Dear colleagues,

On 25 September, the Federation Council approved a draft law implementing the Main Areas of Budgeting, Tax, Customs and Tariff Policy as well as BEPS Action 14 (Draft Law No. 720839-7). This Draft Law introduces major changes to both parts of the Tax Code of the Russian Federation (hereinafter referred to as the Tax Code). In our tax publications, we have been informing you of proposed changes, starting from the date when the Draft Law was sent to the State Duma. Please note that multiple amendments have been made to the final version of the Draft Law and at present the key changes to the Tax Code are as follows:

**Tax control**

Pursuant to the Draft Law:

— the tax authorities have the right to inform taxpayers of their tax debts by SMS and/or e-mail. However, the tax authorities have to obtain prior written consent from taxpayers in order to do this;

— it has been clarified that if a tax audit establishes a violation of tax withholding duty by a withholding agent, then the tax liability is deemed discharged as of the date when the withholding agent presents the payment order to the bank, so long as there is enough money in the account;

— only amounts exceeding 3,000 roubles are subject to enforced collection. If a tax debt amount being demanded has been accumulated within the three-year limitation period from the date of expiration of the deadline for meeting the earliest tax demand, the decision to collect will be made within two months of the date when the amount of tax debt exceeds 3,000 roubles;

— the interest rate on the payment of tax by installments (in accordance with point 7, paragraph 2, Article 64 of the Tax Code) has been increased to match the refinancing rate of the Central Bank in effect during the period of installment payment. The right to pay in installments may be granted for a period of up to three years if the amount of tax (levies, contributions, penalties and fines) due as a result of a tax audit is 30% or more of the revenue for the year preceding the year when the decision based on the results of the audit came into force;

— the tax authorities will post publicly available information on the types of property subject to interim measures such as seizure or use as a pledge on the website of the Federal Tax Service. The exact information to be posted on the website will be determined by the Federal Tax Service. Information about subsequent return after seizure or use as a pledge will also be published. If interim measures have been taken, the tax authorities will automatically have pledge rights if tax debts are not settled within a month. This pledge will have priority over any pledge rights of third parties, except for when a subsequent pledge is prohibited under the civil law of the Russian Federation. If property is seized, the tax authorities, at the taxpayer’s request, may exchange this measure with a bank guarantee, a pledge of property or a third party’s surety;

— obstacles to offsetting different types of overpaid tax have been removed. When a desk audit is conducted, the period for offsetting or refunding tax starts after the desk audit is completed, and if any violations have been established, after the decision made as a result of the audit comes into effect. The three-year period for offsetting or refunding taxes, as well as the period for returning excess taxes collected, may be prolonged if mutual agreement procedures are applied.
Registration of foreign employees with the tax authorities

The Draft Law has introduced a new procedure: now, foreign citizens who have not been previously registered with the tax authorities will be registered automatically after their withholding agent has filed tax reports at the place of registration of the withholding agent, i.e. after the personal income tax forms 6-NDFL and 2-NDFL for the year have been filed. The Federal Tax Service Inspectorate must automatically register the foreign citizen to whom income has been paid within 15 days and send a corresponding notice to the withholding agent within the same period, and the withholding agent, in turn, is obliged to notify the foreign citizen thereof and then send a report to the Federal Tax Service Inspectorate. The foreigner is removed from the register at the withholding agent's inspectorate if the foreigner has not been paid income for 3 years and if the foreigner has not filed the personal income tax form 3-NDFL on his/her own.

Changes in transfer pricing and mutual agreement procedures

Changes to the procedure for carrying out transfer pricing (TP) analysis of transactions with intangible assets:

- it is suggested that specialised functional analysis should be performed for transactions with intangible assets to take into account the following: (1) the functions and risks related to development, enhancement, maintenance, protection and exploitation of intangible assets (in international practice referred to as DEMPE functions), and (2) the specialised criteria for comparing transactions related to intangible assets, e.g. their exclusiveness, existence and the period in which they have legal protection, the territorial limits to their exploitation rights, etc. However, in contrast to the first version of the Draft Law, these comparability criteria serve as guidelines and are not mandatory, as strict compliance with all of the proposed criteria could have hindered, in practice, application of the comparable uncontrolled price (CUP) method.

- amendments have been introduced to Article 105.13 of the RF Tax Code with regard to application of the profit split method to transactions with intangible assets – economic ownership and control for TP tax control purposes are treated as legal ownership when applying this method.

Changes in the calculation of the arm's length price range for exchange-traded commodities:

- amendments have been introduced to paragraph 5 of Article 105.9 of the RF Tax Code to replace the wording "registered by the exchange as at the date when they are made" with the wording "made at the exchange during a similar period of time under comparable conditions". These changes are aimed at clarifying the procedure for calculation of the arm's length price range, as well as opening the possibility of applying the quotation period to exchange-traded commodities.

