Executive summary

Following the enactment of legislation in the European Union (EU) countries, South Korea and Japan, Russia is planning to introduce special indirect tax rules for electronic services. Deputies of the State Duma have prepared Draft Law No. 962487-6 (Draft Law), which stipulates that the place of supply of electronic services will be determined based on the customer location. The current version of the Draft Law is not final and most likely it will be revised during discussions and consideration in the State Duma. It is planned that the provisions would come into effect on 1 January 2017.

The current version of the Draft Law also abolishes the value-added tax (VAT) exemption for the transfer of rights to use the software and databases under a license agreement. The right to recover VAT charged by providers on the costs related to electronic services is proposed as a countervailing measure for the abolishment of the VAT exemption to Russian companies providing electronic services to foreign customers.

An income tax preference is envisaged for the companies which provide rights to use the software and (or) databases. The above-mentioned companies should be able to recognize the costs related to the transfer of rights as expenses for income tax purposes in excess of actual costs, reducing the tax base by 80% thereby.
**Detailed discussion**

**Definition of Electronic Services**

According to the Draft Law, electronic services are the services provided via the Internet data telecommunications network or any other similar network with the use of information technologies, on an automated basis.

In particular, such services include:

- Transfer of nonexclusive rights to use software and databases, including the right of access to online gaming on the Internet
- Enabling the offer of goods (works, services) for sale on Internet websites or in computer software; provision of advertising services and services that provide technical, organization, information and other opportunities to establish contacts and conclude deals between sellers and buyers on the Internet
- Providing and maintaining commercial or personal presence on the Internet
- Storage and processing of information provided by the customer to the seller for the provision of these services via the Internet, subject to the condition that the customer has access to the information stored and/or the possibility to process data
- Provision of domain names and hosting provider services
- Provision of services on remote system administration and remote software support of information systems and websites on the Internet
- Provision of automated services on the Internet while inserting particular data by the customer; automated services on data search, selection and sorting on demand
- Providing information via the Internet, including electronic books, graphic images, musical and audiovisual works
- Providing search systems and other Internet portals
- Keeping statistics on Internet websites
- Online TV and/or radio broadcasting with the use of the Internet
- Communication services provided via the Internet

This list of services is not exhaustive. Respectively, other services provided via the Internet or other similar network on an automated basis should be treated as electronic services.

**Key aspects**

**Place of supply of electronic services**

According to the Draft Law, the provision of electronic services should be subject to VAT at the customer location. Customers should include both legal entities and individuals. The mechanism for identification of the actual location of the customers of electronic services is supposed to be developed by the Russian Ministry of Finance.

Thus, Russia would not be considered as the provision location of electronic services by Russian companies to foreign customers. At the same time, Russian VAT would apply to foreign companies (not registered in Russia) which provide such services to Russian customers. The aforementioned foreign companies will not have the right to recover VAT incurred in Russia.

While providing electronic services by foreign companies to Russian legal entities, Russian VAT should be paid by these Russian legal entities as tax agents.

If services are provided to individuals located in Russia, a foreign company should register with the Russian tax authorities for VAT payment. The registration will be made based on an application and other documents, submitted by the foreign company in electronic form via an online service on the official website of the Federal Tax Service of Russia. Foreign companies should submit the VAT return via the Internet using the taxpayer personal account. Foreign companies will be able to provide information and receive documents from tax authorities using the taxpayer personal account. Tax authorities will also be able to send documents via e-mail using the foreign company’s address indicated on the company’s website.

According to the current version of the Draft Law, the in-house tax audit of the foreign company’s VAT return will be conducted within 6 months. A foreign company will have to provide the documents required in the course of an in-house audit within 30 days.

In case of non-submission of the VAT return, the tax authorities will be able to conduct an in-house audit based on the documents (information) on the foreign company at their disposal. The Draft Law envisages the right for the tax authorities to request documents (information) related to transactions of foreign companies providing electronic services to Russian customers from the national payment card system organization, money transfer operators,
electronic money operators, payment system operators, bank paying agents (sub-agents), payment infrastructure service providers, operation centers, payment clearing centers, processing centers and mobile phone operators.

