



ASSOCIATION OF EUROPEAN BUSINESSES

Tax Conference

**Development of the Russian Tax
System in 2010, prospects for
2011-2012**

December 7, 2010
Swissotel Krasnye Holmy



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**Development of the Russian Tax System in 2010,
prospects for 2011-2012**

Sergey D. Shatalov

State Secretary, Deputy Minister of Finance

December 7, 2010
Swissotel Krasnye Holmy



ASSOCIATION OF EUROPEAN BUSINESSES

Session 1

Developments in areas of profit tax

Moderator: Andrey Ignatov, Partner, Ernst&Young

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Overview of legislative developments

Development of the Russian Tax System in 2010, prospects for 2011-2012

Overview of legislative developments (effective as of January 2010)



- **New thresholds for deductible interest expenses**

- Debt obligations in roubles

In 2010 - 2012: 1.8 times the refinancing rate (except for loans granted before 1. November 2009 in regard to the first six months in 2010)

- Debt obligations in a foreign currency

- In 2010: 15%

- In 2011-2012: 0.8 times the refinancing rate (currently 6,2%)

Old rules starting from 2013?

Overview of legislative developments (effective as of January 2010)



- **Recognition of expenses in an amount equal to taxable income in regard to:**
 - surpluses discovered during a stocktake;
 - inventory obtained as a result of the liquidation of fixed assets;
 - inventory obtained as a result of the repair, modernization, rehabilitation, extension or partial dismantling of fixed assets
- **Special provision for deductibility of social contributions**
(Art. 264 Clause 1 (1) of the RF Tax Code)

Overview of legislative developments (effective as of January 2011)



- **Increase in the minimum value of depreciable assets up to RUB 40.000 (previously RUB 20.000)**
 - what about exclusive rights to computer programs valued at between RUB 20.000 and RUB 40.000?
- **Increase in the quarterly sales income, entitling the taxpayer to pay quarterly tax payments, to RUB 10 million (previously RUB 3 million)**
- **Adjustment in the tax payment deadline for tax agents**
- **Ban on the carry-forward of losses incurred when applying the 0% tax rate**
 - who is affected?

Overview of legislative developments (anticipated)



- **Reduction in the useful life of certain types of intangible assets (minimum two years)**
- **Incentives for non-profit organizations**
- **Consolidation for profit tax purposes**
 - RUB 1.000 billion - Assets
 - RUB 100 billion - Sales revenue
 - RUB 15 billion - Federal taxes paid

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Thin capitalisation related matters

Development of the Russian Tax System in 2010, prospects for 2011-2012

Thin capitalisation



Practical aspects of thin cap rules application

- **Adjustment of the profit**

- Tax authorities: profit gained between Russian and foreign affiliated companies shall be adjusted in case it deviates from the profit to be gained between independent companies (*Letters of the Ministry of Finance No.03-08-05 of 26.05.2010; No. 03-08-05/1 of 22.12.2009*)
- Court practice: affiliation between the companies shall not be regarded as the only and sufficient ground for adjustment of the profit: other conditions shall be considered (*Decision of the FAC of the Moscow Region No. KA-A40/7211-10 of 13.07.2010; Decision of the FAC of the Moscow Region No. KA-A40/2594-10 of 01.04.2010; Decision of the FAC of the Moscow Region No. KA-A40/9121-10 of 14.09.2010*)

Thin capitalisation

Practical aspects of thin cap rules application



- **Application of non-discrimination rules**

- Tax authorities: non-discrimination rules apply to all Russian companies irrespective of tax residency of their shareholders (*Letters of the Ministry of Finance No. 03-08-05 of 24.12.2009 of No. 03-08-05 of 10.11.2010*)
- Court practice: taxation of foreign companies cannot be other or more burdensome than taxation of the Russian resident companies (*Decision of the FAC of the Moscow Region No. KA-A40/6616-05 of 25.07.2005; Decision of the FAC of the Moscow Region No. KA-A40/7211-10 of 13.07.2010*)

- **Loans provided by foreign sister companies**

- Tax authorities: loans received by Russian companies from their foreign sister companies are subject to thin cap rules (*Letter of the Ministry of Finance No. 03-08-05 of 27.11.2009*)
- Court practice: thin cap rules do not apply to loans received by Russian companies from their foreign sister companies because they are beyond the scope of article 269(2) of the Russian Tax (*Decision of the FAC of the Moscow Region No. KA-A40/7211-10 of 13.07.2010; Decision of the FAC of the Moscow Region No. KA-A40/5532-10 of 01.06.2010*)

