



The Finance Ministry Proposes a Draft of Amendments to the Tax Code

International Tax Review ranked EY Russia Tax & Law practice as a **leading tax firm** (Tier 1) in Russia in its annual World Tax guide for 2018.

Follow us

 [facebook.com/groups/EYTaxRussia/](https://www.facebook.com/groups/EYTaxRussia/)

With a view to implementing elements of the Presidential Address to the Federal Assembly on 20 February and the key tax policy objectives for 2019-2021, the Finance Ministry has prepared a draft law¹ setting out numerous amendments to the Tax Code.

In our view, the key changes proposed by the bill are in the following areas:

- ▶ Regulation of the mutual agreement procedure mechanism
- ▶ Significant updates to the transfer pricing rules
- ▶ The introduction of special rules for successor companies regarding the recognition of accumulated losses of reorganized companies
- ▶ Changes to the timeframes for the application of profits tax relief for participants in regional investment projects

¹ <https://regulation.gov.ru/projects/List/AdvancedSearch#npa=84113>

Below we take a more detailed look at these key changes and other proposed amendments to tax legislation.

Mutual Agreement Procedure

The bill proposes a range of amendments relating to the conduct of the mutual agreement procedure (MAP) which is provided for in the majority of Russia's tax treaties as a means of settling disputes over the application of the treaties (including with a view to eliminating double taxation).

There have been few cases of MAPs being used in practice in Russia, mainly because of the lack of a transparent and effective mechanism for doing so.

The introduction of such a mechanism is a mandatory requirement for countries that have signed up to the OECD Action Plan on Base Erosion and Profit Shifting (BEPS), including Russia.

The first steps in this direction have already been taken: on 30 January the Finance Ministry published its Guidance on the Mutual Agreement Procedure Provided for in Double Taxation Treaties. The draft law, for its part, contains detailed provisions relating to the conduct of the MAP process, including the following:

- ▶ A taxpayer may make a MAP request to the Finance Ministry within three years of the effective date of an act of the tax authorities which the taxpayer believes has resulted in tax treatment not in accordance with the relevant treaty. The Finance Ministry must consider the request within 90 days, after which it must make a decision to initiate a MAP or express a reasoned refusal to do so. A MAP may also be initiated by the Finance Ministry at the request of competent authorities of foreign states
- ▶ While a MAP is being conducted the Finance Ministry may instruct a tax authority to conduct an on-site tax audit or a transfer pricing audit. That audit:
 - ▶ may be a repeat audit
 - ▶ may cover periods already covered by tax monitoring
- ▶ may be conducted regardless of when the last audit was carried out and of its subject matter
- ▶ may cover a period not exceeding ten calendar years preceding the year in which the order to conduct the audit is issued
- ▶ A notification of the conduct of a MAP by the Finance Ministry may be a basis for suspending the enforcement of a decision on the imposition or non-imposition of sanctions on a taxpayer for the commission of a tax offence. Depending on the outcome of the MAP, the tax authority would have to annul or resume enforcement of its decision
- ▶ A taxpayer may be asked to provide statutory and tax accounting data and other documents and information needed for the calculation and payment of taxes for all ten years preceding the date of the order to conduct the audit
- ▶ A transfer pricing audit under a MAP may be ordered within two years of a MAP notification being received. Based on the results of the audit, the Russian company may adjust the tax base and amounts of tax due (either upwards or downwards) if the competent authority of the foreign state makes a corresponding adjustment in relation to the related counterparty to the transaction and that adjustment is deemed justified by the Finance Ministry based on the MAP
- ▶ If a MAP results in agreement between the Finance Ministry and the competent authority of a foreign state, a copy of the relevant decision must be sent to the taxpayer and the Federal Tax Service within 10 days. The current three-year limit for the submission of an application for an offset (or refund) of overpaid tax is not applicable in the case of a decision made as a result of a MAP

It is planned that the amendments proposed by the draft law would apply to mutual agreement procedures initiated after 1 January 2020.

- ▶ Although initiating a MAP may increase the administrative burden and demand

significant time and resources, the changes proposed by the draft law ultimately give taxpayers new options, particularly when it comes to settling tax disputes relating to cross-border transactions

- ▶ We advise Russian companies to take immediate steps to review the current tax treatment of profit (income) in cross-border transactions in order to identify situations that have already resulted or may potentially result in tax disputes either in Russia or elsewhere and assess the scope for initiating mutual agreement procedures

