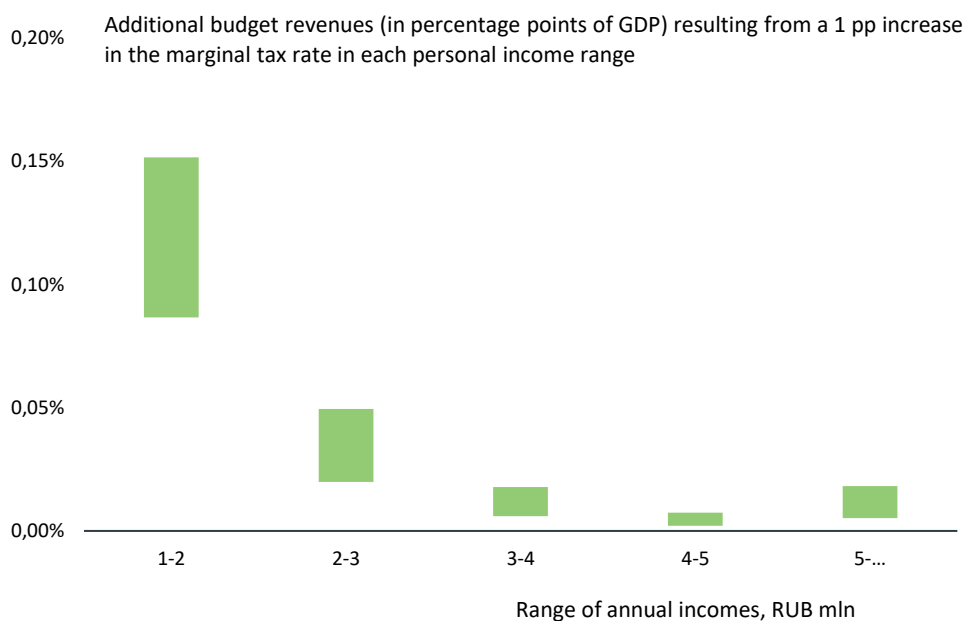
Comparable estimates are applicable to changes in the scale of social contributions (under normal conditions, they generate revenues of 6–7% of GDP to the consolidated budget).

⁶ Rosstat *a priori* assumes that the incomes of the population (the general population) are distributed lognormally at each point in time. Macrostatistical data (System of National Accounts, SNA), as well as sample household surveys are used to estimate two parameters of this distribution model (for example, for 2023: $\mu = 10.56$ and $\sigma = 0.74$). The tabular values in the report “Distribution of the population by per capita monetary income” represent the estimated proportion of the population obtained based on the distribution with estimated parameters. The weak point of the distribution estimation procedure is the initial assumption of lognormality, which in fact excessively simplifies the distribution form for the higher income groups. At the same time, since there is a problem of accessibility of primary information specifically about high-income groups, it is still necessary to make some assumptions about the right end of the distribution. In world statistical practice and some studies in Russia, more flexible distributions with a larger number of parameters or combinations of distributions are used. See, for example, K. O. Bugaeva’s paper [About distribution of population’s incomes in Russia](#) / K. O. Bugaeva // Standard of living in Russian regions. — 2016. — No.2 (200).

⁷ For details about the technical difficulties of the combined use of Rosstat’s model data, survey data and administrative data, see T. Piketty’s [Team on inequality in Russia: a collection of statistical artefacts](#): preprinted edition WP3/2020/01/ R. I. Kapeliushnikov; National Research University Higher School of Economics.

In Fig. 4, each rectangle denotes the range of additional budget revenues from a 1 pp increase in the marginal PIT rate within each range of personal incomes. The upper/low side of each rectangle is the maximum/minimum estimate. Estimation uncertainty is a result of incomplete understanding of distribution of future personal incomes.

Figure 4. Estimated additional budget revenues from an increase in the marginal PIT rate



Source: ACRA

Total effect

According to ACRA's estimates, all reasonable scenarios involving an increase in the CIT rate and a change in the PIT scale may create additional revenues of up to 1.6% of GDP for the consolidated budget. The maximum estimates suggest an increase in the rates for both taxes and a change in the PIT scale from relatively low, but still exceeding the average income, levels of taxpayer's income. The minimum estimates suggest that changes in the PIT scale will include certain reduction in tax rates for low-income groups.

If the tax reform affects other taxes and mandatory payments, such as social contributions, or if the parameters of PIT and CIT change dramatically, the overall effect of the reform may be more significant — in some reasonable scenarios, we can talk about 2.0–2.5 pps of GDP. However, such a prospect is assessed by ACRA as less likely.

INEXPLICIT ISSUES OF AN INCREASE IN TAX PROGRESSION

In addition to PIT, the fairness of a taxation system and the tax burden on labor are determined by other taxes and mandatory payments, as well as by the social support system

The average tax rate is the ratio of tax amount to tax base. The marginal rate is the share of tax paid in the last ruble of the tax base (the highest rate charged from a taxpayer on the progressive tax scale).

