Russian Tax Brief

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Tax Changes Planned in the Federal Budget for 2015-2017

On 30 September the government submitted a draft law concerning the federal budget for 2015 and the planning period of 2016 and 2017 to the State Duma. This draft was discussed and approved by the government on 18 September. The draft mentions a number of other draft laws recently submitted to the State Duma which propose amendments to tax legislation.

The main objective of the Russian authorities’ tax policy is to raise revenue for the federal budget. The instruments to be employed to achieve this goal in 2015-2017 are:

- the increasing and indexation of tax rates,
- implementation of the so-called “tax manoeuver” and
- gaining additional revenues from customs fees.

Future changes in legislation in aggregate are budgeted to increase revenue of the federal budget as follows.

<table>
<thead>
<tr>
<th>Year</th>
<th>Increase in billion roubles</th>
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<tbody>
<tr>
<td>2015</td>
<td>138.4</td>
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<tr>
<td>2016</td>
<td>65.3</td>
</tr>
<tr>
<td>2017</td>
<td>116.7</td>
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Cancelled Tax Proposals

During the discussion on 18 September some proposed tax amendments were rejected and hence were not included in the calculation of the federal budget:

- the introduction of a sales tax,
- the increasing of the VAT rate to 20%,
- the increasing of the personal income tax (PIT) rate to 14-15% and
- the introduction of a progressive scale for PIT.

An alternative to a sales tax proposed is the provision of a right for regions to introduce special fees for the right to trade, or provide catering services, taxi services, etc.

Taxes on dividends

A draft law submitted to the State Duma last month proposes an increase in the rates of PIT and profits tax from 9% to 13% in respect of income which is received by Russian tax residents in the form of dividends. In the case of profits tax, the 13% rate will only apply when the criteria for applying the zero rate are not satisfied. Per the federal budget, the profits tax change should generate 10.9 billion roubles of additional revenue.

Duty-free e-commerce

The draft law also assumes a reduction in the threshold for duty-free e-commerce to 150 euros. The additional budget revenue in 2015 from this amendment is estimated at 20 billion roubles.

Excise Duty

The draft law provides for the imposition of excise duty on gas exported to Turkey through the Blue Stream pipeline, which is planned to generate 41 billion roubles of additional income in 2015.

New excise rates for cigarettes are proposed for 2015 to 2017. The ad valorem excise rate is to increase significantly: in 2015 to 9.5%; in 2016 to 10% and in 2017 to 10.5%. Also, over the three years the minimum excise duty rate is to increase from 960 to 1350 roubles per thousand cigarettes. The budgeted additional revenue from these amendments is 24 billion roubles.

“Tax Manoeuvre”

The federal budget also assumes the implementation of the "tax manoeuver", which was reported in the September 2014 Russian Tax Brief.

Water Tax and Payment for Forest Exploitation

During the discussion concerning the federal budget it was mentioned that since 2005 water tax rates have not been indexed, leading to a significant reduction in the tax burden. The draft budget provides for the application of indices to the tax rate which should be equal to 1.15 in 2015, 1.32 in 2016 and 1.52 in 2017. Similar changes are also provided for payment for forest exploitation - the index for the planned three-year period will increase from 1.05 to 1.15.


2 Draft Federal Law No. 605370-6 submitted to the State Duma on 18 September 2014.
Law Concerning the Initiation of Criminal Cases Involving Tax Matters to be Enacted

On 15 October a draft law concerning the procedure for the initiation of criminal cases involving tax crimes was approved by the Federation Council. Enactment requires only two further steps - signature by the president and official publication - meaning that the new procedure should soon have legal force.

The draft law specifies amendments to Article 144 “Procedure for Considering the Communication on a Crime” of the Criminal-Procedural Code. Currently the investigative bodies may initiate criminal cases on tax matters based only on tax audit materials provided by the tax authorities under legislation on taxes and levies. Enactment of the draft will broaden the scope for initiating cases, reverting to practices in force before 2011.

The President introduced the draft law to the State Duma in October 2013 and it was adopted in the first reading in December. Then the enactment process stalled with the draft being widely criticized by the Government and the business community. In September the draft law passed the second reading after the State Duma made a number of amendments. However, on 6 October the State Duma decided to return the draft law to the procedure of the second reading to allow further amendments to the text. Since then the revised draft has been passed in the second reading again and immediately in the third reading before being approved by the Federation Council.