Transfer Pricing

- ▶ The draft law clarifies the long-standing issue of which date should be taken as the transaction date when applying the comparable uncontrolled price method based on exchange prices. According to the draft, it should be the date on which a transaction was actually concluded, based on actual circumstances and documents drawn up when concluding the transaction and with account taken of the actual behaviour of the parties to the transaction. The draft law allows for price adjustments to be made in determining the arm's length range based on exchange prices, including adjustments for differences in the economic (commercial) conditions of the transactions based on a functional analysis
- ▶ The draft law defines functions and risks that must be taken into account in conducting a functional analysis of parties to controlled transactions involving intangible assets (known in global practice as DEMPE functions and related risks)
- ▶ The proposed amendments establish characteristics of intangible assets that must be taken into account in assessing the comparability of transactions involving such assets (exclusivity, conditions of legal protection, useful life, etc.)
- ▶ It is in relation to the analysis of transactions involving intangible assets that issues most commonly arise in practice. The BEPS Plan accordingly devotes considerable attention to transfer

pricing issues related to transactions involving intangible assets, providing key definitions and setting out detailed guidance on analysing such transactions

The changes proposed in the draft law indicate that Russian tax law is developing in line with global trends.

Profits Tax

Recognition of losses upon reorganization

- ▶ Rules are established on how losses of reorganized companies that arose prior to the reorganization should be treated by the successor company:
 - ▶ In the case of reorganization in the form of acquisition, the successor company may only recognise losses made by the acquired company in tax periods in which the successor and the reorganized companies were related entities on the first day of the tax period
 - ▶ In the case of reorganization in the form of a merger, the successor company may recognise losses made by the reorganized companies in tax periods in which all the reorganized companies were related entities on the first day of the tax period

Depreciation/amortization

- ▶ It is proposed that a fixed asset should be defined as an asset that is used for more than 12 months regardless of its historical cost
- ▶ An amendment is made whereby results of intellectual activity and other intellectual property assets with a useful life greater than 12 months and a historical cost exceeding 100,000 roubles would be treated as amortizable assets
- ▶ Fixed assets received for use without consideration would be treated as depreciable assets for profits tax purposes. However, depreciation expenses for such assets would not be recognised in tax accounts
- ▶ The useful life of fixed assets temporarily removed from service would no longer be

extended by the period for which they were out of service

- ▶ It is established that companies may move from the linear to the non-linear depreciation method no more frequently than once every five years

Other tax amendments

- ▶ It is expressly established that the discovery of errors/misstatements of prior years that resulted in the overpayment of profits tax is not a basis for adjusting tax in the current period if more than three years has passed from the due date for the payment of tax for the period in which the error/misstatement occurred
- ▶ A change is made to the time limit for notifying the tax authorities when granting a loan for the financing of a foreign geological exploration project. Notification of the granting of a loan would have to be given not later than the first day of the quarter following the quarter in which the relevant agreement was concluded

VAT

- ▶ A requirement is laid down for a successor company to recover input VAT previously deducted by a reorganised company if the successor company subsequently uses assets acquired as a result of the reorganization in non-VATable activities owing to the adoption of a special tax regime

Excise Duties

- ▶ Definitions of the excisable products “electronic nicotine delivery systems” and “liquid for electronic nicotine delivery systems” are given in accordance with the National Standard of Russia

Personal Tax and Social Contributions

- ▶ Personal income tax paid by a tax agent when additional charges are imposed/recovered on the basis of a tax audit is not deemed to be income of the taxpayer
- ▶ Companies with multiple subdivisions in one municipality would be able to pay personal income tax and file reports through one of those subdivisions

- ▶ Companies that make payments to individuals under contracts for the sale (exchange) of securities would be required to act as tax agents for personal income tax
- ▶ Social contribution computation may be submitted through subdivisions for which the company has opened bank accounts and which make payments to individuals
- ▶ It is proposed that the staff size threshold above which companies are obliged to submit social contribution computations in electronic form should be reduced from 25 to 10 employees

Changes Relating to Regional Investment Projects

- ▶ Definitions are given of the terms “investment project” and “unified manufacturing process” for the purposes of a regional investment project
- ▶ The last period in which profits tax relief may be applied by participants in a regional investment project would be defined as the period in which the aggregate difference between tax calculated at the 20% rate and at reduced rates starting from the period in which relief began to be applied exceeded the amount of capital investments in the project
- ▶ For regional investment project participants that apply the reduction coefficient C_{te} with respect to oil extraction, the last period in which profits tax relief may be applied would be the tax period preceding the calendar year in which $C_{te}=1$

Other Notable Changes

- ▶ Municipal museums, theatres and libraries would be exempt from profits tax as long as the conditions laid down in the draft law were met
- ▶ The zero rate for organizations engaged in educational and/or medical activities would apply indefinitely
- ▶ Foreign banks and credit organizations would be obliged to register for tax purposes in Russia when opening a

correspondent account with a Russian bank

- ▶ A number of amendments are made regarding special tax regimes. In particular, it would not be possible to apply the licence-based tax system and the unified tax on imputed income when engaging in retail trade in goods bearing identification marks