In addition to PIT, labor taxes include, in a broad sense, social contributions. Their rates also vary depending on income: currently, a regressive scale of social contribution rates is applied in Russia (30% → 15.1%). In this regard, the estimated cumulative average rate on labor income (the sum of PIT and social contributions) decreases monotonously from 33.1% to 26.2%⁸ with income growth, regardless the progression of the PIT scale (Fig. 5).

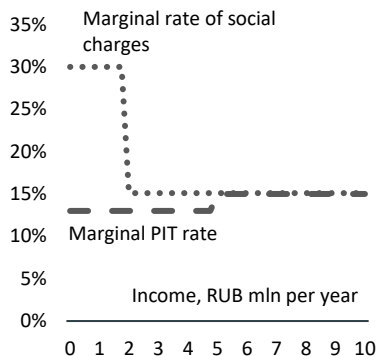
If the goal of the tax reform was to be formulated as the introduction of a flat scale for the sum of labor taxes, then we would see, for example, unchanged rates for incomes of up to RUB 2 mln per year, followed by a linear increase in the PIT rate from

⁸ The percentage is calculated based on the wage fund per employee and social contributions. This is the so-called tax wedge — the share of labor taxes in the total labor expenses of employer.

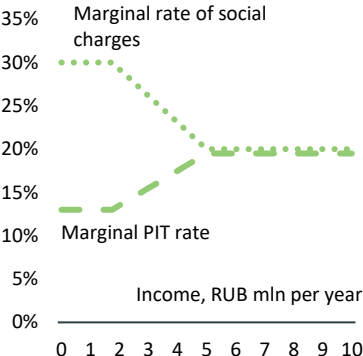
13% to 19–20% for annual incomes of RUB 2–5 mln and a monotonous decrease in the rate of social contributions from 30% to 20% for the same income range. If this framework is applied, the cumulative average rate for any labor income would stay almost unchanged at 33% (close to the OECD average).

Figure 5. Aggregate labor tax rate depending on the specifics of the PIT scale and social contributions (thought experiment for Russia)

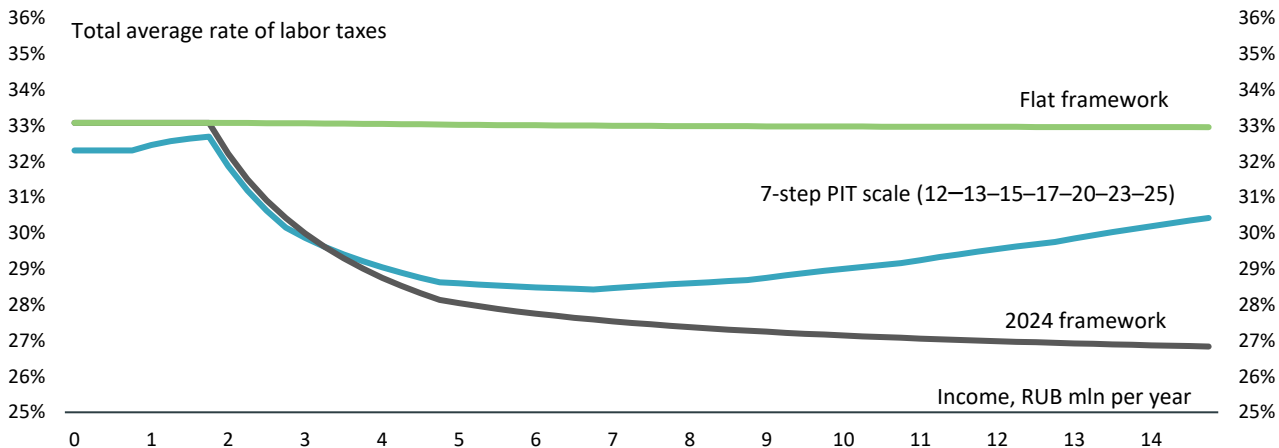
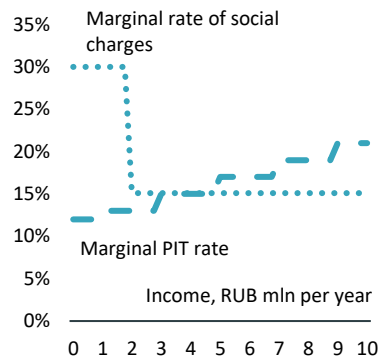
2024 framework



Flat framework



7-step PIT scale



Sources: Federal Tax Service, ACRA

Another hypothetical option — where the PIT scale becomes noticeably progressive (a slight reduction in the rate for low incomes and a progressive 7-bracket increase to 25%), while the scale of social contributions remains unchanged — gives a different profile of the aggregate average labor tax rate. The result is a lower rate compared to the current rate for low and medium incomes, a rate close to the current rate for incomes of RUB 2–4 mln per year, and a rate that outpaces, with acceleration, the current rate for annual incomes over RUB 4 mln.