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Special taxation regimes

Development of the Russian Tax System in 2010, prospects for 2011-2012

Special taxation regimes

SPECIAL

Legally defined special taxation regimes (Section VIII.1. (chap. 26.1.-26.4.) of the Tax Code of the Russian Federation)

Main goal: support for small and medium size businesses

Stable and multi-purpose regimes

'SPECIAL'

“Skolkovo” – Federal Law No. 243 from 28.09.2010, Olympic Winter Games (Sochi 2014) – Federal Law No. 242-FZ from 30.07.2010, Tax support for PPP & Infrastructure projects, Others

Main goal: support for large businesses (in most cases with state support)

Instrument of “manual control” for specific projects (with or without prescribed time frames)

Special taxation regimes

FUTURE DEVELOPMENT OF THE “SPECIAL” TAXATION REGIMES

- ▶ Discontinuation after the end of prescribed time frames
- ▶ Successful use could lead to the continuation of implementation of such instruments for projects realisation
- ▶ Some elements of the “Special” taxation regimes could be permanently included in the Tax Code of the Russian Federation as a part of usual taxation regime
- ▶ “Manual control” in the tax field could lead to the negative results (foreign experience shows that in most cases no similar measures were used)
- ▶ In case of failure of such state “manual control” instruments it will be the usual taxpayers who will suffer

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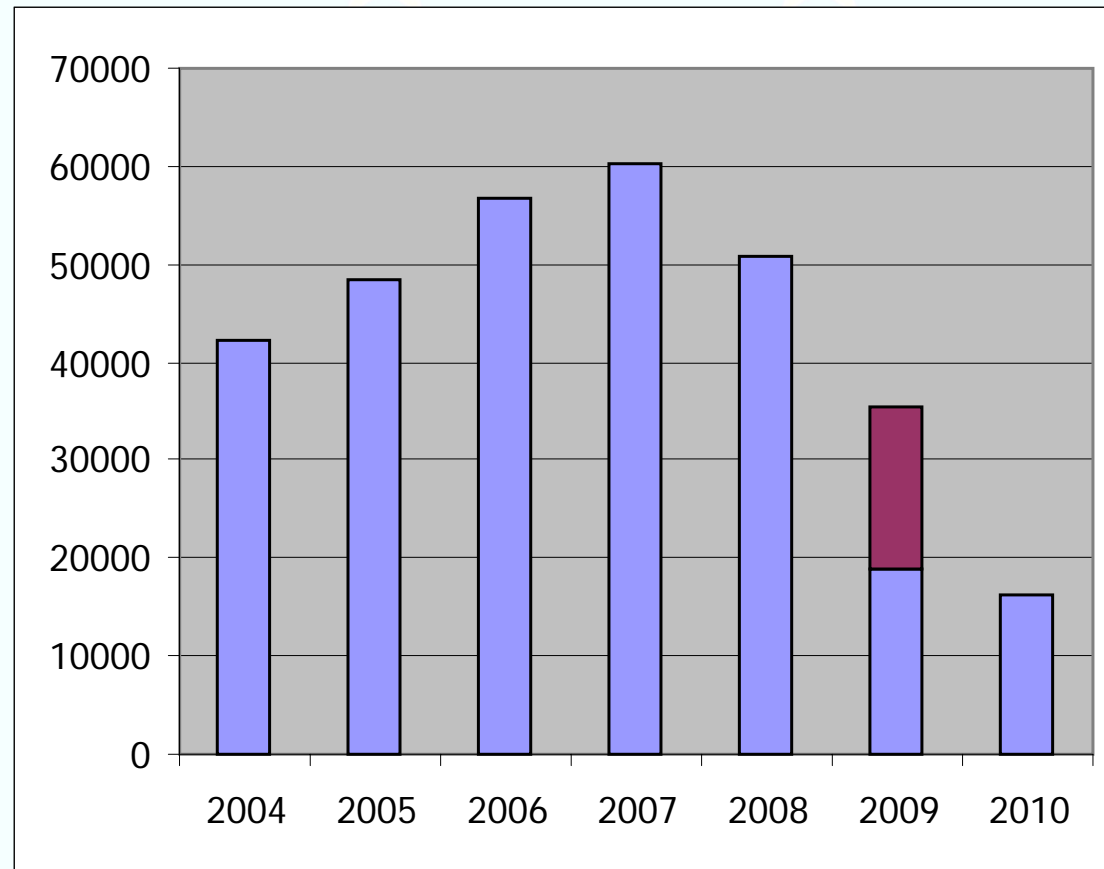


