



**ASSOCIATION OF EUROPEAN
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**The Voice of European Business
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Gide Loyrette Nouel

Open event organized by the Taxation Committee of
the Association of European Businesses in the Russian Federation

5 December 2007

**DEVELOPMENTS OF THE RF TAX CODE REGARDING
TAXATION OF DIVIDENDS**

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Senior Tax Lawyer
GIDE LOYRETTE NOUEL**

THE MOST SIGNIFICANT AMMENDMENTS TO THE RUSSIAN TAX CODE RELATING TO TAXATION OF DIVIDENDS

- **The Federal law of the Russian Federation dated 16 May 2007 No. 76-FZ has introduced the following changes relating to taxation of dividends which will come into force from 1 January 2008:**
- **Personal income tax payable on dividends by a Russian legal entity to non-residents individuals will be 15% (currently 30%);**
- **Profit tax rate payable on dividends by a foreign legal entity to Russian legal entities will be 9% (currently 15%);**
- **Application of 0% profit tax rate on dividends.**

APPLICATION OF 0% PROFIT TAX RATE ON PAYMENT OF DIVIDENDS BY A RUSSIAN LEGAL ENTITY TO OTHER RUSSIAN LEGAL ENTITIES

- **0% profit tax rate will apply to the payment of dividends by a Russian legal entity to other Russian legal entities, provided certain conditions are met:**
 - **a recipient owns not less than 50% of the shares of the distribution company (or depository receipts which provide the right to receive dividends in an amount equal to not less than 50% of the total amount of dividends payable by the distribution company) for not less than 365 days; and**
 - **the cost of acquisition and (or) receipt of ownership of the interest in the share capital of the distribution company (or depository receipts which provide the right to receive dividends) exceeds 500 million RUR.**



APPLICATION OF 0% PROFIT TAX RATE ON DIVIDENDS RECEIVED BY A RUSSIAN LEGAL ENTITY FROM A FOREIGN LEGAL ENTITY

- **Dividends received by a Russian legal entity from a foreign legal entity are subject to 0% profit tax rate, provided certain conditions are met:**
 - **a recipient owns not less than 50% of the shares of the distribution company (or depository receipts which provide the right to receive dividends in an amount equal to not less than 50% of the total amount of dividends payable by the distribution company) for not less than 365 days; and**
 - **the cost of acquisition and (or) receipt of ownership of the interest in the share capital of the distribution company (or depository receipts which provide the right to receive dividends) exceeds 500 million RUR;**
 - **the state of residence of that foreign legal entity must not be included in the list of countries and territories (established by the Ministry of Finance of the RF) that benefit from a preferential tax regime and (or) which do not require the disclosure and provision of information relating to financial transactions.**



APPLICATION OF 0% PROFIT TAX RATE ON DIVIDENDS

- **Confirmation documents;**
- **Issues which require clarifications;**
- **Conclusions.**

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**Commentaries on Federal Law No. 195-FZ
of 19 July 2007 on creating favourable tax conditions for
financing innovation**

*Egor Lysenko, leading attorney
05 December 2007*

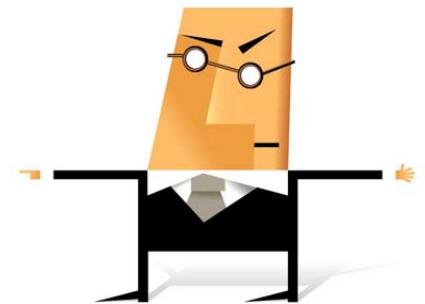
On Amendment of Certain Legislative Acts of the Russian Federation with Respect to Creating Favourable Tax Conditions for Financing Innovation

Comes into effect on 1 January 2008 *



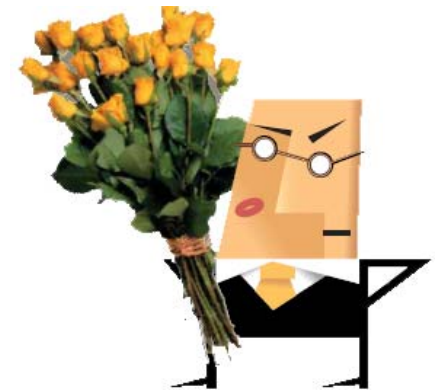
According to clause 1, article 262 of the Tax Code of the Russian Federation, the following are included in R&D costs:

- Expenditure on creating new or improving existing output (goods, work, services), especially on invention,
- Expenditure on forming the Russian Fund for Technological Development*, as well as other branch and inter-branch funds for financing R&D, registered in the manner envisaged by Federal Law of 23 August 1996 No. 127-FZ “On Science and State Scientific and Technical Policy”.



