

Russia to increase standard VAT rate from 18% to 20% as of 1 January 2019

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On 24 July 2018, the Russian State Duma passed, in the third reading, Draft Law No. 489169-7 "Concerning the Introduction of Amendments to Parts One and Two of the Tax Code of the Russian Federation and Certain Legislative Acts of the Russian Federation," which provides, among other things, an increase in the standard rate of Value Added Tax (VAT) to 20%. The tax-inclusive rate, which applies in the case of a sale of an entire enterprise as an asset complex as well as when VAT is calculated and paid by foreign suppliers of electronic services, would rise from 15.25% to 16.67%, accordingly. The reduced rate of 10% for food, children's goods and other certain goods would remain unchanged.

It is planned that the proposed amendments will come into force from 1 January 2019. The new VAT rate would apply to goods, work, services and property rights supplied on or after 1 January 2019.

Practical issues associated with the VAT rate increase

The current version of the draft law does not set forth any transitional provisions for the introduction of the new VAT rate, which raises a number of practical issues, such as:

- ▶ How the new VAT rate would apply to transactions for which the tax base is determined at the time of payment. This would particularly be an issue for suppliers of electronic services and tax agents when calculating and paying VAT.

- ▶ How VAT would be calculated in relation to goods, work and services supplied after 1 January 2019 for which an advance payment was received before that date, and in relation to goods imported into Russia after 1 January 2019.
- ▶ If goods purchased before 1 January 2019 are returned after that date, the question arises as to how the seller should reclaim VAT based on an invoice presented by the purchaser with the new VAT rate applied.
- ▶ In the case of continuing contracts with a fixed VAT-inclusive price or contracts under which work is completed in stages, the increase in the VAT rate would reduce income actually received by the supplier of goods, work and services, thus raising the issue of the need to amend the terms of the contracts.
- ▶ How the VAT return should be filed to reflect VAT invoices issued before 1 January 2019 under the 18% rate when claiming input VAT for recovery and restoring VAT in periods after 1 January 2019.
- ▶ Subsidies for future costs that were arranged taking into account the 18% VAT rate would not fully cover the cost of purchasing goods, work and services under the new rate.

Taxpayers should prepare for the change in VAT rate and the uncertainties by working with their local tax professional to:

1. Analyze existing contracts to identify tax and commercial risks (including the risk of additional costs being incurred as a result of the VAT rate increase.
2. Determine measures to offset the temporary increase in cash outflow, for instance by reviewing potential changes to positions previously adopted by the company in relation to VAT.
3. Prepare a request to the tax authorities or the Finance Ministry for guidance on issues arising in connection with the VAT rate increase.
4. Modify the company's internal systems to ensure that the transactions under the new rate are properly reflected in the recording.

For additional information with respect to this Alert, please contact the following:

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