Key trends in the Supreme Arbitrazh Court practice: Profits tax

Development of the Russian Tax System in 2010, prospects for 2011-2012

Key decisions of the Supreme Arbitrazh Court: Profits tax

Overall trend: Falling number of court cases filed by taxpayers against tax authorities



Source: www.arbitr.ru

Development of the Russian Tax System in 2010, prospects for 2011-2012

Possible reasons for reduction in number of cases



- Reduction of the tax period for VAT from once a month to once a quarter (2007)
- Introduction of an obligatory appeal procedure (2009)
- Elimination of criminal prosecution in case of voluntary settlement of the tax assessment (2010)
- More active role of Supreme Arbitrazh Court in unification of court practice
- Reports of wider use of unofficial settlement procedures by the tax office during field tax audits (“gentleman’s agreement” assessment)

Promotion expenses



Promotion expenses can be deducted (and related input VAT can be recovered) even if they related to already sold goods, eg promotion at the retail chain level

(SAC Resolution dated 22 December 2009 No 11175/09 [DirolCadbury case])

«the taxpayer, being the manufacturer of the sold goods, wanted to increase the sales by incurring expenses and VAT to promote the supplied goods at the retail chain. Increase in sales at the retail chain level results in increase of the sales of the taxpayer.»

Penalty for contract termination



Penalty for contract termination can be deducted for profits tax purposes, even though the penalty was not initially stipulated by the contract, but agreed upon later

(SAC Resolution dated 25 February 2010 No 13640/09 [Novostroy case])

«Out-of-court settlement can not serve as the ground for refusing deduction of penalties, damages and compensations for profits tax purposes»

Partial write-off of accounts receivable



Writing off part of accounts receivable based on a settlement agreement can be deducted for profits tax purposes

(SAC Resolution dated 15 July 2010 No 2833/10)

«Taking into account that the taxpayer has agreed to write off a part of the sum due under condition that the remainder would be paid, such expenses are economically justified»

Key decisions of the Supreme Arbitrazh Court: Profits tax

Developing practice on application of “interest deduction” SAC Resolution No 11200/09 dated 24 November 2009



- Two approaches:

- Deduction when due to pay, ie in line with SAC Resolution
(Resolutions of the North-Caucasus Federal Arbitrazh Court No A53-1490/2010, Moscow Federal Arbitrazh Court No KA-A40/13627-10-2, North-West Federal Arbitrazh Court No A56-89182/2009)
- Attempts to ignore the SAC position (in favour of the taxpayer)
(Resolution of the Moscow Federal Arbitrazh Court No KA-A40/7211-10, 20th Appellate Court No A68-9661/2008)

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ASSOCIATION OF EUROPEAN BUSINESSES

Session 2

International Taxation Matters

Moderator: Arseny Seidov, Partner, Baker&McKenzie

December 7, 2010
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New Protocol to the Russia-Cyprus DTT

Development of the Russian Tax System in 2010, prospects for 2011-2012

New Protocol to the Russia-Cyprus DTT



- **The Protocol which amends the Russia – Cyprus double tax treaty (the “DTT”) has been signed on 7 October 2010;**
- **The Protocol will come into force in the year following the year in which it is ratified both by Russia and Cyprus, except for the following provisions:**
 - the changes to Article 13 “Capital Gains” shall come into effect from the calendar year following the expiration of a period of 4 years from the date on which the Protocol enters into force;
 - the changes to Article 27 “Assistance in Collection” shall come into force upon the introduction by Cyprus of the necessary legal basis (i.e. when Cyprus amends its domestic legislation to allow the application of such assistance).
- **Removal of Cyprus from the Russian “black list”; date and consequences.**

New Protocol to the Russia-Cyprus DTT



- **The principal changes to the DTT are as follows:**
 - Capital gains of a resident of a Contracting State from the sale of shares deriving more than 50% of their value from immovable property situated in the other Contracting State could be taxed in that other Contracting State;
 - The term “dividends” has been extended;
 - Income of mutual equity funds investing only in immovable property will be taxed as income from immovable property;
 - Amendments to the Articles of the DTT on “Exchange of Information” and “Assistance in Collection of Taxes”.



