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Special Investment Contracts – New Rules

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What has happened?

On 2 August the President signed a package of laws aimed at substantially reforming the special investment contract (SPIC) mechanism.[1] The laws come into force on 13 August, with the exception of the amendments to the Tax Code, the first of which take effect from 2 September 2019.

What has changed?

Amendments to the Federal Law "On Industrial Policy in the Russian Federation"

The federal law "On Amendments to the Federal Law "On Industrial Policy in the Russian Federation" Regarding the Regulation of Special Investment Contracts", which has been passed by the State Duma, makes cardinal changes to the subject-matter of a SPIC. Current law defines the subject-

[1] *Federal Law No. 269-FZ "On Amendments to Parts One and Two of the Tax Code of the Russian Federation", Federal Law No. 290-FZ "On Amendments to the Federal Law "On Industrial Policy in the Russian Federation Regarding the Regulation of Special Investment Contracts", Federal Law No. 295-FZ "On Amendments to Article 78 of the Budget Code of the Russian Federation".*

matter of a SPIC as the start-up, modernization or integration of production operations in Russia without establishing any additional requirements relating to products produced.

The new law redefines the subject-matter of a SPIC as the (i) implementation or (ii) development and implementation of modern technologies for the mass production of products that are competitive on the global market. A list of types of technologies that enable the production of globally competitive products is to be approved by the Russian government.

We should point out that a further requirement for products produced under a SPIC, namely that there must be no equivalent products already made in Russia, was excluded from the text of the bill at the second reading stage.

Under the new law, the Russian Federation, a regional entity of the Russian Federation and a municipality will collectively act as the public party to a SPIC. As well as granting incentives they will guarantee the stability of business conditions for the investor.

The stability of business conditions means that, from the date the SPIC is concluded and for its entire duration, the investor will not be affected by Russian laws and regulations coming into force after the date of conclusion of the SPIC that limit and/or prevent the exercise of rights that the investor has acquired or exercises for the purposes of the SPIC, provided that the special safeguards for the investor against changes in laws and regulations governing the arrangements in question were laid down in Russian law at the time the SPIC was concluded.[2]

The law also substantially amends the process by which a SPIC is concluded. In particular, it introduces a competitive selection procedure as a means of choosing the investor for a SPIC (except where only one eligible bid is submitted or a relevant decision is made by the President). Under the current law, SPICs are concluded through an application process without being put to tender.

A new restriction is imposed on incentives granted by the public party whereby they are terminated from the date the aggregate amount of expenses and unreceived revenue of Russian budgets resulting from the application of industry incentives for a project carried out under a SPIC exceeds 50% of the total amount of capital investments in the project as specified in the SPIC.

Among the substantial positive changes made by the law, we should point out in particular the removal of the minimum investment requirement for the conclusion of a SPIC (the current law requires investment of at least 750 million roubles). In addition, the maximum terms for which a SPIC may be concluded is extended from 10 to 15 years (or 20 years if investments are made in excess of 50 billion roubles excluding VAT).

The new legislation is to enter into force in the normal manner and lays down transitional provisions in relation to previously concluded SPICs. In particular:

- SPICs to which the Russian Federation is a party and which are in force on the date the law enters into force will remain in force and will be automatically included by the Industry and Trade Ministry (as the authorized body) in the SPIC register in accordance with the law
- SPICs to which the Russian Federation is not a party and which are in force on the date the law enters into force will remain in force under the terms laid down in the SPICs

Amendments to the Tax Code

The Federal Law "On Amendments to Parts One and Two of the Tax Code of the Russian Federation" makes a number of substantial amendments regarding the application of tax reliefs for parties to SPICs, including in particular:

[2] *Excluding legislative acts adopted pursuant to international agreements of the Russian Federation and/or international agreements of the Russian Federation and acts constituting Eurasian Economic Union law*