The Tax Code has been supplemented with the rules on mutual agreement procedures with the competent authorities of foreign countries:

- based on the results of a mutual agreement procedure, excess taxes paid/withheld may be refunded or offset, including as a result of adjusting the tax base under TP rules;

- the procedure and deadline for submitting an application for a mutual agreement procedure and the procedure and deadline for considering this application are to be determined by the RF Ministry of Finance (the procedure will be developed by the Ministry of Finance after the law comes into effect), taking into account the provisions of the international tax treaties of the Russian Federation;

- the mutual agreement procedure may be initiated not only by a taxpayer but also at the request of a competent authority of a foreign country with which the Russian Federation has a double taxation treaty.

These amendments to the RF Tax Code are expected to come into force on 1 January 2020.

VAT

The Draft Law specifies:

- the procedure for restoring VAT when a taxpayer switches to the unified tax on imputed income at the same time while applying the general taxation regime;

- the procedure for restoring VAT for the successor in cases when a company undergoes a reorganisation; in particular, when successors begin to carry out VAT-exempt activities or switch to special taxation regimes;

- the taxpayer's right to deduct VAT amounts charged to the taxpayer on property rights acquired to perform construction and installation;

- the taxpayer's right to deduct VAT amounts charged to the taxpayer during the performance of work (provision of services) to create an intangible asset, and the procedure for deducting such VAT amounts. Указанные изменения вступят в силу с 1 января 2020 г.

These changes will come into effect on 1 January 2020.
Moreover, the Draft Law specifies the list of documents the taxpayer needs to provide to confirm its right to apply the zero VAT rate:

— when taking supplies to other countries of the Eurasian Economic Union and outside the Eurasian Economic Union;
— in respect of goods sent by international mail, as well as express cargo.

These changes will come into effect on 1 April 2020.

Personal income tax

The amended Tax Code introduces the following changes in relation to the personal income tax:

— Russian gambling zones have become more attractive:
  — the winnings of individuals who are not tax residents of the Russian Federation, received from gambling in casinos and slot machine halls, are not taxed;
  — the tax base is determined not for each win, but as the difference between the amount received by the gambling participant from those organising the gambling and the amount paid by the participant to those organising the gambling in exchange for the presented exchange notes of the gambling establishment during the tax period; the tax is payable by 1 December (inclusive) of the year following the expired tax period based on a tax notice sent by a tax authority; the obligation to include winnings paid by those organising gambling on areas that do not qualify as sports betting or pari-mutuel betting in the tax return of individuals has been canceled;
  — collection of taxes that have been unlawfully unwithheld (or part of the amount unlawfully withheld) by withholding agents has been simplified: the tax authorities now have the right to charge additional tax amounts to, and collect these taxes from, withholding agents as a result of a tax audit; it should be noted that the amount of tax paid by the withholding agent (or collected from the withholding agent) is not recognised as the taxable income of the individual taxpayer;
  — the procedure applied to deposits has been extended to cover interest income accrued on the balances of accounts held with Russian banks (i.e. only income exceeding a set threshold is taxed);
  — the procedure for paying taxes following the receipt of real estate as a gift has been specified in more detail (if the income is not exempt from taxation) – taxable income should be calculated based on the cadastral value;
  — the procedure for paying taxes when an individual, being a tax resident of the Russian Federation, sells property has been clarified:
    — when such an individual sells property (with the exception of securities) received on a gratuitous basis or following only partial payment, as well as under a deed of gift, then income from the sale of that property may be reduced by the amount of documented expenses in the form of amounts on which taxes were charged and paid when the property was acquired (received);
    — when such an individual sells property received by way of an inheritance or gift that is exempt from taxation according to paragraphs 18 and 18.1 of Article 217 of the RF Tax Code, the expenses of the legator (giver) to acquire this item of property may be claimed for deduction;
  — Russian organizations and individual entrepreneurs making payments under securities purchase and sale (exchange) agreements concluded by them with individuals are recognised as withholding agents; it should be noted that actually incurred and documented expenses related to the acquisition and storage of corresponding securities and incurred by an individual without the involvement of the withholding agent are taken into account on the basis of individual applications;
  — the obligation to file tax returns on individuals who are not registered with the tax authorities on the grounds provided for by the RF Tax Code, with the tax authorities has been explained in more detail;
  — the obligation to register and deregister foreign citizens and stateless persons who are not individual entrepreneurs, have no place of residence (place of stay) in the Russian Federation or immovable property and (or) vehicles belonging to them, and who are not registered with the tax authorities on the grounds provided for by the RF Tax Code, with the tax authorities has been explained in more detail;
  — the obligation to file tax returns on individuals who are foreign citizens and stateless persons referred to in the previous paragraph – if the withholding agent has not withheld taxes when paying income and informed tax authorities thereof – has been clarified;
  — an earlier date has been set for submitting the calculation of tax amounts calculated and withheld by the withholding agent for the year, as well as information about the income of individuals for the tax period – by 1 March (inclusive) of the year following the expired tax period, instead of 1 April.
Insurance contributions

The approved Draft Law:

— has clarified the procedure for paying contributions by payers who do not make payments or pay other remuneration to individuals and who are individual entrepreneurs, lawyers, notaries, etc., specifying that certain periods when these persons do not carry out their activities shall be exempt from contributions;

— has made it obligatory to submit reports on insurance contributions for payers of insurance contributions electronically if their average headcount for the preceding reporting period exceeds 10 people, and not 25 people as before.