- **The other important changes to the DTT are as follows:**
 - The definition of a permanent establishment has been extended;
 - A new Article “Limitation of Benefits” has been introduced;
 - The condition for the application of a reduced 5% withholding income tax rate on dividends has been amended, i.e. the amount of direct investment into the capital of the company paying the dividends has been increased from USD100 000 to Euro100 000.
- **Amendments are planned to other double tax treaties signed by the Russian Federation (in particular, to the treaty with Luxemburg, Switzerland, Belgium, Austria, etc.).**

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Beneficial Ownership Concept

Development of the Russian Tax System in 2010, prospects for 2011-2012



Beneficial Ownership Concept

- **2009:**
 - President's message
 - MinFin's proposals
- **2010:**
 - No change in the Tax Code
 - Beneficial ownership is now not a problem for federal eurobonds (MinFin's Letters No. 03-00-08/61 of 16 April 2010; No. 03-04-08/2-211 of 8 October 2010; No. 03-08-05 of 27 August 2010)
 - Generally MinFin continues to stick with the OECD's approach
 - New Russian Tax Treaty Model contains the beneficial ownership test (Government Resolution No. 86 of 24 February 2010)



Market's Trends

- Beneficial Ownership is a hot issue in many cross-border structures
- No common approach
- More demand for tax advice on beneficial ownership
- Russian tax agents increase pressure on the foreign recipients of income



Potential Solutions

- Intra-group structures
- Contracts with third parties

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Court Practice

Development of the Russian Tax System in 2010, prospects for 2011-2012

Court practice



- **OECD Model Tax Convention and Commentary**
 - Ministry of Finance's numerous letters with reference to the Commentary
 - Recent precedents
 - 9th AAC Nr. 09ΑΠ-25019/2009-AK – 23.12.2009
 - OECD Commentary cannot be viewed as a source of law
 - 9th AAC Nr. 09ΑΠ-17695/2010-AK – 17.08.2010
 - decision on dependent status of an agent based on the Commentary
 - Tendency to acknowledge methodological relevance of the Commentary



- **Tax residency confirmation**

- Requirements of the Tax Code (Article 312.1)
- Extended interpretation made by the Federal Tax Service in the profit tax guidelines (order Nr. БГ-3-23/150 – 28.03.2003, section 5.3)
- Recent precedents
 - MO Nr. KA-A40/3115-10 – 08.04.2010
 - residency confirmation can be provided after payment of income
 - reference to a certain year is not required
 - other evidence regarding tax residency should be accepted
 - SAC Nr. 9999/10 – 08.10.2010
 - case will be heard by PSAC due to lack of uniformity in court practice
- Tendency to “substance over form” approach

