Key tax changes in 2019
Tax amendments in 2018

December 2018

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Dear colleagues,

The end of December is traditionally the time to recap the results of the outgoing year and draft plans for the future. To help you with this task, we prepared an overview of the key amendments that have been introduced to tax legislation in 2018 and that we can expect in 2019.

I think that the year 2018 was in general fairly rich in terms of the number of innovations: an investment tax deduction for the profits tax was introduced; general provisions on special administrative regions – “Russian offshore zones” – entered into force; the federal tax benefit for movable property was abolished.

And it is already clear today that we can expect no less and maybe even more far-reaching changes in 2019: a number of amendments to the Tax Code of the Russian Federation will already enter into force from 1 January 2019 – a higher VAT rate; a new procedure for imposing VAT on e-services; abolition of the tax on movable property; the introduction of a new “oil” tax – tax on additional income from hydrocarbon production (additional income tax - AIT), and many others.

We hope that you will find our overview useful and that it will help you keep abreast of all the changes. And, of course, we wish you the best of luck next year.

Mikhail Orlov,
Head of Tax and Legal, KPMG in Russia and the CIS
VAT
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The duration of VAT desk audits has been shortened
Increase in the VAT rate to 20%

Effective 1 January 2019, the standard VAT rate will increase to 20%. The 20% rate will apply to goods, work and services shipped, performed and rendered from 1 January 2019.

The Federal Tax Service of the Russian Federation issued a letter where it clarified certain issues related to the application of the VAT rate in the transitional period:

— The 20% VAT rate will apply to goods, work and services shipped, performed and rendered from 1 January 2019, irrespective of the date when the respective contract was concluded;
— The change in the tax rate does not change the procedure for and time of the determination of the tax base for VAT;
— There is no need to amend contracts in connection with the increase in the VAT rate. However, the parties may clarify the procedure for settlements and the cost of the goods, work and services being sold;
— The seller must calculate VAT on a prepayment received in 2018 at the rate of 18/118. If the shipment takes place in 2019, the 20% rate will have to be applied, while the VAT previously calculated at the rate of 18/118 may be filed for a deduction;
— If the buyer paid an advance and made an additional payment of the difference of 2% in 2018 before the shipment in 2019, this is an additional payment of the tax. The seller must issue an adjusted VAT invoice indicating the rate of 20/120 and additionally pay 2% to the budget at the time of the receipt of compensation — the total amount of the received compensation.
— The Federal Tax Service of the Russian Federation also clarified a number of other issues related to the transitional period, including the procedure for applying VAT in the event of a change in the cost and in the case of a return of goods, and the procedure for the calculation of VAT by tax agents and foreign companies providing e-services.

In connection with the increase in the VAT rate, the temporary outflow of funds may increase at a number of companies (for example, in the case of long periods for the receipt of payment from customers). In some cases companies may incur additional costs (for example, if a supplier imposes an additional 2% VAT under contractual terms on a buyer that does not file VAT for deduction, or if the contract does not allow the seller to impose an additional 2% VAT on the buyer over and above the agreed price). The increase in the VAT rate also necessitates consideration of a number of methodological issues (for example, revising the time of the determination of the tax base and approaches in respect of certain transactions, including in the case of long-term construction, the return of goods and transfer of property rights). In this regard, we recommend analyzing contractual terms and conditions, approving with counterparties and, where necessary, introducing changes to contracts, and also analyzing current approaches to the risks related to the change in the VAT rate.

Moreover, owing to the increase in the rate, businesses will have to update or introduce changes to their accounting systems and the software used to operate cash registers. However, the Federal Tax Service of the Russian Federation clarified that if companies don’t manage to reconfigure their cash registers by the beginning of 2019 and issue cash register receipts indicating a VAT rate of 18%, this will not be considered a violation of Russian legislation on the use of cash registers, provided that certain conditions are met (the tax reporting for a corresponding period was prepared using the correct VAT rate and the cash register software was updated within a reasonable timeframe in Q1 2019).

<table>
<thead>
<tr>
<th>Year</th>
<th>VAT rate</th>
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<tr>
<td>1992</td>
<td>28%</td>
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<tr>
<td>1993</td>
<td>20%</td>
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<tr>
<td>2004</td>
<td>18%</td>
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Effective 1 January 2019, the rules for applying VAT are changing for foreign companies that provide e-services. Now, regardless of whether a foreign company provides e-services to individuals or organizations, the foreign company must register with the tax authority, file VAT returns and pay VAT on its own.

E-services are determined as services rendered through information and telecommunication networks, including the Internet, in an automated way using information technology. The RF Tax Code contains a list of services classified as e-services.

The following are the most widespread services that may be recognized as e-services:

— intra-group services rendered by foreign companies to the Russian companies of a group, such as online access to corporate platforms and programs (for example, ERP systems), databases;

— granting of rights to use computer programs and databases over the Internet by IT companies, including the provision of computer programs over the Internet to distributors in the Russian Federation for subsequent distribution among Russian end users;

— provision of online platforms for the conclusion of transactions between sellers and buyers;

— provision of online space for data storage.