The amended version of the draft law provides a procedure for the investigation of criminal cases which has been modified to address some of the concerns raised by the initial proposals. According to this procedure, when the members of the Ministry of Internal Affairs inform the Investigation Committee about a tax crime, a criminal investigator is to send the supporting documents and a preliminary estimation of arrears to the tax authorities within 3 days. The tax authorities should respond within 15 days of receiving such documents. There are three categories of report which may be issued:

- a report that such violations were identified in the course of a prior on-site tax audit, that the arrears have been calculated correctly, that the decision of the on-site tax audit is in force and whether there is an ongoing appeal process;
- a notification that the on-site tax audit is still in progress or the decision of the on-site tax audit has not yet been reached or is not yet in force; or
- a notification that the tax authorities have no information about any arrears if the findings mentioned in the investigator’s request have not been noted during an on-site tax audit.

The criminal investigator can initiate criminal proceedings only after receiving the report/notification from the tax authorities and not later than 30 days from receipt of the original notification about the crime.

The investigator will be able to bring criminal charges for tax evasion without approval from the tax authorities only if serious matters are involved or if there are sufficient facts indicating the elements of a crime. Therefore the cross-division control should reduce the scope for abuse of the procedure.

The Challenge of Proving a Negative: Guidance to Tax Agents on Beneficial Ownership

For six months now, tax agents and tax authorities have been expected, based on guidance issued by the Ministry of Finance, to take into consideration not just the country of residence of a foreign recipient of Russian-source income but also whether or not that recipient is the beneficial owner of the income. However, neither the letter issued by the Ministry of Finance in April nor the Tax Code provides any information as to how a tax agent might demonstrate sufficient diligence in checking whether or not a recipient is the beneficial owner to avoid exposure to liability for failing to withhold the appropriate amount of tax.

A recently published letter of the Ministry of Finance (hereinafter “the Letter”) addresses the question of the documents needed to determine the actual recipient of dividend income (the beneficial owner).

The Letter acknowledges that the procedures laid down in Articles 232 and 312 of the Tax Code, for payers of personal tax and profits tax respectively, for the application of benefits arising under

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4 Letter No.03-00-R3/16236 of 9 April 2014.

5 Letter No. 03-08-05/36499 of 24 July 2014.

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international double tax treaties do not contain provisions requiring the Russian tax agent to carry out procedures aimed at identifying the actual controllers of the income of taxpayers. The requirement specified in these articles is to obtain a confirmation of residence in a treaty jurisdiction for the purposes of the relevant tax treaty from the foreign competent authority. Such certificates do not include information on beneficial owners (actual controllers) of a taxpayer’s income.

The Letter includes the view that the absence of references to specific documents in the Tax Code indicates that the legislator is more interested in the actual content of the information received by a tax agent and prefers not to limit tax agents to a particular list. This is a little disingenuous given that the Tax Code does not establish and never has established a requirement for tax agents to check whether the recipient of income is the beneficial owner. Any such requirement at present must arise from the relevant double tax treaty. The amendments required to introduce such a requirement in the Tax Code are likely to be enacted this year and have effect from 1 January 2015.

The Letter suggests that the tax agent may request the following documents besides the certificate of residence:

1) evidence as to whether or not the taxpayer enjoys discretion in regard to the disposal and use of the dividends received, including:
   ▶ documents confirming (refuting) the existence of contractual or other legal obligations to third parties (whose place of residence or registration is not a treaty jurisdiction, i.e., not somewhere with which Russia has concluded a double tax treaty) which limit the rights of the income recipient with respect to the use of the dividends received for the purpose of deriving benefit from alternative use;
   ▶ documents confirming (refuting) the predetermined nature of the subsequent transfer of funds by the income recipient to third parties (whose place of residence or registration is not a treaty jurisdiction);

2) documents (information) confirming that an income recipient whose place of registration or residence is a treaty jurisdiction “incurs tax obligations which are payable and the existence of which confirms that no saving on tax at source in Russia was made upon the subsequent transfer of funds received to third parties” (whose place of residence or registration is not a treaty jurisdiction);

3) documents (information) confirming that the income recipient carries on actual entrepreneurial activities in the jurisdiction in which it claims tax residence for treaty purposes.