Federal Law No.195-FZ of 19 July 2007 raised the percentage of expenditures contributed to forming funds for financing R&D (par. 1, clause 3, article 262 of the Tax Code of the RF).

Such expenditures are now limited to 1.5% (and not 0.5%, as previously) of the taxpayer's incomes (gross proceeds).



Commentaries. See.:

- Federal Law No. 127-FZ of 23 August 1996 “On Science and State Scientific and Technical Policy” (clause 8, article 15);
- The procedure for forming and using extra-budgetary funds of federal executive authorities and commercial organisations for the purpose of scientific research and experimental development, approved by Resolution of the Government of the RF dated 13 October 1999 No. 1156 (clauses 1 and 6);
- Order of Rosnauka of 21 December 2005 No. 196 “On organisation of the work of the Federal Agency for science and innovation on maintaining a register of branch and inter-branch funds for financing R&D work”;
- Conclusion of the Committee for economic policy, business and tourism of the Federal Assembly of the RF dated 05 March 2007 No. 3.8-13/272

R&D* carried out by organisations and relating to the following are exempt from taxation (subclause 16.1, clause 3, article 149 of the Tax Code of the RF):

- creation of new products and technologies;
- improvement of produced output and technologies.

At the same time, however, R&D must include the following types of activity:

- development of the structure of an engineering facility or technical system;
- development of new technologies*;
- creation of industrial prototypes* of machinery, equipment and materials bearing fundamental specifics characteristic of innovations and not intended for sale to third parties;
- testing of industrial prototypes of machinery, equipment and materials for the period of time necessary for obtaining data, gathering experience and reflecting them in the technical documentation.

Commentaries. R&D is now exempt from the tax (subclause 16, clause 3, article 149 of the Tax Code of the RF) if financed:

- by budgetary funds;
- by the Russian Fund for Fundamental Research or the Russian Fund for Technological Development;
- by extra-budgetary funds of ministries, departments and associations if set up for these purposes in accordance with the legislation of the RF;
- by educational institutions and scientific organisations on the basis of commercial agreements.

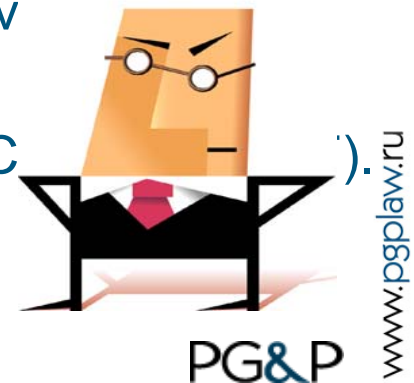


Sale of the following is tax exempt (subclause 26, clause 2, article 149 of the Tax Code of the RF):

- exclusive rights to results of intellectual activities;
- rights to use the results of intellectual activities on the basis of a licensing agreement.

Results of intellectual activity include:

- inventions, utility models, industrial prototypes (chapter 72 of the Civil Code of the RF);
- computer software and databases (chapter 70 of the Civil Code of the RF);
- topologies of integral microcircuits (chapter 74 of the Civil Code of the RF);
- production secrets (know-how) (chapter 75 of the Civil Code of the RF).



Target financing not counted as income now additionally (paragraph 12, subclause 14, clause 1, article 251 of the Tax Code of the RF) includes monies received from funds for support of scientific and (or) scientific and technical activities that are:

- registered in the manner envisaged by Federal Law No. 127-FZ of 23 August 1996 “On Science and State Scientific and technical Policy”;
- on the list approved by the government of the Russian Federation.

Previously only monies received from the following were counted:

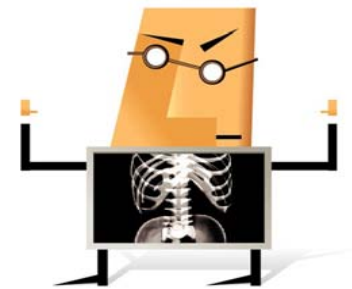
- Russian Fund for Fundamental Research;
- Russian Fund for Technological Development;
- Russian Humanitarian Scientific Foundation;
- Fund for promoting development of small forms of enterprise in the scientific and technical sphere;
- Federal Fund for Production Innovation.