Registration with the tax authority is required even if the e-services are exempt from VAT (for example, rights to use computer programs under license agreements). A foreign company providing e-services must submit its tax registration application before 15 February 2019.

We would like to recall that until 2019 only foreign companies providing e-services to individuals had to pay VAT on their own and register with the tax authority. If a foreign company provided e-services to Russian organizations or individual entrepreneurs, then VAT was payable by such buyers in the Russian Federation acting as tax agents. Effective 1 January 2019, Russian companies acquiring e-services from foreign companies must stop paying VAT as tax agents. Such Russian companies will retain their right to a VAT deduction on e-services if they meet the eligibility criteria for the deduction. However, to be able to deduct VAT, such Russian companies need to ensure that they have correctly prepared documents in compliance with the new requirements (in particular, a contract, payment and/or settlement documents containing the amount of VAT, TIN and KPP (Tax Registration Reason Code) of the foreign provider of the e-services).

**Parties affected:** Technology companies and any other companies that provide or acquire e-services, including foreign companies providing services to Russian companies under intra-group contracts.

**When:** From 1 January 2019

**Effect:** Foreign companies providing e-services to Russian companies are required to calculate and pay VAT, register with the Russian tax authorities and file a VAT return and other documents. Russian companies acquiring such services must stop paying VAT as tax agents and ensure that they have documents necessary for the deduction of the VAT paid to a foreign company.

**Laws and regulations:**

*Federal Law No. 335-FZ dated 27 November 2017*
The amendments will affect taxpayers receiving subsidies or budget investments:

- If subsidies or budget investments are received to finance the future payment of goods, work and services, then the corresponding input VAT may be deductible if the documents on the granting of the subsidies and/or budget investments stipulate the financing of the relevant expenses without the inclusion of input VAT in such expenses.

- If subsidies or budget investments are provided for the reimbursement of expenses on goods, work and services that have already been acquired, then there is no need to restore the corresponding input VAT if the documents related to the subsidies stipulate the reimbursement of expenses without the inclusion of input VAT in such expenses.

In all other cases, corresponding amounts of input VAT regarding the receipt of subsidies and/or budget investment, cannot be filed for a deduction/must be restored pursuant to the special procedure.

**Amendments to VAT that entered into force in 2018.**

**The declarative procedure for a VAT refund is now more accessible**

The threshold amount of aggregate tax payments enabling companies to apply the declarative procedure for a VAT refund without a bank guarantee has been reduced from RUB 7 billion to RUB 2 billion. Effectively, this expands the number of entities that may use the declarative procedure for a VAT refund within the framework of article 176.1 of the RF Tax Code. The threshold amount of tax payments for guarantors has also been reduced from RUB 7 billion to RUB 2 billion. In addition, the maximum amount of liabilities under guarantees has increased from 20% to 50% of the net asset value.

Previously, the right to file for a VAT refund through the declarative procedure without providing a bank guarantee was granted to organizations which had paid during three calendar years VAT, excise taxes, profits tax and mineral extraction tax in the amount of RUB 7 billion or more, excluding taxes paid in connection with the movement of goods across the border of the Russian Federation and as a tax agent.
Effective 1 January 2019, regions will not be able to set reduced rates of the profits tax to be credited to the budgets of constituent entities of the Russian Federation. This measure has been dictated by the need to reduce regional budget deficits through an increase in tax revenues. Now the tax rate may only be reduced for certain categories of taxpayers if this is expressly stipulated by the RF Tax Code, for example, for the residents of special economic zones and the participants of regional investment projects. Reduced tax rates established by the laws of constituent entities of the Russian Federation before 1 January 2018 may apply until 1 January 2023. In this case the regions will have the right to increase these rates for the 2019-2022 tax periods.

The provisions of the laws of constituent entities of the Russian Federation adopted after 1 January 2018 (including laws that have retroactive force), establishing reduced rates of corporate profits tax to be credited to the budget of a constituent entity for certain categories of taxpayers not stipulated by Chapter 25 of the Tax Code of the Russian Federation, are not applicable after 1 January 2019.

We recommend that companies using regional reduced rates of the profits tax assess the potential impact of the increase in tax payments and consider the expedience of concluding regional investment contracts for the retention of benefits.

By applying the investment tax deduction, the profits tax may be reduced on a non-recurring basis by the expenses on the acquisition, additional construction, retrofitting and other similar expenses in the following proportions:

— 90% of expenses on fixed assets reduce the part of the tax to be credited to the regional budget. The remainder of the tax payable to the regional budget may not be less than the tax calculated at the rate of 5%. At the same time, the constituent entity of the Russian Federation may set another rate, and also reduce the amount of the deduction.

— 10% of expenses reduce the amount of tax to be credited to the federal budget.

The deduction applies to fixed assets in depreciation groups 3 to 7 in respect of which expenses have been incurred on the acquisition, additional construction, retrofitting, reconstruction, upgrade, technical retooling or other similar expenses. Exception: expenses on liquidation. The deduction is applied to the tax calculated for the tax period in which the fixed asset was commissioned or when its historical cost was changed.

