



New VAT Rules for E-Services

2016



« On 15 June 2016, the Russian Parliament passed a new Law that imposes VAT obligations on foreign suppliers of e-services to Russian customers



The Law, which comes into force on 1 January 2017, introduces comprehensive VAT rules for the supply of e-services to Russian consumers. The new rules are aimed at collecting Russian VAT from the sale of e-services at the place of their consumption (i.e., in Russia) by requiring foreign suppliers of such services to register for VAT purposes. In this manner, the Law levels the playing field for Russian and foreign suppliers of e-services.

The key provisions of the Law, some of which were outlined in our previous newsletters, are summarized below along with key challenges for businesses.

1 The place of supply rules for e-services have changed

The RF Tax Code includes a new term - "e-services" - which includes, for example: services relating to remote access to PC software and updates thereto; Internet advertising; Internet-platforms; cloud storage; hosting; provision of domain names; data storage and processing; remote system administration; sales of e-books, images, music, and movies; etc.

The Law provides that for VAT purposes the place of supply for e-services will be determined based on the location of the customer.

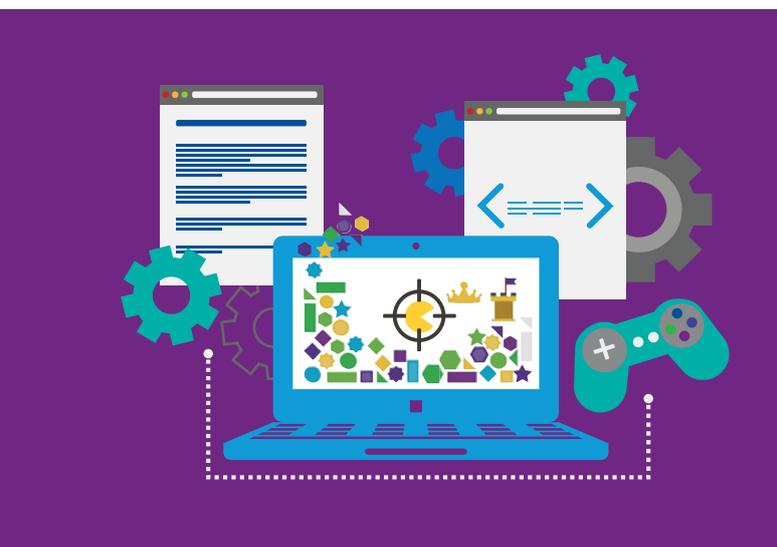
The business implications for foreign companies will vary depending on the role they play in the provision of e-services (i.e., as a service provider, a payment intermediary, an agent, etc.) to Russian individual customers.

 Effective from 2017, it will be necessary to:	Service providers			Intermediaries	
	Direct sales	Sales through a foreign intermediary	Sales through a Russian intermediary	Resale to an individual	Resale through a foreign or a Russian intermediary
 Registration	✓	✗	✗	✓	✗
 Filing of tax reporting	✓	✗	✗	✓	✗
 Payment of VAT	✓	✗	✗	✓	✗

Foreign e-service suppliers (and intermediaries) providing services directly to Russian individual customers **are required to register for VAT purposes** in Russia. This registration includes the obligation to communicate with the Russian tax authorities on VAT compliance matters (including exchanging supporting documentation relating to completed transactions where necessary). In view of this registration obligation, foreign e-service suppliers may potentially need to consider restructuring their sales channels, for example, by establishing a Russian subsidiary to be the seller in the Russian Federation and transferring part of the functions of the foreign e-service supplier to such Russian subsidiary.

If a foreign or a Russian legal entity is an intermediary in a complex e-service supply chain, it may be difficult to identify which party should **act as the VAT agent** for a foreign e-service supplier. This is why intermediary legal entities should structure their transactions carefully with counterparties and pay close attention to the wording of the related contracts.

Some companies use a variety of sales channels; the Law requires a more comprehensive review of those structures for sales to Russia. One way or another, foreign legal entities must expect additional administrative burdens and costs in conducting transactions with Russian individual customers and structure their activities accordingly.



2 The application of the VAT exemption for e-services becomes ambiguous

In one of the earlier drafts of the Law the existing VAT exemption for the supply of software and/or databases on the basis of a license agreement was abolished. In the final version, lawmakers decided to retain that VAT exemption. However, lawmakers could revisit the VAT exemption in 2017.

As many e-services by their nature involve the use of software or databases, many providers of e-services are likely to face difficulties in categorizing their services as VATable or VAT-exempt. Also, taxpayers will need to prepare a supporting file to justify the VAT-exempt treatment of services if challenged by the tax authorities.

3

Penalties apply to foreign companies that fail to register and pay VAT in Russia

The Law requires a foreign company that meets certain criteria to register for VAT with the Russian tax authorities and to file VAT returns.

If a foreign organization registers for VAT under the new law, but:

- submits inaccurate information upon registration;
- fails to pay VAT, any fine or penalty;
- fails to provide the tax authority with the requested documents; or
- fails to file tax returns with the tax authorities,

then the foreign company (a “non-compliant foreign company”) will be de-registered with the Russian tax authorities and suffer the following consequences.



A non-compliant foreign company will be de-registered by the Russian tax authorities and no re-registration will be possible until any VAT, penalty and late payment interest have been paid

If a non-compliant foreign company is de-registered with the Russian tax authorities, the company cannot properly fulfill its VAT obligations. Such company can no longer provide e-services to Russian individuals, as the company would be increasing its unpaid VAT liability, and expose the company to further penalties and late payment interest.

A non-compliant foreign company that has been de-registered can re-register only after all outstanding taxes, fines and late payment interest have been paid (the payment of such items has no statute of limitations). Such VAT tax re-registration will take at least a month.



After de-registration, a non-compliant foreign company will not be able to use its Taxpayer's Personal Account for one year

Without a personal account, a taxpayer must communicate with the tax authorities electronically using a telecommunication channel provided by an electronic document management operator. This channel will increase costs and pose additional administrative burdens for signing all electronic documents by means of an encrypted and certified digital signature.



A foreign company that provides e-services without a VAT registration will face criminal liability

If a foreign company sells e-services to Russian individuals without a VAT registration and the company's unpaid VAT liabilities exceed RUB 1.5 million, the company's officials will face criminal liability for illegal business activities.



The Law changes the rules of the game for foreign e-service companies

KPMG was actively involved in analyzing and commenting on the new law to the Russian Government and lawmakers. As foreign e-service companies reconsider their business structures, KPMG is ready to assist in understanding the impact of the Law and to address the Law's requirements.

KPMG can assist in several areas: initial diagnostics review as to whether sales fall within the definition of e-services; analysis as to whether the VAT exemption for software/data bases applies; identification of the legal entity in the supply chain responsible for VAT; consideration of alternative business structures; process of VAT registration; and ongoing VAT compliance.

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