Court practice



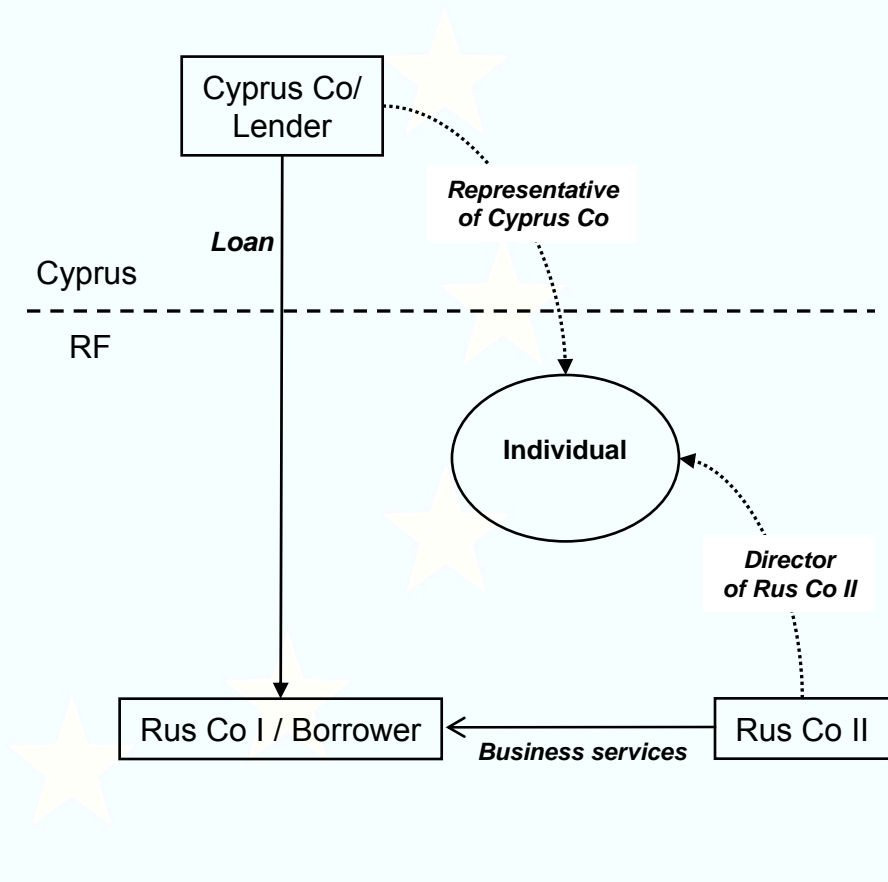
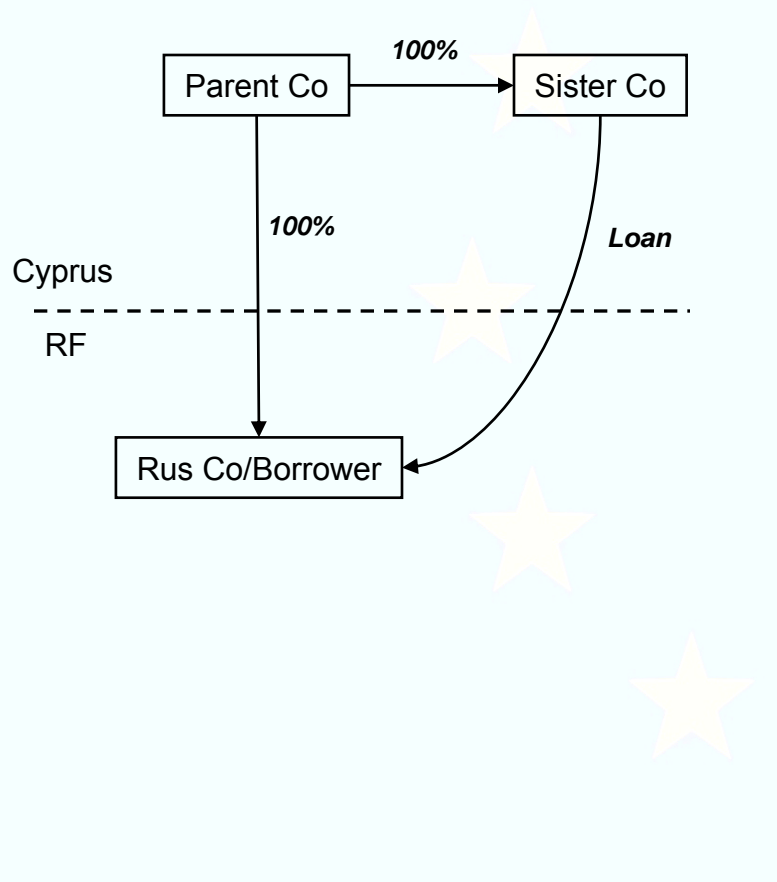
- **Developments in application of tax abuse concept**

- PSAC Nr. 53 – 12.10.2006
 - “business purpose” test as a measure against tax-driven structures
 - until recently not widely used in the context of international structures
- Recent precedents
 - 9th AAC Nr. 09ΑΠ-2972/2010-AK – 09.04.2010 (no reference to PSAC Nr. 53)
 - 9th AAC Nr. 09ΑΠ-17695/2010-AK – 17.08.2010
 - cases on tax investigation against (Russian and foreign) group companies and individuals involved in the structure, with a tax reconstruction attempted

Court practice

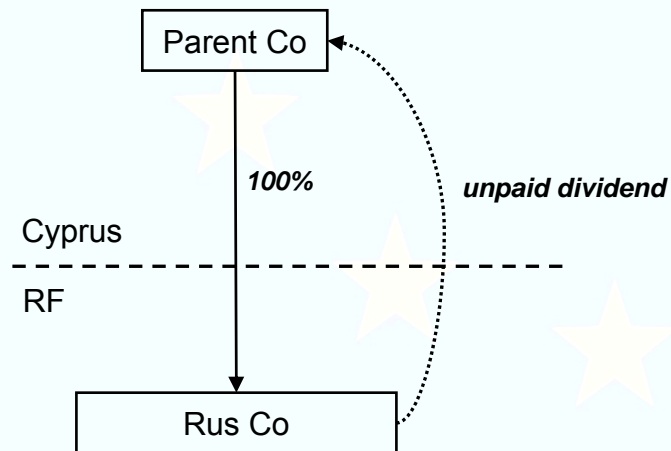


- Developments in application of tax abuse concept (continued)