Commentaries. See:

- subclause 1.1, clause 2, article 251 of the Tax Code of the RF
target financing received for creating the funds themselves shall not be considered as income;
- version of clause 1, article 262 of the Tax Code of the RF in effect until 1 January 2004
Expenditure on R&D shall be recognised as including <...> as well as outlays on forming the Russian Fund for Technical Development and other branch and inter-branch R&D financing funds according to the list approved by the Government of the RF in accordance with the Federal Law “On Science and State Scientific and Technical Policy”
- Ruling of the Constitutional Court of the RF of 09 April 2002 No. 68-O
The gap in the legislative regulation remaining as a result of inaction on the part of state legislative (representative) authorities and local representative authorities over a long period of time that would have sufficed to eliminate it cannot serve as an insuperable barrier to resolving disputable issues, if exercise of civil rights and legitimate interests deriving from the Constitution of the Russian Federation depends on this.
- Judicial practice of the federal arbitration courts

In relation to depreciated fixed assets used only for scientific and technical purposes, the special $k_{\text{deprec.}} \leq 3$ (paragraph 4, clause 7, article 259 of the Tax Code of the RF) can be applied.

Scientific and technical activities – activities orientated on obtaining and applying new knowledge for resolving technological, engineering, economic, social, humanitarian and other problems and providing for the functioning of science, technology and production as a unified system (article 2 of Federal Law of 23 August 1996 No. 127-FZ “On Science and State Scientific and Technical Policy”).



Costs under the Simplified Taxation System have been supplemented (subclauses 2.1-2.3, clause 1, article 346.16) by expenditures:

- on acquiring exclusive rights to the results of intellectual activities (see VAT);
- on acquiring rights to the results of intellectual activities (see VAT) on the basis of a licensing agreement;
- on patenting and (or) payment for legal services in obtaining legal protection for results of intellectual activities, including means of individualisation;
- On R&D, recognised as such in accordance with clause 1, article 262 of the Tax Code of the RF.

Also exempt from taxation (subclause 26, clause 3, article 149 of the Tax Code of the RF) are operations relating to:

- assignment (acquisition) of creditors' rights (claims) under obligations deriving from agreements on extension of loans in cash and (or) from credit agreements;
- Fulfilment by a borrower of its obligations towards a new creditor under the initial agreement on which an assignment agreement is based.

Commentaries. See article 155 of the Tax Code of the RF



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GLOBAL SERVICE/ INDUSTRY

Developments of the Russian Tax Code regarding Personal Income Tax and Unified Social Tax

Donat Podnyek, Senior Manager
5 December 2007

AUDIT / TAX / ADVISORY / LINE OF BUSINESS

Agenda

- **Recent Developments**
- **Personal Income Tax - Main changes**
- **Unified Social Tax - Main changes**
- **What is Next?**

Recent Developments

- **Changes to the Tax Code made in 2007 (per tax development policy for 2008-2010)**
 - Federal Law of 16 May 2007 #76-FZ:
 - Law comes into effect as of 1 January 2008
 - Federal Law of 24 July 2007 #216-FZ:
 - Majority of provisions come into effect as of 1 January 2008
 - Some provisions act retroactively
- **Further adjustments to eliminate inaccuracy expected**

Personal Income Tax - Main Changes (1)

● Tax Rates

- 15% instead of 30% on dividend income received by tax non-residents
- 13% instead of 35% on deemed income of tax residents under voluntary life insurance contracts concluded for < 5 years

● Social Deductions

- Taxpayer's contributions for non state pension security and voluntary pension insurance - deductible
- Total deduction increased up to RUB 100'000 per year (except education and expensive cure); taxpayer may choose how to allocate expenses for the deduction

Personal Income Tax - Main Changes (2)

- **Deemed Income (Material Gain)**

- Does not arise if a loan is used for purchase or construction of a dwelling in Russia
- Calculated according to Bank of Russia's rate on the date of interest payment rather than date of loan receipt