- Changes to the time limits on the application of profits tax reliefs by parties to SPICs:
  - The 2025 cut-off for profits tax reliefs is abolished. Under the new rules, reduced tax rates may be applied until the reporting/tax period in which the SPIC is terminated
  - A restriction on incentives is introduced whereby tax reliefs are not applicable beyond the period in which the aggregate amount of expenses and unreceived revenue of Russian budgets resulting from the application of industry incentives for an investment project carried out under a SPIC exceeds 50% of the total amount of capital investments in the project as specified in the SPIC
- The new law also makes an extremely positive change regarding the "90-10" rule for SPIC participants, under which profits tax reliefs are applicable only where the SPIC accounts for at least 90% of revenue earned. This criterion severely limits the availability of reliefs for companies that carry on multiple activities.

  Under the new rules, companies not meeting the revenue ratio criterion will benefit from an alternative provision allowing reduced rates to be applied exclusively to profits derived from activities under a SPIC. In order to exercise that right, SPIC participants will have to keep separate records of SPIC-related income and expenses. The law does not lay down the rules for keeping such records, and the procedures developed by the taxpayer must be laid down in its accounting policies and may not be changed during the term of the SPIC.

  The transitional provisions laid down in the amendments to the Tax Code also allow participants in federal SPICs concluded before the effective date of the amendments (but not earlier than 1 January 2017) to benefit from the new rules (reduced tax rates for profit derived from a SPIC subject to separate records being kept by the taxpayer) if the SPIC in question specifies profits tax relief as an incentive. Such taxpayers may apply the new rules starting from the profits tax period following the tax period in which the relevant procedures for determining the tax base are laid down in their accounting policies.
- An important change is made regarding the application of profits tax reliefs by participants in "regional" SPICs.[3] At present, profits tax reliefs that were established by regional laws before 3 September 2018[4] and are not directly provided for in the Tax Code[5] may be claimed until 1 January 2023[6], while those established after 3 September 2018 ceased to have effect from 1 January 2019. The new law grants participants in regional SPICs concluded before 1 January 2019 the right to claim regional profits tax relief until the tax period in which the agreement is terminated.

The bulk of the amendments enter into force one month after the official publication date of the law, but not earlier than the first day of the next tax period for profits tax, i.e. from 1 January 2020.

Amendments to the Budget Code of the Russian Federation

With a view to expanding the range of tools designed to ensure demand for products produced under a SPIC, amendments are made to the Budget Code allowing for subsidies to be granted in the context of a SPIC on a long-term basis (for more than one budget period) along the same lines as the current preferential regime

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[3] *SPICs concluded without the involvement of the Russian Federation as a party to the agreement*

[4] *The date of entry into force of Federal Law No. 302-FZ of 3 August 2018 (clause 1 of Article 4 of Federal Law No. 302-FZ of 3 August 2018)*

[5] *The Tax Code provides for profits tax reliefs to be granted only in relation to parties to SPICs concluded with the participation of the Russian Federation ("federal" SPICs)*

[6] *Paragraph 5 of clause 1 of Article 284 of the Tax Code*

for arrangements made under the laws on public-private partnerships and concession agreements.

What does it mean for businesses?

The new legislation substantially alters the legal framework for SPIC arrangements. The mandatory involvement of the Russian Federation in newly concluded agreements, the redefinition of the subject-matter of a SPIC and the introduction of a competitive procedure for the selection of an investor make the process of concluding agreements more complex. On the other hand, the elimination of the minimum investment requirement increases the range of potential SPIC participants, while the extension of the maximum term of a SPIC makes the mechanism feasible for longer-term projects.

The amendments to the Tax Code first and foremost address practical problems associated with the application of profits tax reliefs by SPIC participants (by introducing an alternative to the revenue ratio criterion and removing the 2025 cut-off for the application of tax relief). Another positive development for taxpayers is in the form of the special and transitional provisions relating to agreements already concluded, including regional SPICs. At the same time, a new restriction has been put in place that cuts off tax relief once the amount of incentives exceeds 50% of the amount of capital investments in an investment project.

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