- **Other precedents**

- PSAC Nr. 14977/09 – 06.04.2010
 - declared but not paid dividend converted into capital of Russian LLC
 - unpaid dividend constitutes taxable income of the Parent company
 - penalties charged on Russian LLC



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Presentation

The Practice of Tax Control and Developing a Concept for Unjustified Tax Benefit

Speaker: Anton Nikiforov, Partner, Attorney-at-law, Pepeliaev Group

December 7, 2010
Swissotel Krasnye Holmy

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**The Practice of Tax Control
and Developing a Concept
for Unjustified Tax Benefit**

Development of the Russian Tax System in 2010, prospects for 2011-2012

The Practice of Tax Control

Tax Audits



1. The topicality of procedural issues in conducting an audit and handing down a decision
2. Making an appeal more effective
3. Reasons (retroactive effect, increasing time periods)

Successes

- Taking additional tax control steps (Resolution of the Russian Supreme Arbitration Court № 391/09 16.06.09)
- Acquainting the taxpayer with the audit files (Resolution of the Russian Supreme Arbitration Court 14.04.10)
- Procedure for tax authority to hand down a decision (Resolution of the Russian Supreme Arbitration Court № 4903/10 29.09.10)
- Guarantees under decisions on refunds (refusal to refund) VAT (Resolution of the Russian Supreme Arbitration Court № 162/10 20.04.10)

Disappointments

- Taxpayer participating when its appeal is considered (Resolution of the Russian Supreme Arbitration Court № 5172/09 28.07.09)
- Reclassification of the transaction (Resolution of the Russian Supreme Arbitration Court № 16064/09 01.06.10)
- Pre-trial expenses (Resolution of the Russian Supreme Arbitration Court № 3303/10 15.07.10)

Tax Audits



Issues for 2011

- Refunding attorney's fee (amount)
- Procedure for carrying out an audit and handing down a decision
- Electronic document management

Developing a Concept for Unjustified Tax Benefit



1. Tax disputes involving fly-by-nights and the simplified taxation procedure

2. The story of successes

- Profit tax (Resolution of the Russian Supreme Arbitration Court № 15574/09 09.03.10)
- VAT (Resolution of the Russian Supreme Arbitration Court № 18162/09 20.04.10)
- Reconstruction (Resolution of the Russian Supreme Arbitration Court № 2341/10 29.09.10)

3. Issues for 2011

- Reality of the transaction – receiving goods from a specific person
- Legal optimisation of taxation, business purpose in a group of companies

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Pepeliaev Group



ASSOCIATION OF EUROPEAN BUSINESSES

Presentation

Transfer Pricing and Tax Consolidation

**Speakers: AEB Taxation Committee TP working group: Evgenia Veter,
PricewaterhouseCoopers, Henrik Hansen, Ernst&Young**

December 7, 2010
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Transfer Pricing and Tax Consolidation

Development of the Russian Tax System in 2010, prospects for 2011-2012

Status on Proposed TP Reform

- **Draft TP Law**

- 2nd reading postponed
- Introduction date is not certain
- Transition rules are possible

- **Draft Tax Consolidation Law**

- Approved during 1st reading on 22 October 2010
- 2nd reading has not yet been scheduled
- Planned for introduction together with TP Law

TP Draft Law

No official law is available yet – but some indications of what it may contain

- Role and definition of functional analysis
- Definitions/clarity with respect to financial transactions
- Definitions/clarity of applied thresholds
- TP methods – further alignment with international practice
- Clarification of audit procedures/gradual introduction and corresponding adjustments
- Applicability to domestic transactions
- Cost Sharing
- Applicability to PEs



Tax Consolidation Draft Law

- Criteria after the 1st reading:
 - total amount of federal taxes for the preceding year > RUB 15 billion
 - total amount of sales for the preceding year > RUB 100 billion
 - total assets as of 31 Dec of the preceding year > RUB 1 trillion
- Only few groups would qualify with these criteria
- Proposals to amend the criteria
- More certainty should appear by the 2nd reading

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ASSOCIATION OF EUROPEAN BUSINESSES

Session 3

Developments in area of VAT

Moderator – Vladimir Konstantinov, Partner (PwC)

December 7, 2010
Swissotel Krasnye Holmy

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Overview of legislative developments

Development of the Russian Tax System in 2010, Prospects for 2011-2012

Overview of legislative developments



- **What's new in Chapter 21 of Tax Code?**
 - Electronic VAT invoices – right for efficient document management
 - New requirements for VAT invoice compliance
 - The procedure for claiming rights to refunds/ offset when using the 0% VAT rate on barter transactions (including exchange of goods).
 - Procedure for filing tax returns and making payments for foreign companies
 - Benefits for “Skolkovo”

Overview of legislative developments



- **Possible changes to Chapter 21 of Tax Code from... 2011? 2012?**
 - Discounts on good already delivered may be recognized in a separate VAT-invoice
 - Cancellation of obligation to reinstate input VAT which was previously recognized on fixed assets that are obsolete.