The list of suggested documents has no legal force, but is nonetheless interesting. The April letter suggested that the subsequent transfer of funds to a company resident in a different jurisdiction could be treated as grounds for concluding that the immediate recipient of Russian-source income was not the beneficial owner, regardless of whether a direct payment from Russia to the indirect recipient would have qualified for a reduced rate of tax under another treaty. This Letter differs in that it refers to whether not the indirect recipient is incorporated or resident in any treaty jurisdiction.

The second category of document listed is so strangely worded that it is impossible to be sure what was intended. The problematic wording is that quoted above.

Where treaty relief is claimed in relation to a dividend there would of course be a saving of tax at source in Russia on the transfer of funds to the taxpayer – that is after all the point of treaty relief. Furthermore, the incurring of (reduced) tax at source in Russia or tax in its country of residence by the taxpayer (recipient of a dividend) would not confirm that no saving on tax at source in Russia was made upon the subsequent transfer of funds received to third parties.

The third category of document suggests a form of substance test – the taxpayer having a place of residence in the treaty jurisdiction in question may be justified by its having entrepreneurial activities there. Documents confirming such activities would not, however, be relevant to whether the taxpayer is the beneficial owner of dividends received from Russia. Also, a pure holding company would not be able to provide such a document regardless of whether it was the beneficial owner of dividends. The question is whether proof of entrepreneurial activities might be accepted by the tax authorities as sufficient in itself to justify the application of treaty benefits or whether companies with entrepreneurial activities would remain subject to the same criteria as a pure holding company or other passive investment vehicle for determining whether the recipient of a dividend is the beneficial owner.

The Letter does not address the obvious issue of how a negative is to be proved. Clearly the existence of a contractual obligation may be evidenced by a copy of the contract. But the only document a taxpayer could easily supply to refute the existence of any such contractual obligation
would be one issued by the taxpayer itself. A third-party confirmation would require due diligence work including a review of the taxpayer’s contractual obligations. The question is, would a tax agent which accepts a written assurance from the taxpayer be secure from liability should the tax authorities later decide that the taxpayer was not the beneficial owner of the income? Overall, the Letter may raise more questions than it answers.

A Fresh Example of the Successful Application of the Unjustified Tax Benefit Concept

It is not uncommon for the tax authorities to challenge transactions concluded between related parties by applying the unjustified tax benefit concept if there is a reason to suspect that there was manipulation of prices or the implementation of a tax minimization scheme. The courts’ position regarding this issue is mixed, with the outcome of cases usually dependent on the circumstances of the case in question and on the evidence provided. It is noteworthy that the tax authorities are progressively broadening the information sources used in collecting evidence. One of the latest trends is to refer to information supplied by the Federal Security Service.

A decision by the court of second instance in September in the Business Media Case is a fresh example of the successful application of the unjustified benefit concept by the tax authorities using a variety of information sources. According to the court ruling, the tax authorities challenged the price per the share purchase agreement used by Business Media LLC (hereinafter – Business Media or the Company) when calculating expenses for profits tax purposes and the deductibility of interest incurred on a loan received from a related party, charging additional tax, a fine and penalties totalling 79 million roubles.

The tax authorities decided that expenses relating to both transactions (the purchase of shares and the loan) should not be deducted since the transactions were concluded between related parties on a non-arm’s-length basis, were of a fictitious nature and had no economic rationale other than the receipt of an unjustified tax benefit. To support their position with respect to the excessive share purchase cost deducted by the company, the tax authorities brought forward the following evidence:

- The taxpayer’s representations were ambiguous and contained significant discrepancies;
- The taxpayer’s accounting policy did not provide any guidance with respect to the method to be used for determination of the actual share price;
- The valuer’s report provided by the taxpayer was inaccurate and did not correspond to the applicable legal requirements;
- The share price, based on the net assets value of the issuer, mainly represented by software rights contributed to the share capital, was overstated by more than 500 times, according to an expert opinion;
- The seller (a Cypriot company), the buyer (Business Media) and the issuer of the shares were controlled by the same person, Mr. Gavrilenko A.G., and therefore deemed to be related parties;
- The resale of the shares at the purchase price indicated that the company had no intention to obtain any economic effect from the transaction;
- The absence of claims from the seller with respect to non-payment by the Company or deferral of payment for more than 4 years permitted by the seller signified that the transaction was fictitious.

Arguments supporting the tax authorities’ position with respect to the disallowance of interest expenses incurred under the loan agreement were as follows:

- The loan was provided to Business Media by a related party and the money received was transferred through a chain of affiliated parties to the initial lender within one working day with all transfers being within a single bank;
- The transitory or circular character of the transaction indicated the absence of a real economic purpose and that the form of the transactions performed did not correspond to their real nature.