The investment tax deduction may not be applied simultaneously with the depreciation bonus. Additionally, if the tax deduction is applied, expenses on the acquisition or upgrade of fixed assets may not be recognized when determining the tax base for the profits tax.
The procedure for calculating the profits tax when applying the investment tax deduction is as follows:

1. Calculate the profits tax by budget types.

2. Calculate the amount of expenses deductible from the tax payable to the federal budget. The expenses may not exceed 10% of the expenses on acquisition and upgrade.

3. Deduct the amount of the expenses from the tax amount payable to the federal budget. This amount needs to be transferred to the federal budget.

4. Calculate the maximum amount of the deduction. For this purpose, the tax calculated at the rate of 5% needs to be deducted from the tax amount payable to the budget of a constituent entity.

5. Compare the maximum amount of the deduction and 90% of expenses on the acquisition and upgrade of fixed assets.

6. Deduct the smallest amount from the tax payable to the budget of the constituent entity. This amount needs to be transferred to the budget of the constituent entity. The remainder of the deduction may be carried over to subsequent periods.
Effective 1 January 2019, movable property will be removed from the corporate property tax base. Property is qualified as real estate based on the entry made in the Unified State Register of Immovable Property. If there is no entry in the Register, the issue of qualifying the property arises: is it movable or immovable?

To classify property types, the Federal Tax Service recommends determining the following:

— whether the property is connected with the ground;
— whether the property can be relocated without incommensurate damage to its intended purpose.

In other clarifications the Federal Tax Service cites a number of court disputes where the subject matter was the qualification of fixed assets, primarily assets, the rights to which are not registered in the Unified State Register of Immovable Property and may not be qualified as real estate only based on their name. In particular, pursuant to court findings, immovable property includes such assets as: “industrial pipelines”, “gas pipes”, a “self-elevating floating drilling rig”, “deck cranes”, “transformer substation with a new modular complete transformer substation”.

We advise companies to think about developing a methodology for the classification of property as movable and immovable property, especially in the case of complex manufacturing equipment requiring installation. It is also worthwhile thinking about the reconfiguration of accounting systems in order to eliminate manual labor and the possibility of errors.

Previously, in 2018 a region could exempt movable property from the tax or reduce the tax rate, after publishing a corresponding law. If the authorities did not establish such benefits or reduced rates in a region, the tax on movable property must be paid at the rate of 1.1% by the end of 2018. Until 2018 movable property was exempt from the payment of the property tax based on a federal tax benefit.

New rules for calculating the property tax if the cadastral value has been contested

Starting from 2019, the property tax can be recalculated for all the periods of the incorrect cadastral value if the cadastral value has been challenged. It would be possible to refund or offset excess payments of property tax for the previous three years.

The tax may be recalculated if the competent state authority adopted a decision to change the cadastral value after 31 December 2018.

Until 2019, if the cadastral value is contested, the tax may be recalculated, starting from the year when the application was filed on contesting the cadastral value.

Laws and regulations:
Federal Law No. 302-FZ dated 3 August 2018
Federal Law No. 335-FZ dated 27 November 2017
Letter No. BS-4-21/14968 of the Federal Tax Service dated 2 August 2018
Letter No. BS-4-21/20327 of the Federal Tax Service of Russia dated 18 October 2018 “On Court Cases on the Qualification of Assets as Immovable”

Laws and regulations:
Federal Law No. 334-FZ dated 3 August 2018
In the event of withdrawal from a company or its liquidation, the dividends of any participating individual will be calculated according to the following formula:

\[
\text{Dividends at the time of liquidation (withdrawal from the company)} = \text{Market value of the obtained assets} - \text{Expenses on the acquisition of shares (participation interests, units)}
\]

In addition, if an individual subsequently sells or redeems securities/property/property rights obtained after the liquidation of or at the time of withdrawal from the company, then the individual may, when calculating the personal income tax, reduce his/her income by the value of these securities/property/property rights recognized as the taxpayer’s income (before the application of deductions and exemptions) obtained in connection with the liquidation of the organization or the withdrawal of such taxpayer from the organization. Previously, the entire amount of income was taxable.

The sale of “old” shares and participation interests in Russian entities is exempt from personal income tax

Now, the sale of certain shares and participation interests that they hold for more than 5 years is exempt from personal income tax, irrespective of when they were acquired.

Previously, this rule applied only to certain shares and participation interests that had been acquired after 1 January 2011.

Parties affected: Individuals receiving income when they withdraw from an organization or the organization is liquidated
When: The new rules will apply to all income received after 1 January 2019
Effect: Positive, as a smaller amount of income will be taxable

Laws and regulations:
Federal Law No. 424-FZ dated 27 November 2018

The ambiguities in qualifying property rights for PIT purposes have been eliminated

The ambiguities in the qualification as income of property rights that an individual obtained in certain cases have been eliminated.

Now, the RF Tax Code expressly states that such property rights are recognized as income in kind that needs to be included in the PIT base.