In case of non-submission of the VAT return within 30 days of the expiry of the term for provision of the VAT return, foreign companies will receive requests on submission of the VAT return from the tax authorities.

The Draft Law also envisages the right for the tax authorities to de-register a foreign company providing electronic services to Russian customers, in the following cases:

- Providing incorrect information upon registration
- Non-compliance with the VAT payment request within a year from the date of expiry of the request term
- Non-compliance with the request on the provision of documents within six months from the date of expiry of the request term
- Non-submission of VAT return within a year from the date of expiry of the VAT return provision term

De-registration in the aforementioned cases will be only conducted after the collection of overdue VAT amounts, fines and penalties.

The collection of overdue VAT amounts, fines and penalties will only be applied towards foreign companies if these foreign companies have either accounts in Russian banks, or property in Russia which can be foreclosed. At de-registration of a foreign company providing electronic services to Russian customers the fines and penalties arrears and debts will be recognized as non-recoverable.

If foreign companies overpay VAT to the budget, the Draft Law envisages the refund of tax overpayment to the foreign company’s account in the bank located in Russia.

Agents registered with the Russian tax authorities and operating under agency contracts with foreign companies providing electronic services to Russian individuals should pay Russian VAT as tax agents.

Foreign agents participating in settlements between the foreign company providing electronic services to Russian individuals should also be recognized as tax agents for VAT purposes and have to register with the Russian tax authorities.

Abolishment of the VAT exemption for the rights to software and databases

Under the new rules, the abolishment of the VAT exemption for the rights to software and databases provided under license agreements is proposed.

Benefits for Russian providers of electronic services

Russian providers of electronic services to foreign customers should be able to recover Russian VAT incurred on the costs related to such services. The tax authorities will have the right to request the documents confirming the claimed VAT recovery, including a bank statement (copies of a bank statement), which confirm the actual receipt of revenues from electronic services provision, and documents which confirm the place of the services provision.

The Draft Law envisages the right to reduce the tax base for the income tax by 80% for the Russian companies providing the rights to use computer software and (or) databases under a license agreement, including the access rights and additional functionality. Therefore, the costs related to the revenues from the transfer of these rights should be recognized as costs for income tax purposes in excess of actual costs.

The income tax preference, according to the Draft Law, will be granted to Russian companies which are accredited as the companies operating in information technologies, and provided that the revenues from the transfer of the specified rights will exceed the costs related to these revenues. In this case, revenues and costs from the transfer of rights and other activities should be separately recorded in the accounting records. If the expenses are related to both revenues from the transfer of rights and other revenues, the amount of expenses will be calculated based on the proportion. The proportion will be defined as the ratio of revenues from the transfer of rights to use computer software and databases under a license agreement for the reporting period to the total amount of revenues for the reporting period.

Therefore, providers of electronic services will be subject to the effective income tax rate of 4% with respect to electronic services. Notably, there is no requirement for these companies that the ratio of revenue from electronic services to total revenue should exceed certain threshold.
Implications

The changes stipulated by the current version of the Draft Law can significantly impact the business of many companies. However, they should mainly impact the following companies:

- Foreign companies (including foreign companies being a part of a Russian group) providing software and electronic services
- Foreign intermediaries upon provision of software and electronic services (e.g., electronic trading platforms)
- Russian companies providing software and electronic services

In this respect, businesses should prepare for the new rules, e.g., the following actions may be required:

- Review the current business model and identify transactions which should be subject to the new VAT rules in Russia
- Develop an action plan to register with the Russian tax authorities and meet new requirements
- Adjust supply chains, business models and document framework to mitigate VAT risks and extra costs in Russia
- Analyze the possibility to apply tax benefits

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