It is noteworthy that to collect solid evidence to support their reasoning, aside from information provided by the taxpayer, the tax authorities used sources including: sources in the public domain such as the web-sites of Business Media, its affiliated parties and the ICIJ Offshore Leaks Database; official sources, including data from the Official Single Register of Legal Entities, letters received...
from the economic security service of the Federal Security Service and an opinion provided by an independent expert.

The courts of the first two instances considered the position of the tax authorities to be reasonable and well-substantiated and supported them in full. This case provides a good example of some of the varied sources of information and inventive methods of argumentation the tax authorities employ when challenging taxpayers’ positions using the unjustified tax benefit concept.

Consideration of the case in the court of third instance is expected to take place in November. We will report further developments concerning this case in future editions.

Unresolved Questions Concerning Thin Capitalisation

In spite of the fact that thin capitalisation has been one of the most closely examined topics in Russian tax practice of recent years, there are still some areas of uncertainty with respect to the application of the rules (in Clauses 2-4 of Article 269 of the Tax Code).

One example is when the parties to a debt are two Russian entities controlled by the same foreign entity. The debt in this situation is directly stipulated in the Tax Code to be a controlled debt. Therefore, the difference between the interest calculated under the thin capitalisation rules and interest actually accrued should be treated as dividends paid to the foreign entity and withholding tax applied accordingly. However, the interest is actually paid to a Russian entity obliged to include it in its income subject to profits tax. Therefore, withholding tax at source would lead to double taxation. Furthermore, given that a Russian recipient cannot obtain a certificate of residence in a treaty jurisdiction, the tax withheld would be at the maximum rate for dividends of 15%.

This anomaly has resulted in many requests for clarification to the Finance Ministry. In a recently issued clarification regarding the apparent necessity to withholding tax, the ministry pointed out that the purpose of the thin capitalization rules is to combat tax abuses associated with the concealed distribution of dividends under the guise of the payment of interest. If in fact interest is paid to a Russian company, there is no reason in principle for withholding tax to apply as the interest will be subject to profits tax as interest income of that company. The letter also states:

“The [Tax] Code does not provide for tax to be levied at source when income is paid in the form of interest payable to Russian organizations in respect of debt obligations under a loan agreement (credit agreement) with Russian organizations.”

This point is also made in earlier clarifications on the issue. While it may not be explicitly stated in the Tax Code that WHT applies in such circumstances, such a conclusion follows logically from the provisions of clauses 2 to 4 of Article 269 where the interest is paid on controlled debt and is in excess of the maximum interest deductible under clause 2. The issue is rather that the Tax Code does not exclude such interest income from direct taxation as part of the Russian recipient’s profits tax base and therefore the application of clause 4 of Article 269 to interest paid to a Russian company would result in double taxation.

The ministry’s position is that the thin capitalisation rules should be applied to loans between two Russian entities only with respect to calculating the limit on interest deductible by the borrower. This is based on Article 7.3 of the Tax Code whereby all unresolvable doubts, contradictions and ambiguities in tax law should be interpreted in favour of the taxpayer. A second argument sometimes included in clarifications is that Article 269 concerns the inclusion of interest on debt obligations in expenses, not the treatment of interest income. This is consistent with the current title of Article 269 “Special Considerations Relating to the Classification of Interest on Debt Obligations as Expenses” but disregards the fact that clause 4 concerns the taxation of interest income.

Historically, court practice has varied in regard to the situation in question. There have been court decisions supporting the position that no WHT arises in the case of interest paid to a Russian lender but the alternative position can also be supported by court practice. For this reason it is prudent for borrowers to obtain a clarification from the ministry to provide protection from fines and penalties.

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9 For example, Letters No. 03-08-05/16607 of 11 April 2014 and No. 03-08-05/9669 of 6 March 2014.
10 With effect from 1 January 2015 this title will be changed to “Special Considerations Relating to the Treatment of Interest on Debt Obligations for Taxation Purposes”.
11 Ruling of the Federal Arbitration Court of the Moscow district of 24 August 2011 No KA-А40/9171-11.
12 Ruling of the Federal Arbitration Court of the North-Siberian district of 7 May 2014 No A81-2782/2013.