These examples show that it is important to discuss the issues of tax progression and the level of tax burden in a broader context than just the PIT tax scale. Moreover, income inequality is affected by taxes that do not formally differentiate rates by income (for example, VAT and property taxes), as well as the system of social support and tax deductions⁹.

A tax rate increase may improve the balance sheets of budgets that do not receive this tax

⁹ Leukhin R.S. Labor tax progression in Russia: current situation and potential consequences of PIT reform options / R. S. Leukhin, A. L. Suslina // Financial Journal. — 2017. — V. 6. — No. 40; Salvador Barrios, Viginta Ivaškaitė-Tamošiūnė, Anamaria Maftעי, Edlira Narazani and Janos Varga (2018), Progressive tax reforms in flat tax countries, JRC Working Papers on Taxation and Structural Reforms No 02/2018, European Commission, Joint Research Centre.

Hypothetically, pensions are paid and mandatory medical insurance and temporary disability insurance compensations are made at the expense of social contributions received by the budgets of social funds. PIT revenues, which are distributed mostly among the federal and regional budgets, are used to cover general-purpose expenses (with the exception of additional federal budget revenues from PIT charged at a 15% rate, which are assigned for medical care of minors with rare and severe diseases). If these revenues were completely divided between budgets of different levels, then the estimated budget effects for each of them could be independent. In practice, the federal budget annually transfers a large amount to maintain the balance of the consolidated pension system. Therefore, if a decision is made to increase the progressivity of the tax system through social contributions, rather than through personal income tax, this will most likely lead not to an improvement in the balance sheets of social funds, but to an improvement in the balance sheet of the federal budget, as the need for the mentioned transfer will diminish.

The importance of indexing the ranges of income levels depends on which income level the progression begins from

Depending on the point where the progression begins in the new PIT scale or where the scale of social contributions is modified, the stability and predictability of tax conditions — stated in the presidential address as 2030 goals — can be achieved in different ways.

On the one hand, the invariable boundaries of income levels in monetary terms are formally predictable tax conditions. On the other hand, over time, these boundaries shift downwards in real terms due to inflation, which can hardly be called stability in an economic sense, since in the absence of border indexing, the average tax burden increases by itself. At the same time, in the case of inflationary shocks from the aggregate supply, this effect aggravates, and fiscal policy becomes pro-cyclical.

If, for example, we assume that the border of any of the new levels of annual income in Russia will be at RUB 2 mln and remain unchanged from 2025 to 2030, then the proportion of people who cross this border toward a higher tax rate during this time will be about 3% (only due to inflation being at the target level of the Bank of Russia). Under this hypothetical scenario, the proportion of people living in households taxed at a rate above 13% may increase by about 6 percentage points over the six-year period. For higher income ranges, the problem is less pronounced: in three years from the effective date of the 15% PIT rate, only a fraction of a percent of the Russian population could cross the RUB 5 mln border of annual income due to inflation.

In view of the above facts, according to ACRA's estimates, the lower the annual income level where the progression starts/changes on the personal income tax scale, the higher the probability that the boundaries of income levels will somehow be indexed within a six-year period to ensure the stability of tax conditions. Similar considerations are relevant to the scale of social contributions.

An increase in the progression and discreteness of the tax scale can create new incentives for companies and employees to switch to informal, so-called gray practices

In income-differentiated tax systems, incentives for tax optimization^{10, 11} may grow stronger. Externally, this may manifest itself in the fact that the number of taxpayers who declare income that is minimally required in order not to fall into the category

¹⁰ Johnson, Shane and Breunig, Robert V. and Olivo-Villabrilie, Miguel and Zaresani, Arezou, Individuals' Responsiveness to Marginal Tax Rates: Evidence from Bunching in the Australian Personal Income Tax. — August 1, 2023. TTPI — Working Paper 11/2023.

¹¹ Adam S., Browne J., Phillips D., Roantree B. Frictions and taxpayer responses: evidence from bunching at personal tax thresholds. International Tax Public Finance. — 2021. — 28(3). — 612–653.

with the next (higher) level of the tax rate significantly exceeds the number of taxpayers with any levels of declared income close to the threshold on the scale¹²; although gross income (before taxes and transfers) should, theoretically, have a distribution that is weakly dependent on tax scales or social support. Such phenomena indirectly indicate that in order to reduce the tax base, the income structure is optimized, legally or illegally, which affects the effective tax collection. Ultimately, an increase in the number of income levels and tax rates applied to high income levels may complicate, to some extent, tax administration.

The optimization effect is usually more pronounced in the taxation of income that is not a wage. This category includes, for example, the income of the self-employed and business owners.

¹² A similar situation is sometimes observed when social support depends on income. In this case, taxpayers may be grouped by income below the threshold that reduces the support (aka *bunching*).

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