- **Per-diems Capped**

- RUB 700 per day of trip within Russia
- RUB 2500 per day of trip abroad

- **Definition of a Tax Agent Extended**

- Any registered office rather than a permanent establishment

Unified Social Tax - Main Changes

- **Scope**

- No UST on remuneration of foreign employees hired for work in Russian companies' offices outside of Russia

- **Deduction**

- Expenses borne by individuals under civil contract - deductible

What is Next

- **No significant drafts on approval at the moment**
- **What we need:**
 - Totalization agreements with other countries

Questions



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Moscow, December 5, 2007

DEVELOPMENT OF COURT PRACTICE



Alexey Panich
Partner, Salans Moscow



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I. DOCTRINE ON JUSTIFICATION OF TAX BENEFITS



- ◆ Substance over form
- ◆ Business purpose principle
- ◆ Principle of the reasonable caution
- ◆ Who must be recognized as a “bad faith” supplier?

II. VAT. ACTUAL EXPENSES.



- ◆ RF Supreme Arbitration Court: borrowed funds do not cause any problem for VAT deduction (Resolution No. 8349/07 dated October 30, 2007)

III. VAT & PROFITS TAX. “PROBLEM” SUPPLIERS



- ◆ Should taxpayers check suppliers are in good faith?
- ◆ Who is an authorized person?
- ◆ Defects in evidence
- ◆ Contradictory court practice of court districts on “problem” suppliers

IV. VAT. ECONOMIC SUBSTANTIATION OF DEDUCTIONS?



- ◆ Do VAT deductions depend on expenses for profits tax purposes?

V. VAT INVOICES



- ◆ What should be recognized as a material defect of VAT invoice?
- ◆ Amended VAT invoice

VI. VAT. NEGATIVE FX DIFFERENCES



- ◆ Court practice explains the law: taxpayers entitled to reduce VAT base by negative FX differences

VII. PROFITS TAX. THIN CAPITALIZATION



- ◆ Applicability of Russian thin capitalization rules with regard to treaty countries
- ◆ Non-discrimination
- ◆ Re-characterization
- ◆ Deductibility?

VIII. WITHHOLDING PROFITS TAX



- ◆ Tax agents cannot be prosecuted for failing to withhold profits tax from income of the foreign companies if such income is tax free under a double tax treaty (regardless of confirmation of tax residency before payment of income - Resolution of the Presidium of RF Supreme Arbitration Court No. 13225/06 dated February 6, 2007)

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VAT Developments in Russia

5 December 2007

Vladimir Konstantinov
Indirect Tax Services
Director

Agenda

- VAT developments in 2007
- VAT changes in 2008

Tax control measures in the VAT area

- Obligatory desk audits of the VAT returns with the VAT amount due from the budget
- Criteria for selecting tax payers to be audited (Order of Federal Tax Service № MM-3-06/333@ dated 30.05.2007)
- VAT committees

VAT legislation developments

- Paragraph 4 of Article 168 of the Tax Code: separate cash payment of VAT in case of mutual liabilities offsets, barter transactions and settlements by securities

Settlements by own property

- Reference to Paragraph 4 of Article 168 is introduced in the procedure of input VAT recovery (Paragraph 2 of Article 172)

Tax Period

Starting from 2008 VAT shall be reported and paid to the budget on a quarterly basis

Advantages:

- Less administration
- Fewer VAT refund situations
- Delay in the remittance of VAT to the budget

Disadvantages/changes:

- Possible 2 month delay in refund
- Required adjustments in accounting policies and processes

Starting from 2008 new exemptions are introduced for:

Transfers of know-how, software, databases, useful models, industrial models and some other intellectual property rights

Research and development services related to new products and technology or improvement of existing ones

Implications:

- Transition
- Range of tax payers affected

Other changes

Exemption for:

- Assignments of loan agreements is introduced
- Ferrous metals is abolished
- Zero VAT rate for certain supplies related to space activities

Completion of transition period

VAT balances as of 31 December 2005

Accrued output VAT to be recognized in the first quarter of 2008

Balance of input VAT is recovered in the first quarter of 2008
regardless of its payment to the suppliers

Questions?