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8 Letter No. 03-08-05/43013 of the Ministry of Finance of 28 August 2014.
penalties prior to paying interest without withholding tax on any excess interest paid. Another common situation is when a loan from an independent bank to a Russian entity is guaranteed by a foreign parent or other foreign affiliated company. In this situation too, the Finance Ministry has repeatedly expressed the position, based on similar arguments to those summarized above, that no withholding tax should apply to interest where the lender is a Russian independent bank. The ministry’s position changes if a loan was provided by a foreign bank even if the bank is clearly independent of the borrower. According to the ministry, interest payable to the bank in this case is subject to WHT if the loan meets the criteria for controlled debt in the thin capitalisation rules. This is consistent with a literal interpretation of the rules. However, it creates an inconsistency not found in Article 269 in the tax implications for Russian and foreign third-party banks, giving rise to an additional tax burden for foreign banks which are taxed on gross income whereas a Russian lender would be subject to profits tax on net income.

Despite numerous clarifications on different aspects of the Russian thin capitalisation rules, unresolved questions may still arise and we recommend taxpayers monitor the trends in court practice regarding the thin capitalisation rules.

It is conceivable that the thin capitalisation rules will be amended with effect from 1 January 2015. We will report any developments in this respect in future editions.

**Accelerated Capital Allowance for Leasehold Improvements**

Current court practice reveals that the taxation of capital investments in leased fixed assets in the form of inseparable improvements frequently causes tax controversy. Although Article 258 of the Tax Code specifies that a lessee may deduct such expenses by means of depreciation if no cost reimbursement by the lessor is due, uncertainty exists with respect to a tenants’ right to apply the accelerated capital allowance provided for in Clause 9 of Article 258 to inseparable leasehold improvements.

Court practice is developing, and in its recent Determination 15, the Supreme Court supported the applicability of the capital allowance. The court declared that tax law provides only general conditions for the deductibility of the allowance and does not establish any restrictions applicable to leaseholders in this respect.

The taxpayer involved in this litigation is a retail company which rents space in various shopping malls in Russia. The rent agreements provide for the taxpayer’s right to carry out fit-out works at its own expense. Upon the termination of a rent agreement the capital improvements are transferred to the lessor without any reimbursement of the lessee’s costs. The taxpayer deducted the accelerated capital allowance with respect to such improvements.

The tax authorities, in the course of a field tax audit, challenged the deductibility of such costs. They noted that the capital improvements in question were inseparable from the rented premises and recorded on the lessor’s balance sheet rather than the lessee’s. They argued that rules concerning the accelerated capital allowance are not applicable to leaseholders.

The taxpayer submitted a court claim, and the courts of all three instances and the Supreme Court decided in its favour based on the following:

- The fit-out costs challenged by the tax audit meet the criteria for deduction established in the Tax Code, in particular, a new design was essential for functionality of the commercial premises, the taxpayer was making profit during the period audited, and the relevant agreements with subcontractors and primary supporting documentation were produced in evidence and found to have been properly prepared;
- Notwithstanding the fact that inseparable improvements should be treated as a part of the rented property that is booked on the owner’s balance sheet, the accounting requirements do not affect the right to deduct an accelerated capital allowance in the tax accounts;
- The Tax Code directly provides that non-reimbursable capital investments in leased fixed assets in the form of inseparable improvements are treated as depreciable assets, hence other rules related to depreciation, including those

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13 Letters of the Finance Ministry No. 03-08-05/8180 of 26 February 2014, No. 03-08-05/3278 of 29 January 2014, No. 03-08-05/519 of 14 January 2014, No. 03-08-05/56706 of 14 December 2013 and No. 03-08-13/56090 of 19 December 2013.

14 Letter No. 03-03-06/1/27314 of the Finance Ministry of 6 June 2014.

15 Determination No. 305-KG14-1382 of the Supreme Court of 9 September 2014.
related to the accelerated capital allowance (in Russian termed a depreciation bonus), should also apply:

▸ Lastly, tax legislation does not contain any restriction preventing leaseholders from deducting an accelerated capital allowance.

Modification and adaptation of rented premises has become common practice among retailers and a necessary condition for their business activities (and brand recognition). The case discussed gives taxpayers grounds to support deducting an accelerated capital allowance with respect to capital investments in leased fixed assets in the form of inseparable improvements subject to such expenses being properly documented, economically justified and profit-driven.