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Electronic VAT invoices

Development of the Russian Tax System in 2010, Prospects for 2011-2012

Way to the implementation of electronic VAT invoices



•2008

The government of Russian Federation includes the plan of implementation of electronic VAT invoices in “The main directions of the tax policy for 2009 and the planned periods 2010 and 2011”

•From January 2009 to June 2009

Administration of the Federal Tax Authorities in Moscow jointly with ten Moscow companies carried out the field trial aimed at creation of system for issuing electronic VAT invoices

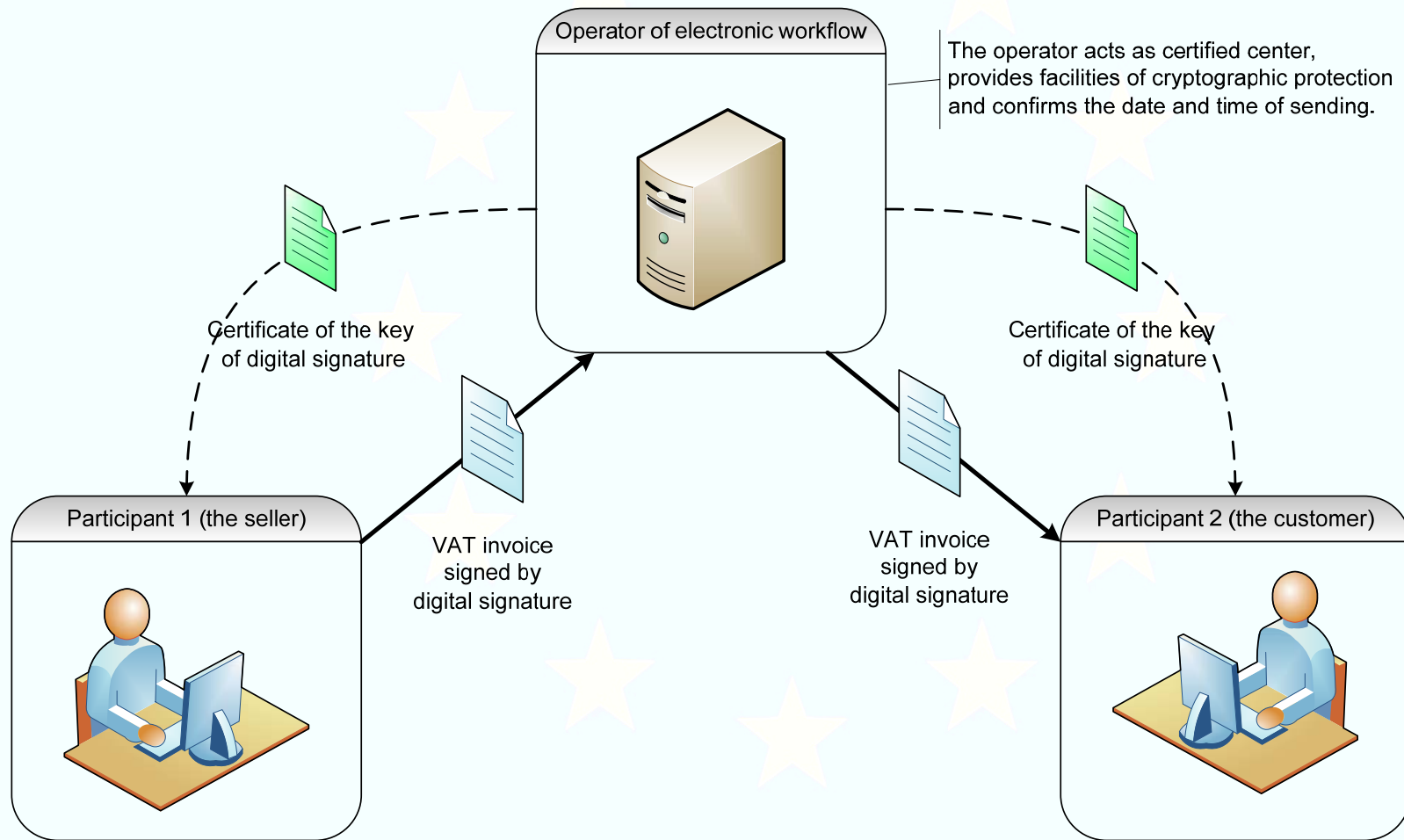
•Summer 2010

The government of Russian Federation has accepted the Federal law # 229-FZ of 27 July 2010 which allows issuing VAT invoices in electronic form. However, the law does not contain any provisions which allow issuing primary documents in electronic form

•Nearest future

Procedure of issuing and receiving electronic VAT invoices through telecommunication channels with application of electronic signature and format of electronic VAT invoices, registry of received and issued VAT invoices, purchases books and sales books in electronic form should be established

Scheme of interaction of the participants within the field trial



Provisions of the Federal law # 229-FZ related to electronic VAT invoices



- **exchange of electronic VAT invoices is possible if:**
 - the parties reached mutual agreement, and
 - capabilities for receiving and processing of VAT invoices and compatible technical equipment are available
 - **electronic VAT invoices should be signed by the head of organization or other persons authorized by the order of organization or acting on the basis of power of attorney**
 - **companies may keep registries of received and issued VAT invoices, purchases books and sales books in electronic forms**
 - **application of new regulations will be possible after the following steps are performed:**
 - Ministry of finance should approve procedure of issuing and receiving of VAT invoices via telecommunication channels with application of electronic signature
 - Russian tax authority should approve a format of VAT invoices, registry of received and issued VAT invoices, purchases books and sales books in electronic forms



Advantages of electronic VAT invoices

Advantages

- cost savings on paper, print and courier services
- cost savings on keeping of archive of paper documents
- reducing of percent of “late” VAT invoices
- more comfortable and faster search of necessary VAT invoices upon tax audit
- verification of received VAT invoices in terms of their compliance with requirements of the tax law will be easier
- preparation of the companies to the smooth move to electronic workflow

Limitations

- accepted Federal law # 229-FZ does not permit issuing primary documents in electronic form, although such documents are necessary for confirmation of VAT recovery