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Developments of the RF Tax Code regarding profits tax and property tax

Oleg Sabitov

December 05, 2007

Developments of the RF Tax Code regarding profits tax and property tax

Federal Law # 195-FZ

- Adopted: July 19, 2007
- Enters into force: January 1, 2008

Federal Law # 216-FZ

- Adopted: July 24, 2007
- Enters into force: January 1, 2008 (for profits tax and property tax developments)

Profits tax: Major developments invented by the Federal Law # 195-FZ:

- Accelerated depreciation (up to 3 times) can be applied for fixed assets which are used only for scientific and technological activity

Note: *What is understood under “scientific and technological activity” is unclear*

- Tax deductible R&D expenses in the form of contribution to registered funds for the financing of research and development work will be increased to 1.5 % income/gross receipts

Note: *Currently the allocation norm is 0,5%*

Profits tax: Major developments invented by the Federal Law # 216-FZ:

Deductible payments under voluntary personal insurance agreements will be increased from 10,000 to 15,000 rubles a year per one insured employee

Note: Employees' insurance deductibility limit of 12% of the payroll remains unchanged

Changing the criterion of attribution for assets to depreciable property: minimum value is increased from 10,000 to 20,000 rubles

Note: Equalization of criteria in accounting and tax accounting

Increasing of a minimum historical cost for cars which's basic depreciation shall be applied with a special decreasing coefficient 0.5:

- motor cars: from 300,000 to 600,000 rubles
- vans: from 400,000 to 800,000 rubles

Profits tax: Major developments invented by the Federal Law # 216-FZ:

Acquiring an enterprise as a property complex: positive and negative goodwill concept is introduced (New Article in the Tax Code - # 268.1)

Buyer	Seller
<p>Positive goodwill is considered as a premium to reflect future economic benefits and is amortized evenly over five years</p>	<p>Positive goodwill is considered as a taxable income</p>
<p>Negative goodwill is recognized as an income in the moment of property right registration</p>	<p>Negative goodwill is considered as a loss which may be carried forward</p>

Note: Tax value of an enterprise as a property complex is determined as a net assets value of this enterprise

Profits tax: Major developments invented by the Federal Law # 216-FZ:

Transactions with mortgage certificates for profits tax purposes should be accounted for as assignment of rights

Note: Under the Civil Code a mortgage certificate is a security, but for the tax accounting purposes it is not treated as a security

Profits tax: Major developments invented by the Federal Law # 216-FZ:

Other changes:

- depreciation premium is attributed to indirect expenses (Article 265)
- allocation of insurance expenses among reporting periods (Article 272)
- procedures for payments of regional part of profits tax (Article 288)
- Banks have a right to terminate the accrual of interest on the basis of the agreement with the borrower or on the basis of a bank's decision on write-off of bad loan receivables (Article 292)
- payment of tax and tax reporting in respect of taxpayers with business units abroad (Article 311)
- procedure for the use of reserves for vacation allowances (Article 324.1)

Property tax: Major developments invented by the Federal Law # 216-FZ:

Since 2008 the tax base is determined using the property value as of the last day of current tax period

Note: Revaluation as of January 1 will not affect the previous year taxable base

Russian companies may enjoy property tax credit in the amount of foreign property tax paid for taxable property located outside Russia regardless of the existence of double taxation treaty with the country of the property location. (New Article in the Tax Code - #386.1)

Note: The payment of property tax outside Russia should be confirmed by the tax authorities of the country of location. The company should pay «foreign property tax», if the name of the tax is different, the situation is unclear

Property tax: Major developments invented by the Federal Law # 216-FZ:

Other changes:

- Obligation of management companies of unit funds to pay the property tax is attempted to be legally set up in the Tax Code

Note: *The situation is still not 100% clear*

- The method of property tax calculation by foreign organisations in respect of the immovable property, the right to which is passed in the middle of accounting period is based on a number of full months of ownership in the tax (reporting) period

Deloitte.