Recent Court Case With Respect to Depreciation of Fixed Assets in the Absence of State Registration

The possibility to deduct depreciation with respect to fixed assets which are subject to state registration used to be a cause of dispute with the tax authorities. In 2012 the position of the courts, that depreciation is not dependent on the state registration of property rights, was expressed in Ruling No. 6909/12 of the Presidium of the Supreme Arbitration Court of 30 October.

To add more clarity some specific language was added to the relevant provisions of the Tax Code with effect from 2013. Those amendments, introduced by Federal Law No. 206-FZ of 21 November 2012, allow a taxpayer to start depreciating fixed assets after the fixed assets were put into use regardless of whether state registration has occurred. Initially, Federal Law No. 206 did not contain any provisions prohibiting the application of the same approach to fixed assets which were put into use before 1 January 2013. Amendments introduced by Federal Law No. 215-FZ of 23 July 2013 established that depreciation of fixed assets brought into use before 1 January 2013 should be charged from the first day of the month after the submission of documents for state registration, meaning that the provision concerning depreciation of fixed assets put into use regardless of the status with respect to state registration does not have a retroactive force. The same approach was confirmed by several clarifications of Ministry of Finance.

However, court practice with respect to this issue seems to be moving in the opposite direction. This can be illustrated by the following recent court case. In the first quarter of 2013, a company submitted an adjusted profits tax return including additional depreciation expenses related to fixed assets without state registration for 2012. The tax authorities disallowed the depreciation expenses and the Company applied to the court. The courts of first, appeal and cassation instances decided in favour of the Company, stating that the position expressed in Ruling No. 6909/12 of the Presidium of the Supreme Arbitration Court is applied to both the old and new wordings of Article 259 of the Tax Code. The presidium ruled that the absence of state registration of the property rights to the fixed assets cannot be considered a basis for not charging depreciation. In its decision the court of cassation instance also noted that the adjusted tax return was submitted before the provisions of Federal Law No. 215 came into force and that given that the amendments enacted in that law worsened the position of taxpayers they could not have retroactive force. Consequently, the Company had the right to deduct depreciation expenses related to assets without state registration in 2012.

Based on the results of the court case it is possible to conclude that if a taxpayer submitted an adjusted tax return with respect to such depreciation expenses in the period from 1 January 2013 through 22 August 2013 then there is a possibility that any tax dispute arising would be resolved in favour of the taxpayer. However, the specific facts and circumstances should be taken into account to evaluate the risk of a successful challenge from the tax authorities in any particular case.

Amendments to the Procedure for Calculating the Property Tax Payable by Individuals Enacted


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16 Letters No. 03-03-06/1/279 of 13 January 2014, No. 03-03-06/1/57292 of 25 December 2013, and No. 03-03-06/1/42746 of 3 October 2013.

17 Ruling of the Arbitration Court of the Moscow region on case No. A40-9302/14 of 26 September 2014.
Property Taxes of Individuals" (hereinafter, the "Law") will take effect on 1 January 2015. Under the Law, tax on the property of individuals will be calculated according to its cadastral and not inventory value.

The new procedure will take effect gradually. Each constituent entity of the Russian Federation ("region") will decide independently when the new procedure for calculating the property tax of individuals will take effect in its territory. The transition to the new system must be completed by 1 January 2020. Until that date, regions may continue to use the inventory value for calculating tax multiplied by a deflator which depends on the inventory value of property.

When calculating the tax base, a tax deduction will be taken into account, depending on the object of taxation, e.g. the tax base for apartments will be calculated by deducting the value of 20 sq. m of the total size of an apartment from its cadastral value. The tax base will be reduced by 50 sq. m for house owners. Room owners can reduce the taxable amount by the value of 10 sq. m of the room in question. Where residential premises in the form of a single unit are included in a unified real-estate complex, 1 million roubles will be deducted from the cadastral value of the complex in order to calculate its tax base. In this respect, the representative bodies of municipalities (legislative [representative] bodies of state authorities of the cities of federal significance, i.e. Moscow, St. Petersburg and Sevastopol) will be allowed to increase those tax deductions.

The following property located in a municipality will be deemed an object of taxation:
1) a residential building;
2) residential premises (apartment, room);
3) a garage, parking place;
4) a unified real-estate complex;
5) an object of construction in progress;
6) any other building, structure, facility or premises.

The tax rate for residential premises will be 0.1% of the cadastral value. The local authorities can increase the tax rate for residential premises up to 0.3% or reduce it to zero.