Previously, the RF Tax Code had no general provision on recognizing the receipt of property rights as taxable income, but include indirect provisions for such recognition in specific situations (for example, the gifting of participation interests in the charter capital), resulting in ambiguities.

Parties affected: Individuals who received property rights as income
When: The change will apply to property rights obtained by an individual after withdrawal from an organization or its liquidation or in the event of the receipt of a right of claim against the organization on a gratuitous basis, or with partial payment starting from 2019
Effect: Neutral, as the tax authorities previously adhered to a similar position and accrued additional PIT on property rights

Laws and regulations:
Federal Law No. 424-FZ dated 27 November 2018
The general 22% rate on pension contributions has become indefinite, but the threshold amount has increased

The rate of statutory pension insurance contributions will equal 22% instead of 26%, within the limits of the established threshold amount. The rate of contributions exceeding the threshold amount set at RUB 1,150,000 for 2019 (RUB 1,021,000 in 2018) will remain at 10%. As a result, the total rate of insurance contributions to state extra-budgetary funds decreased from 34% to 30%, which should in the opinion of legislators offset the increase in the tax burden due to an increase in the base VAT rate.

The threshold amount for temporary disability and maternity insurance contributions also increased: from RUB 815,000 in 2018 to RUB 865,000 in 2019.

![threshold_amount](815 000 2018) ![threshold_amount](865 000 2019)

The preferential rate of insurance contributions for non-profit organizations and charitable organizations applying the simplified tax system remains unchanged: 20% for pension insurance and 0% for statutory medical and social insurance in the case of temporary disability and maternity. The reduced rate will remain in effect until the end of 2024

PIT exemption is now available to non-residents

Now all individuals, irrespective of their tax residence status, will be exempted from PIT when they sell property (other than securities and property used in entrepreneurial activity) that they owned for a set minimum period or longer. As a rule, this minimum period is 3 or 5 years – depending on the type of property and grounds for its acquisition.

Previously, such an exemption was only applicable for Russian tax residents.

Sale of property used in entrepreneurial activity

Individuals who sold a residential house, flat, room, country house, garden cottage or vehicle used in entrepreneurial activity will be able, in certain conditions, when calculating the tax base, to reduce the proceeds from the sale by documented expenses on the acquisition of this property.

Previously, the proceeds from the sale of such property were subject to PIT in full.

Parties affected: All companies making payments to individuals
When: From 1 January 2019
Effect: The amount of contributions will increase, as the threshold amount has increased. Subsequently, the 10% rate will apply instead of 22%
Laws and regulations:
Federal Law No. 303-FZ dated 3 August 2018
Resolution No. 1426 of the Russian Federation Government dated 28 November 2018

Parties affected: Individuals who are not tax residents of the Russian Federation
When: With respect to income from the sale of property starting from 2019
Effect: Positive, as the exemption is now available to all individuals
Laws and regulations:
Federal Law No. 424-FZ dated 27 November 2018

Parties affected: Individuals using the property for entrepreneurial purposes
When: The amendments apply to income from the sale of property, starting from 2019
Effect: Positive, as the amount of taxable income will be reduced
Laws and regulations:
Federal Law No. 424-FZ dated 27 November 2018
Effective 1 January 2019, the majority of Russian domestic transactions will be exempt from transfer pricing control.

Effective 1 January 2019, domestic transactions will be subject to control if the amount of income from such transactions exceeds RUB 1 billion and one of the following conditions is met:

— companies apply different profits tax rates (for example, residents of Priority Development Areas or the Free Port of Vladivostok, participants of regional investment projects);

— one of the parties to a transaction pays the mineral extraction tax at ad valorem rates;

— at least one of the parties to a transaction applies a special tax regime (unified tax on imputed income, unified agricultural tax);

— one of the parties to a transaction is exempt from profits tax;

— one of the parties to a transaction is an operator or a holder of a license to develop a new offshore field;

— at least one of the parties to a transaction is a resident of Skolkovo Research Center;

— at least one of the parties to a transaction applies the investment tax deduction for profits tax purposes.

We would like to recall that prior to the introduction of these amendments, all domestic transactions exceeding RUB 1 billion were subject to control without any exceptions. The amendments apply to transactions in respect of which the income is recognized from 1 January 2019, irrespective of the contract date.

Effective 1 January 2019, cross-border transactions are recognized as controlled transactions if the annual income exceeds RUB 60 million.

We would like to recall that at present no threshold amount has been established on the amount of income from foreign trade related-party transactions for recognizing such transactions as controlled transactions, while the threshold amount has been established at RUB 60 million for other transactions equable to related-party transactions (transactions with goods traded on international exchanges, transactions with offshore companies).

Despite the positive impact of a reduction in the administrative burden, we do not rule out the risk that the tax authorities will try to challenge transactions on the basis of an unsubstantiated tax benefit (article 54.1 of the Tax Code of the Russian Federation). Moreover, taxpayers will lose the opportunity to make corresponding adjustments that are only possible in controlled transactions. We advise you to check in advance how strong the positions of companies in intra-group transactions are and whether such transactions demonstrate a real business purpose.