- Additional verification should be required in view of differences in time between processing of VAT invoices in electronic form and paper documents

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Overview of court practice on VAT issues

Development of the Russian Tax System in 2010, Prospects for 2011-2012

VAT Implications related to Export operations



- 0% VAT rate could be applied to export realization of technical documentation purchased as goods from 3rd parties
- To confirm the VAT export rate only the copy of the addendum to the export agreement providing that the payments of the exported goods are made by the 3rd party
- The 18% VAT rate could be applied to transportation costs related to the exported goods because the transporter does not know and could not know that the goods are exported

Undue Tax Benefit according to the Resolution N 53 as of 12.10.2006



- The payment for the goods from the sources contributed to the charter capital by the owner does not declare about reception of the undue tax benefit in form of refund input VAT from the budget
- The taxpayer is entitled to deduct input VAT formed from the purchase of goods paid by promissory note even if he paid for this promissory note later than the goods were purchased
- The affiliation and low profitability of the operations or invoices containing the unreliable information do not declare without indication of any other facts about undue tax benefit if the transactions were actually carried out
- However, the Supreme court has made decisions in the favor of the tax authorities concluding that the provided invoices along with other facts do not confirm the business operation



- The VAT tax base could be decreased in amount of retrospective discounts provided by the seller⁷; accordingly, the amount of retrospective discounts should be treated as payment to the buyer for the services rendered and respective VAT should be charged
- The taxpayer is entitled to deduct agent VAT even if he accruals and pays the agent VAT over the sums stated in the agreement and invoice
- Restriction on VAT deduction is applied to the expenses recognizable within limits for profit tax purposes that are listed in the 21 Chapter
- Input VAT formed by the expenses on dismantling of the depreciated assets could be deducted because the assets were used in VATable activity
- Issuing negative invoices is not forbidden by the RTC; it is lawful to issue negative invoice because the taxpayer do not deduct VAT based on it, the VAT base is corrected
- VAT could be claimed for deduction in the later period than the goods are recorded in accounting. The RTC provides limits related to the three-year period of VAT deduction

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Thank you for your attention!

December 7, 2010
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