Trade and administrative business centres (complexes), offices, trade units and public catering units will be taxed at 2% of their cadastral value. That rate will also apply to objects of taxation worth over 300 million roubles; the local authorities cannot change the tax rate for this category of property, and there are no tax benefits for property in this category.

A tax rate of 0.5% is established for other items.

Draft Law Concerning Increasing the Land Tax Rate

Draft Law No. 601423-6, which proposes amendments to the land tax rate for certain categories of land, was recently sent to the State Duma's tax committee for consideration.

Currently, the maximum tax rate (established by Article 394.1 of the Tax Code) is 1.5% for "other plots of land", i.e., land which is not agricultural or farmland and on which there are no residential buildings or related utilities structures. Local authorities are entitled to establish a land tax rate which is not higher than the maximum level.

The draft law, introduced by the Legislative Assembly of Vologda Region, proposes doubling the maximum rate to 3% from 1 January 2015. According to the explanatory note to and the financial and economic grounds for the draft law, land tax, being one of the key local taxes, has a significant impact on local budget revenue. The authors of the draft law regard the wide-scale nature of the lawsuits filed in 2012-2014 against the cadastral value of land (in favour of its decrease) as one of the factors which adversely affect revenue received by the budget. According to the authors, most of these lawsuits are upheld by the courts (both in the Vologda Region and other large regions), substantially reducing the tax base (e.g., by 1.7-fold to 44-fold).

The authors of the draft law believe that a higher land tax rate for other land would help to minimize municipal losses when the results of the state cadastral valuation of land are reduced. The financial and economic grounds provided refer to a situation concerning land on which there are, for instance, trading centres of large chain organizations which generate substantial revenue by, among other things, leasing out the areas of trade centres but paying "minimum taxes to the budgets of all levels."

If the draft law is adopted, there will be a heavier tax burden on owners and lessees of land plots occupied by commercial real estate. When the cadastral valuation of such land plots is raised, tax payments will increase accordingly. Therefore, it is important for taxpayers to have the opportunity to contest the state cadastral valuation.

Amendments to Federal Law No. 135-FZ of 29 July 1998 Concerning Valuation Activities in the Russian Federation have changed the procedure for contesting the cadastral value, e.g., the period within which an application can be submitted to the commission for the revision of the cadastral value has been extended from 6 months to 5 years and
such an application must now be submitted by legal entities prior to litigation. Another important fact is that the revised cadastral value can now be applied from 1 January of the calendar year in which the relevant application to revise the cadastral value was submitted; previously this was not the case.

When deciding whether to contest the cadastral value, an analysis should be made of the tax effect if the examination of the case by a commission or court has a favourable result, comparing it with the expenses of commissioning a valuation and of the proceedings entailed in achieving such an outcome. Moreover, it is advisable to check certain information concerning the region in question: will another cadastral valuation be held in the immediate future (from 2015, the cadastral value can be reviewed not more than once every three years, and in cities of federal significance, not more than once every two years), and what are the latest statistics concerning the outcomes of such litigation and how do they vary in the case of (if applicable) litigation initiated by the lessee and not by the land owners.

Criteria for Designating Russian Legal Entities as Major Taxpayers

The Federal Tax Service has issued Order No. MMV-7-2/483® of 19 September 2014, amending the criteria for designating Russian legal entities as major taxpayers from the date of the order. Several former criteria related to tax administration either at the federal and regional levels have been abrogated or subject to insignificant adjustments. One criterion by which a legal entity may be deemed to be a major taxpayer will now be whether it has a licence to carry out any of the following financial activities:

► banking operations;
► insurance, re-insurance, mutual insurance or intermediary activities as an insurance broker;
► pension provision and pension insurance activities;
► the activities of a professional participant in the securities market;
or a licence to maintain a register of holders of securities.

In addition to the existing criteria for classifying a legal entity as a major taxpayer, such as the total amount of income received, net assets value and paid federal taxes, the company must have an average number of employees exceeding 50. Once classified as a major taxpayer, a company will retain the status for two years following any year in which it ceases to satisfy the criteria. Legal entities applying special tax regimes do not fall into the category of major taxpayers.