There will be fewer controlled transactions

**Parties affected:** Companies concluding related-party transactions

**When:** The changes only affected transactions with income (or expenses) recognized from 1 January 2019

**Effect:** On the one hand, the effect may be considered positive thanks to a reduction in the administrative burden on business regarding the preparation of transfer pricing documentation and the issue of notifications on controlled transactions. On the other hand, excluding these transactions from control may give the Russian tax authorities wider discretion during audits that are not special transfer pricing audits.

**Laws and regulations:**

*Federal Law No. 302-FZ dated 3 August 2018*
Provisions on three tiers of transfer pricing documentation have started to be applied

The innovations will apply to international corporate groups (hereinafter referred to as ICG) which earned income (revenue) based on the group’s performance in the relevant financial pursuant to consolidated financial statements, up from:

— RUB 50 billion if the parent company of the group is a tax resident of the Russian Federation;
— the amount established by the legislation of a foreign state or territory for the emergence of the obligation to file a country-by-country report if the parent company of the group is the tax resident of this foreign state or territory.

Certain participants of ICG need to file the following documents:

— Notification on participation in ICG. It is filed electronically in the format established by the Federal Tax Service within 8 months of the closing date of the reporting period for the parent company of ICG.
— Global documentation on ICG. The documentation is filed in free form within 3 months of the date of receipt of the claim of the Federal Tax Service.
— National documentation. The documentation is filed in free form within 30 days of the date of the claim of the Federal Tax Service.
— Country-by-country report. The report is filed electronically in the format established by the Federal Tax Service within 12 months of the closing date of the reporting period.

The provisions on three-tier documentation apply on a mandatory basis to financial years starting in 2017 (for national documentation – starting from 2018). The notification on participation in ICG and the country-by-country report for financial years starting in 2016 may be filed voluntarily.

If claims for the submission of the indicated documents are not observed, a fine (from RUB 50,000 to RUB 100,000) will be imposed on the taxpayer.

Transitional provisions have been established for a number of the innovations.
Significant amendments have been introduced to the RF Tax Code concerning the concept of the actual beneficiary of income. Some of these amendments apply retrospectively, starting from 1 January 2018. In particular:

— The possibility of applying the ‘look-through’ approach is formalized in instances when the direct recipient of income not recognized as the beneficiary of this income is the tax resident of a state that has no double taxation treaty with the Russian Federation;

— One provision is expressly stated, which stipulates within the ‘look-through’ approach the application of the tax rates pursuant to the RF Tax Code to the actual beneficiary of the income located in countries that have no double taxation treaties with the Russian Federation (i.e. 15% for dividends, 20% for interest and royalty, and 10% for income from the lease of vessels in connection with international transportation);

— The formal duty of obtaining confirmation of the actual beneficiary of the income for each payment under one contract has been abolished; moreover, the possibility of applying different approaches with respect to the actual beneficiary of the income for different payments is permitted;

— The possibility of applying the ‘look-through’ approach to all types of Russian-source income and not only to dividends has been expressly formalized;

— A special procedure has been established for applying the ‘look-through’ approach in the event of payment of income on securities which are the subject matter of a repo transaction or a securities lending transaction;

— A simplified procedure has been introduced for confirming the status of the actual beneficiary of the income for certain categories of persons (individuals, public companies, sovereign funds, direct subsidiaries of the Russian Federation or a foreign state);

— A provision of the Tax Code of the Russian Federation that made it possible to recognize that an individual is the actual beneficiary of the income only to the extent of the individual's participation interest has been abolished;

— A withholding income tax exemption is stipulated in cases when dividends are paid through a foreign company that has admitted that it is not the actual beneficiary of the income to the Russian organization paying the dividends and the actual beneficiary of such income (within the framework of ‘looped’ participation).

It should also be taken into account that in addition to legislation the concept of the actual beneficiary of the income was also developed in the clarifications of the Federal Tax Service of the Russian Federation. For example, in April 2018 the Federal Tax Service issued a second letter based on available court practice with recommendations for its territorial subdivisions concerning the application of limitations on benefits under the international double taxation treaties of the Russian Federation.

In its letter, the Federal Tax Service confirmed one more time that the concept of the actual beneficiary of the income is the ‘universal tool’ for combating abuses with double taxation treaties. Such an approach enables the Federal Tax Service to apply limitations on the application of benefits under double taxation treaties not only to dividends, interest and royalty, but also to any other types of income: lease payments, income from the sale of real estate, etc.

**Parties affected:** Persons paying passive income to foreign companies

**Effect:** Positive, the possibility of applying the ‘look-through’ approach will be clarified

**Laws and regulations:**
- Federal Law No. 424-FZ dated 27 November 2018
- Letter No. SA-4-9/8285 of the Federal Tax Service of the Russian Federation dated 28 April 2018
- Draft Law No. 511610-7
The Federal Tax Service of Russia notes that in addition to the previously established criteria used to recognize foreign companies as the actual beneficiaries of the income*, special attention should be paid to assessment of the independent nature of the company’s business activities abroad. All the evidence of independent activities should be assessed from the perspective of the creation of an economic profit center of the company in the foreign jurisdiction.