- ▶ The draft law includes a number of changes relating to the trade levy. In particular, it introduces rules regarding the calculation and payment of the trade levy when carrying on activities in accordance with a simple partnership agreement (joint activity agreement), a commission, agency or delegation agreement or a fiduciary agreement

Authors:

Anna Tsembeleva

Elena Luts

Anastasia Maryina

For additional information please contact the authors of this publication:

Victor Borodin
+7 (495) 755 9760
Victor.Borodin@ru.ey.com

Elena Luts
+7 (921) 594 2237
Elena.Luts@ru.ey.com

Anna Tsembeleva
Anna.Tsembeleva@ru.ey.com

Inquiries may be directed to one of the following executives:

Moscow

CIS Tax & Law Leader Irina Bykhovskaya	+7 (495) 755 9886
Oil & Gas, Power & Utilities Alexei Ryabov Victor Borodin	+7 (495) 641 2913 +7 (495) 755 9760
Financial Services Alexei Kuznetsov Maria Frolova Ivan Sychev	+7 (495) 755 9687 +7 (495) 641 2997 +7 (495) 755 9795
Industrial Products Andrei Sulin	+7 (495) 755 9743
Consumer Products & Retail, Life Sciences & Healthcare Dmitry Khalilov	+7 (495) 755 9757
Real Estate, Hospitality & Construction, Infrastructure, Transportation Anna Strelnichenko Svetlana Zobnina	+7 (495) 705 9744 +7 (495) 641 2930
Technology, Telecommunications, Media & Entertainment; Tax Performance Advisory Ivan Rodionov	+7 (495) 755 9719
Tax Technology Sergey Saraev	+7 (495) 664 7862
People Advisory Services Ekaterina Ukhova Gueladjo Dicko Sergei Makeev	+7 (495) 641 2932 +7 (495) 755 9961 +7 (495) 755 9707
Private Client Services Anton Ionov	+7 (495) 755 9747
Customs & Indirect Tax Vadim Ilyin	+7 (495) 648 9670
Transaction Tax Yuri Nechuyatov	+7 (495) 664 7884

Cross Border Tax Advisory Vladimir Zheltonogov Marina Belyakova Andrey Vostokov	+7 (495) 705 9737 +7 (495) 755 9948 +7 (495) 755 9708
--	---

Transfer Pricing and Operating Model Effectiveness Evgenia Veter Maxim Maximov	+7 (495) 660 4880 +7 (495) 662 9317
--	--

Tax Policy & Controversy Alexandra Lobova Alexei Nesterenko	+7 (495) 705 9730 +7 (495) 622 9319
---	--

Global Compliance and Reporting Yulia Timonina Alexei Malenkin	+7 (495) 755 9838 +7 (495) 755 9898
--	--

Law Georgy Kovalenko Alexey Markov	+7 (495) 287 6511 +7 (495) 641 2965
--	--

St. Petersburg

Dmitri Babiner	+7 (812) 703 7839
----------------	-------------------

Vladivostok

Alexey Erokhin	+7 (914) 727 1174
----------------	-------------------

Ekaterinburg

Irina Borodina	+7 (343) 378 4900
----------------	-------------------

Krasnodar

Alexei Malenkin	+7 (495) 755 9898
-----------------	-------------------

For information about Foreign Countries Business centers in EY Moscow office please follow the [link](#).

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global EY organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY works together with companies across the CIS and assists them in realizing their business goals. 4,800 professionals work at 20 CIS offices (in Moscow, St. Petersburg, Novosibirsk, Ekaterinburg, Kazan, Krasnodar, Togliatti, Vladivostok, Yuzhno-Sakhalinsk, Rostov-on-Don, Almaty, Astana, Atyrau, Bishkek, Baku, Kyiv, Tashkent, Tbilisi, Yerevan, and Minsk).

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Contacts

Almaty	Moscow
+7 (727) 258 5960	+7 (495) 755 9700
Astana	Novosibirsk
+7 (7172) 58 0400	+7 (383) 211 9007
Atyrau	Rostov-on-Don
+7 (7122) 99 6099	+7 (863) 261 8400
Baku	St. Petersburg
+994 (12) 490 7020	+7 (812) 703 7800
Bishkek	Tashkent
+996 (312) 39 1713	+998 (71) 140 6482
Ekaterinburg	Tbilisi
+7 (343) 378 4900	+995 (32) 215 8811
Kazan	Togliatti
+7 (843) 567 3333	+7 (8482) 99 9777
Kyiv	Vladivostok
+380 (44) 490 3000	+7 (423) 265 8383
Krasnodar	Yerevan
+7 (861) 210 1212	+374 (10) 500 790
Minsk	Yuzhno-Sakhalinsk
+375 (17) 240 4242	+7 (4242) 49 9090

© 2019 Ernst & Young (CIS) B.V.

All Rights Reserved.

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global EY organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.