VAT Treatment of Interest on Commercial Credit: New Position of the Ministry of Finance

The Ministry of Finance has recently issued a number of letters reflecting a change in its view on the VAT treatment of interest on commercial credit (such as payment for goods by instalments). The ministry believes that the payment of interest on commercial credit is not a VATable event. Historically, the ministry considered that interest arising under a commercial credit arrangement should be included in the VAT base. The main argument applied in arriving at that conclusion referred to the definition of commercial credit stipulated in the Russian Civil Code. Per the Civil Code, the performance of contractual obligations which is associated with the transfer of monetary funds or other assets may provide for the granting of credit, including in the form of advance payment, prepayment, deferred and instalment payment of goods, works or services (commercial credit). From this, the ministry concluded, commercial credit linked to the sale of goods (work, services) should not be considered a separate activity, but should be deemed part of the relevant sales-purchase agreement.

On this basis, per the ministry’s previous guidance, interest received by a seller from a customer on payment by instalments for goods (work, services) should be characterized for VAT purposes as payment for such goods (work, services) sold. As a result, sellers should include the interest in the VAT tax base.

However, more recent letters describe a new approach to the VAT treatment of interest on commercial credit. The ministry now agrees with the prevailing opinion on the matter supported by court practice. Interest on commercial credit

20 For instance, Ruling of the Supreme Arbitration Court No. VAS-14084/12 of 1 November 2012: and Ruling of

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should be viewed as payment for the use of monetary resources and subject to the provisions of the Civil Code concerning loan agreements. Consequently, it should be treated as a payment for commercial credit under an agreement separate from the sales-purchase agreement. Being treated in such manner, interest should not lead to VAT consequences and should not increase the VAT tax base.

On 8 July this year the Federal Tax Service issued Letter No. RG 4-3/13219@ to local tax inspectorates as guidance to be applied in their day-to-day work, in which the FTS referred to the ministry’s Letter No. 03-07-15/28722. Local tax inspectorates should take into account the official position of the ministry and should not assess VAT on interest paid on commercial loans.

In summary, recent letters of the Ministry of Finance have provided taxpayers with additional support for the non-application of VAT to interest on commercial credit. In our view, this allows taxpayers to avoid overpaying VAT with a low risk of disputes with tax authorities.

OECD Releases Highly Anticipated 2014 Output of BEPS Action Plan

On 16 September, the Organisation for Economic Co-operation and Development (OECD) released a series of deliverables (the 2014 Deliverables) that address seven of the focus areas in its Action Plan on Base Erosion and Profit Shifting (BEPS). The documents released consist of:

- a brief explanatory statement,
- final reports with respect to:
- Action 1 (Digital Economy) and
- Action 15 (Multilateral Instrument),
- an interim report with respect to Action 5 (Harmful Tax Practices), and
- reports with agreed draft recommendations on:
- Action 2 (Hybrid Mismatch Arrangements),
- Action 6 (Treaty Abuse),
- Action 8 (Transfer Pricing for Intangibles), and

These reflect agreements reached by the OECD and G20 member countries. The documents also describe further OECD work planned in these focus areas. For further details please see our Global Tax Alert of 18 September.22

On 8 October, the OECD issued an updated calendar for planned consultation with stakeholders on the BEPS project. The OECD expects to issue Discussion Drafts on Actions 1 (Digital Economy), 4 (Deductibility of Interest), 6 (Treaty Abuse), 7 (Permanent Establishment), and 8-10 (Transfer Pricing) before the end of 2014. Comments on these documents will be due in late 2014 and early 2015, and the first public consultations will be held in January 2015.

Actions Taken in Russia to Address BEPS

While the OECD continues its work on the BEPS Action Plan, countries around the world are already acting to address concerns about BEPS through legislative and regulatory changes and changes in administrative practices. In the case of Russia, actions include the Ministry of Finance issuing guidance on beneficial ownership and treaty shopping4 and developing draft legislation to introduce the following in tax legislation:

- controlled foreign company (“CFC”) rules
- anti-abuse provisions to limit the application of treaty benefits
- reporting and disclosure on beneficial owners and
- rules allowing foreign incorporated companies to be deemed Russian tax residents in certain circumstances (under existing legislation, tax residency follows the place of incorporation for entities).

In addition, the Russian government has recently published a Model Agreement on Exchange of Information on Tax Matters (approved by Decree No. 805 of 14 August 2014) to be used as the basis for bilateral agreements with low tax jurisdictions.23 Multinational should keep informed about developments in the OECD BEPS project and related developments in the domestic tax laws and practices in the countries where they operate or invest.

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