In particular, the tax authorities note that the foreign company must receive active income that it will use to create an economic profit center. It notes separately that such activity should not seek to “create the semblance” of business activities.

In the clarifications, the tax authorities emphasize that if the company’s main income and assets are related to Russia and the company is not actively engaged in business in the jurisdiction of its tax residence, then it cannot be held that such a company has an economic profit center abroad.

The Federal Tax Service of Russia highlights a number of lines of business carried out by a foreign company that will indicate that it does not have an economic profit center abroad:

- **The provision of information and consulting services;**
- **The one-time purchase of preferred shares, the receipt of income in the form of an exchange gain from the purchase and sale of foreign currency, income in the form of a high interest rate on deposits;**
- **Investments in and the financing of companies of a group (holding company) and related companies;**
- **Ownership of the shares of and participation interests in affiliates;**
- **Establishment of subsidiaries if the actual decisions are adopted by other persons;**
- **Transactions involving the acquisition of participation interests in various companies if there is no participation in the activities of the acquired companies, the companies do not perform any real activities and do not generate any income received;**
- **Activities that consist only in serving the interests of the company’s own group if the receipt of income is not economically justified.**

* See more details in KPMG’s publication concerning the previous letter of the Federal Tax Service of Russia about the actual beneficiary of the income dated 17 May 2017
The rules on controlled foreign corporations (CFC) have been clarified

The following amendments entered into force on 27 December 2018:

— According to the additional grounds that have been introduced, a person is not recognized as the controlling person of a foreign entity (in addition to participation through a public Russian company/companies) if the minority interest in the foreign company is exercised through direct or indirect participation in listed foreign companies.

— When determining the share of income of active foreign companies (including holding and sub-holding companies), and also of the companies engaged in mineral extraction, the income specified in clause 3 of article 309.1 of the RF Tax Code is not taken into account (except for income from the sale/disposal of participation interests in the entity’s charter capital).

— The provisions regarding the submission of notifications on CFC have been clarified – notifications must also be submitted when a CFC incurs losses.

Thus, as part of the confirmation that a foreign company has the status of actual beneficiary of income, it will be necessary to assess not only whether there are indicia of intermediaries in the structure of the income flow from the Russian Federation and the authority to independently dispose of the income, but also whether there is an actual economic profit center abroad based on the above criteria.

In general, the clarifications once again confirm the intention of the tax authorities to actively combat the application of benefits in respect of foreign companies and structures that do not have sufficient actual and economic presence abroad.
Organizations that are involved in R&D activities on the territory of innovative centers and have the status of project participant are eligible for the following tax benefits:

— Exemption from profits tax until the organization has attained the recoupment level established by the RF Tax Code, or for 10 years;

— Exemption from VAT; however, it should be noted here that if a participant applies the VAT exemption, its transactions with related parties are deemed controlled transactions when the amount of income reaches RUB 1 billion;

— Exemption from property tax and land tax with regard to land plots on the territory of the center;

— Reduced rates of insurance contributions: the rate of contributions for statutory pension insurance – 14%, statutory medical insurance – 0%, temporary disability and maternity insurance contributions – 0%.

A ban has been introduced on the creation of new consolidated groups of taxpayers and a validity period has been determined for existing consolidated groups of taxpayers

Effective 1 January 2019, the creation of new consolidated groups of taxpayers is prohibited. Any agreements on the creation of consolidated groups of taxpayers registered by the tax authorities in 2018 will be considered unregistered and will not be applicable. Existing consolidated groups of taxpayers may retain their status until the expiration of the respective agreement on the creation of a respective consolidated group of taxpayers, but no later than 1 January 2023. In addition, during their effective term consolidated groups of taxpayers will be required to notify the regional tax authorities in advance of forecast profits tax remittances from members of the consolidated group of taxpayers to regional budgets in each current and subsequent financial year. At present 16 consolidated groups of taxpayers consisting of more than 400 companies have been registered. A moratorium on the creation of new consolidated groups of taxpayers was in effect in 2014-2017.

In connection with this fact, we assume that groups may encounter the following challenges during the “transitional period”: decentralization of tax reporting; the need to change the tax accounting methodology, corporate regulations and business processes for each company of the group and shared services centers; increase in labor costs on the preparation of tax reporting and the reconfiguration of accounting systems; an increase in the number of possible mistakes. It would also be a good idea to start developing an integrated approach to the planning of the tax burden for groups of companies, for example, to consider the possibility of applying targeted regional benefits and participating in regional investment projects, and also transferring key companies of a group to the tax monitoring regime.

Not just Skolkovo: all innovative scientific and technological centers are now eligible for tax benefits
A new tax in the oil sector – additional income tax (AIT)

A new tax is introduced – the tax on additional income from hydrocarbon production (additional income tax - AIT).