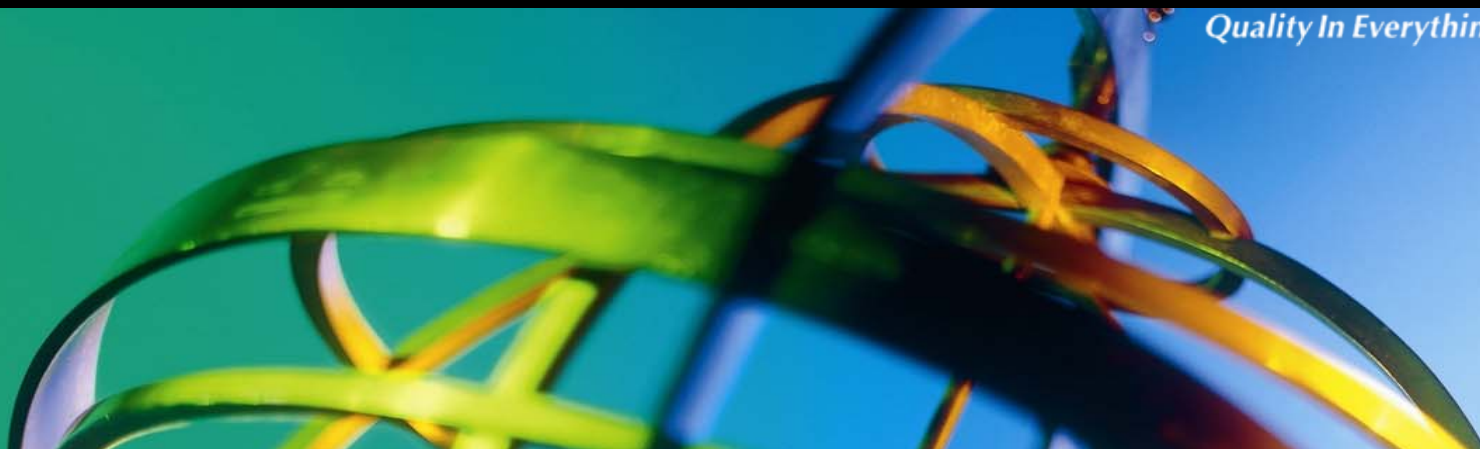
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Prospects of the RF tax system development in 2008-2010

Mikhail Sokolovsky, ITS Tax Manager

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Basic guidelines of the state tax policy in the Russian Federation in 2008-2010

- Some important proposed changes related to profits tax
 - Changes in transfer pricing rules
 - CFC rules
 - Definition of tax residency for legal entities
 - Limitation of double taxation treaty benefits
 - Consolidated tax accounting

Transfer pricing Changes in effect from 2009 (?)

Key changes

- Wider list of controlled transactions
- Broadening of definition of "related parties"
- Introduction of a list of supporting documents and information justifying the prices of the controlled transactions
- Broadening of information sources used for determination of market prices
- Additional methods of market price determination
- Introduction of advance (pre-filing) pricing agreements (APA)

Controlled Foreign Companies

Goal: taxation of undistributed profits of foreign subsidiaries (“controlled foreign companies”) at the level of Russian holding companies

Possible changes:

- definition of a “controlled foreign company” as an inter-related company with Russian strategic participation
- imposition of obligations to state in tax returns information regarding “controlled foreign companies”, amount of participatory holding and to pay tax in proportion to undistributed profit of such foreign subsidiary
- signing by the Russian Ministry of Finance of agreements on information exchange with jurisdictions widely used by Russian residents for concealment of profits
- Would new rules cover Russian private individuals?

Tax residence for the companies

Goal: to consider nominal foreign companies managed/owned by Russian persons as Russian tax residents and to tax worldwide income of these companies in Russia

Possible changes:

- introduction of place of management and control
- criterion of strategic participants' residence

Limitation of treaty benefits

Goal: limitation of benefits in respect of companies and individuals that should not be considered tax residents of treaty countries and securing of information exchange relating to tax obligations

Possible changes:

- application of Double tax treaty provisions only to companies performing real economic activity and not acting as an intermediary company used only for minimization of tax burden
- tightening tax legislation in respect of thin capitalization rules
- introduction of more strict requirements in respect of reporting of cross-border transactions and foreign holdings
- development and implementation of principles of detection of "tax havens", preparation of a list of such jurisdictions

Consolidated tax accounting

Goal: equal distribution of taxes among regional and federal budgets, preventing transfer prices in intra-group transactions

Possible changes:

- aggregating for tax purposes financial results of all Group's companies
- parent companies are responsible for tax filing on behalf of all Group's companies
- inter-group operations are not taken into account for tax purposes (e.g. dividend distribution, transactions between group members)

Consolidated tax accounting

Risks / opportunities:

- Utilization of losses incurred by group companies against profits of other group companies in the current tax period
- Tax neutrality of intra-group transactions
- Tax risks of one company are transferred to the other group companies
- Additional costs for preparation of tax consolidated documentation
- Recommended to monitor legislation to have time for restructuring



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