The goal of the introduction of this tax is to support the development of low-margin fields requiring significant volumes of investments. Unlike the existing tax system applicable to hydrocarbon production based on the taxation of the volume of output, the additional income tax will be levied on profits from hydrocarbon production. Consequently it will reflect more fairly actual savings on projects on the development of subsoil blocks. If AIT is applied, the mineral extraction tax still has to be paid, but at a lower rate.

AIT is applicable to oil, associated and natural gas, gas condensate. For more details on AIT, please read the brochure Tax on Additional Income from Hydrocarbon Production on KPMG's website in the section Publications.

General provisions on the mechanism of special administrative regions (SAR) for international companies on Russky Island and Oktyabrsky Island have entered into force

The package of laws introduces a new preferential regime of special administrative regions – territories with a special legal status for redomiciliation of foreign companies.

A new preferential regime for special administrative regions (SAR) is introduced in Russia on Russky Island in Primorsky Territory and Oktyabrsky Island in Kaliningrad.

In order to redomiciliate in a SAR, a foreign company should meet the following conditions:

— The company should be a legal entity involved in entrepreneurial activity directly or through controlled persons in the Russian Federation and abroad.

— The company should be established in a country that is a member or has observer status of FATF and/or a member of MONEYVAL.

— The company should file an application on the conclusion of a contract on operating in the Russian Federation as a SAR participant and conclude a respective agreement with the management company. The functions of the management company on Russky Island are performed by JSC Far East Development Corporation (FEDC).

— The company should assume obligations to make investments of no less than RUB 50 million in Russia within six months of the date of registration in the Russian Federation. An investment project is not tied to a specific territory – it may be any constituent entity of the Russian Federation. In addition, there are no specific requirements on the form of investment. Those can be both capital investments based on special investment contracts (SICs), concession agreements, PPP or another agreement, and contributions to the charter capital.

SAR residents meeting the criteria of an international holding company (IHC) will be eligible for the following tax benefits:

The income of an international holding company is exempt from tax received in the form of:

Parties affected: Oil producers operating fields that require major investments

When: From 1 January 2019

Effect: The additional income tax enables a company to defer the tax burden until it generates actual income

Laws and regulations:
Federal Law No. 199-FZ dated 19 July 2018

Parties affected: Foreign holding companies interested in returning capital to Russia

When: 3 August 2018

Effect: Positive due to the tax concessions

Laws and regulations:
Federal Law No. 290-FZ dated 3 August 2018
Federal Law No. 291-FZ dated 3 August 2018
Federal Law No. 292-FZ dated 3 August 2018
Federal Law No. 293-FZ dated 3 August 2018
Federal Law No. 294-FZ dated 3 August 2018
Federal Law No. 295-FZ dated 3 August 2018
Federal Law No. 296-FZ dated 3 August 2018
Federal Law No. 424-FZ dated 27 November 2018
— CFC profit;
— dividends if the participation interest in a subsidiary is no less than 15% for no less than 365 days;
— income from the sale of shares;
— application of a tax rate of 5% with regard to dividends.

Profits tax benefits for IHC will enter into force, starting from calculations of the profits tax for 2018, and not from 2019, as initially expected.

At present SAR version 2.0 is being developed to eliminate contradictions and gaps in the first version: there are plans to expand the range of parties, adjust the timeline for the application of tax benefits, provide an opportunity to apply provisions of foreign corporate law to redomiciliated companies, and retain the option of preparing financial statements according to IFRS or other standards for the purpose of dividend payments.

“In the case of the residents of PSEDA and FPV, legislative acts that place the taxpayer in a worse position (increase, cancelation of reduced rates on taxes and insurance contributions, cancelation or changes to the provisions for granting tax benefits) will not take effect until the onset of the following dates:

— the date of the loss of status as a resident of PSEDA or FPV;
— the date of the expiration of the reduced rates, benefits and other preferences if the expiration date of such preferences comes earlier than the loss of status as a resident of PSEDA or FPV.

Parties affected: The residents of priority development areas and the Free Port of Vladivostok (FPV)

When: The provisions are applicable to legislative acts on taxes and duties, which entered into force from 1 January 2019 and cover the residents of Priority Social and Economic Development Areas (PSEDA) and FPV who received their status before 2019.

Effect: Positive, as it guarantees the immutability of the provisions of legal regulation

Laws and regulations:
Federal Law No. 300-FZ dated 3 August 2018 (as amended by Federal Law No. 424-FZ dated 27 November 2018)
Effective 1 January 2018, a new Customs Code of the Eurasian Economic Union of Armenia, Belarus, Kazakhstan, Kyrgyzstan and Russia (hereinafter the EAEU Customs Code) entered into force and replaced the previous Customs Code of the Customs Union (hereinafter the Customs Code of the Customs Union). In addition, a number of international agreements regulating customs legal relations and concluded during the effective period of the Customs Code of the Customs Union ceased to have force. However, most of these contracts were transferred to the text of the new code that became much bigger – it almost tripled in size.

Considering the provisions of international conventions on customs duties and also the contemporary level of IT development, the EAEU Customs Code is innovative and significantly simplifies and expedites customs transactions by automating the processes applicable to customs declarations and the release of goods. In addition, numerous customs regulation issues were transferred from the national level of EAEU participating countries to the supranational level. The following legislative innovations may be classified as the main benefits of the EAEU Customs Code:

**Priority of the electronic customs declaration**

Opportunity to submit a customs declaration without the submission of supporting documents

Reduction in the overall timeframe for the release of goods (4 hours)

Increase in the overall timeframe for the temporary storage of goods (4 months)

Automatic registration, verification of a customs declaration and release of goods without the actual participation of a tax inspector

Introduction of a “single-window” principle that makes it possible to submit on a one time basis the documents and data required for the completion of customs transactions

**Participants affected:** Participants of foreign economic activity

**When:** From 1 January and 4 September 2018

**Effect:** New stage of the legal regulation of activities within the EAEU

**Laws and regulations:**

*Customs Code of the Eurasian Economic Union (Appendix No.1 to the Agreement of the Customs Union of the Eurasian Economic Union)*

*Federal Law No. 289-FZ dated 3 August 2018*
Federal Law No. 289-FZ dated 3 August 2018 “On Customs Regulation in the Russian Federation and on Amendments to Certain Legislative Acts of the Russian Federation” (hereinafter the Law) entered into force in Russia from 4 September 2018. The appearance of this document is attributable first and foremost to the introduction of the new EAEU Customs Code, whose provisions contain a significant number of references to the national legislation of the EAEU member states.

The new Law regulates the import and export of goods, their temporary storage, customs declaration and customs control. It also establishes the rights and obligations of customs representatives, customs carriers, owners of customs or free warehouses and owners of duty-free shops.

Speaking about the main innovations of the law, the following should be noted:

— They formalize the right of individuals to obtain written clarifications from the RF Ministry of Finance on the application of Russian legislation on customs regulation;
— They establish an opportunity to obtain a preliminary decision on the issues of applying methods for determining the customs value of goods imported into the Russian Federation;
— The deadline for the adoption of preliminary decisions on the classification of goods has been decreased from 90 to 60 days, while their validity period has been increased from 3 to 5 years;
— They introduce amendments applicable to the customs control procedure, establishing in particular the timeframe for customs audits and inspections. The powers of the customs authorities to check the labeling of imported goods are spelled out in more detail;
— The norms concerning the status of authorized economic operator (AEO) have been brought into compliance with the EAEU Customs Code, etc.

The new legislative act replaced the previous document on customs regulation No. 311-FZ. At the same time, however, certain provisions will remain in force for two more years. For example, some of the current customs rules enshrined in Law No. 311-FZ (for example, articles regulating the procedure for obtaining AEO status) will remain in force until 1 January 2020. In addition, certain provisions of the new Law enter into force on different dates. For example, articles concerning the customs procedure of a free warehouse will enter into force from 1 July 2019. At the same time, it will only be possible to apply provisions regulating the refund of advance payments after the entry into force of a separate international agreement with the Russian Federation, and the procedure regulating the receipt of a preliminary decision on applying the methods for determining the customs value should be developed additionally.

In this regard, the regulatory and legal framework of the EAEU customs legislation during the transitional period will be based simultaneously on three legal acts: the EAEU Customs Code and two versions of the law on customs regulation.
A number of tax administration rules are introduced, in particular:

— When filing a revised tax return, a repeat field tax audit may only be performed to verify the correctness of the tax calculation based on the amended indicators of the tax return, while the period during which the revised tax return was revised is no longer subject to a repeat audit.

— The tax authorities are not entitled to demand that the taxpayer repeatedly provide information and documents regardless of the grounds on which such documents were previously provided. The taxpayer may provide a notification that such documents and information were provided to the tax authority earlier indicating the document based on which such information and documentation were provided. This amendment will allow companies to save a significant amount of time and effort on the preparation of responses to the claims of the tax authorities on the submission of documents.

— The deadline for responding to the claims of the tax authorities on the submission of documents and information outside of field and desk tax audits has been extended from 5 to 10 days.

— The procedures for implementing additional tax control measures have been formalized. Now all procedural issues, additional evidence and conclusions of the tax authorities based on the results of additional tax control measures should be documented in an addendum to a tax audit report. The tax authorities have 15 days to prepare such addenda to the tax audit report and five days to deliver it to the taxpayer subject to the tax audit (10 days – for members of corporate groups of taxpayers, 20 days – for foreign organizations registered with a tax authority). The taxpayer is granted the right to submit its written objections to the addendum to the report within 15 days. These rules are applicable in the event of the adoption of decisions based on the results of tax audits completed after 3 September 2018.

The duration of VAT desk audits has been shortened

The duration of a VAT desk audit has been reduced from three to two months. The tax authority is entitled to extend it to 3 months only if it discovers any indicia of a possible violation of tax legislation. It should be noted that the duration of a desk audit of a foreign company providing e-services and registered with the Russian tax authorities remained the same – six months, the possibility of its extension is not stipulated.
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