Corporate profits tax

Clarifications on depreciable property

The approved Draft Law:

— has excluded the criterion of the “value being written off by means of charging depreciation” from the definition of depreciable property, i.e. it is proposed that the following property be considered depreciable: property owned by the taxpayer and used by the taxpayer to generate income for more than 12 months and worth more than 100,000 roubles (subparagraph 1, paragraph 1, Article 256 of the RF Tax Code);

— has additionally implied the possibility of charging depreciation on fixed assets provided for gratuitous use, while the corresponding expenses will not be recognised in tax accounting (paragraph 16.1, Article 270 of the RF Tax Code);

According to the explanatory note to the Draft Law, the purpose of these amendments is to provide the opportunity to form the “tax” residual value adjusted for depreciation that is not included in tax expenses of property not used in activities aimed at generating income.

However, in our opinion, the amendments have not been thoroughly worked through, since 1) the property provided for gratuitous use does not meet the criterion of depreciable property (it is not used to generate income) and 2) the possibility of depreciating the property is not directly established by the RF Tax Code.

— proposes that those items which the organisation’s management has decided to mothball for a period longer than three months from depreciable property (subparagraph 2, paragraph 3, Article 269 of the RF Tax Code) be not excluded – i.e. it is supposed that expenses in the form of depreciation on mothballed fixed assets can continue to be taken into account for profits tax purposes; however, this innovation does not correspond to the logic of the abovementioned changes in terms of forming the residual value of depreciable property temporarily not used in activities aimed at generating income;

— has canceled the extension of the useful life of mothballed fixed assets for the period of their mothballing (paragraph 3, Article 269 of the RF Tax Code);

— has corrected the logical error in the provision on changing the depreciation method – the taxpayer’s right has been confirmed to change the depreciation method from non-linear to straight-line and vice versa no more than once every 5 years (subparagraph 4, paragraph 1, Article 259 of the RF Tax Code).

Loss carryforward

The Draft Law has provided for the following:

— it is proposed that the limitation on the amount of losses carried forward be extended (not by more than 50% of the tax base for the current period) for one more year – till 31 December 2021 (paragraph 2.1, Article 283 of the RF Tax Code);

and:

— an additional ‘business goal’ test has been introduced to be carried out when acquiring loss-making companies. If subsequent tax control measures reveal that the reorganisation has been carried out with the main goal of minimising taxes, the successor will be denied the opportunity of accounting for the accumulated losses of the reorganised company (paragraph 5, Article 283 of the RF Tax Code). At the same time, in the current version of the Draft Law, the additional restriction on accounting for losses in case of an acquisition or a merger of interdependent companies has been excluded.

Taxation of the profits of controlled foreign companies (CFCs)

The approved Draft Law:

— has introduced a number of changes into the calculation of a CFC’s profits. According to the current version of the RF Tax Code, dividends originating in Russian organisations are not considered profits of a CFC if the controlling person of this CFC is the beneficial owner of that income (paragraph 1, Article 25.15 of the RF Tax Code). The Law stipulates that a CFC’s profits shall exclude not only dividends but also other taxable payments specified in paragraph 1 of Article 309 of the RF Tax Code (e.g. interest and royalty) originating from Russian organisations. This is a positive change in terms of the application of the “look-through” approach by tax residents of the Russian Federation to income other than dividends;

— has supplemented the existing rules for calculating CFC profits upon disposal of stakes in subsidiaries by adding a provision that, when calculating a CFC’s profits, expenses shall also include the funds
contributed by the CFC to the assets (capital) of this subsidiary in 2015 and in any subsequent financial year, if these expenses change the value of the stakes as shown in the CFC’s accounting records (the new version of paragraph 3.1, Article 309 of the RF Tax Code). This change allows for a correct calculation of a CFC’s profits when the CFC sells a stake in a subsidiary that was acquired before 2015 and in which the CFC made cash investments in subsequent periods.

The said changes apply to those profits of a CFC determined in periods beginning in and following 2018 (paragraph 9, Article 3 of the Law).

Changes related to regional investment projects

The approved Draft Law:
— has introduced the term “a single technological process” (Article 258 of the Tax Code) which now means a set of interrelated technological operations required to produce goods during implementation of a regional investment project (RIP) using the property with respect to which expenses have been incurred and these expenses constitute the amount of capital investments made by a participant in the regional investment project;

moreover,
— participants of regional investment projects now have the right to choose the method for determining the profits tax base to which reduced tax rates apply: (1) to the tax base from activities carried out as part of the investment project having RIP status (in cases when there is separate accounting for income (expenses) received (incurred) in the course of activities to implement the regional investment project and income (expenses) received (incurred) in the course of other activities), or (2) to the entire tax base if the structure of the taxpayer’s income meets the “90% criterion” (i.e. if the income from the sale of goods produced as part of the investment project having RIP status makes up at least 90% of all income taken into account when determining the tax base (excluding income in the form of a positive exchange rate difference)). The method for determining the tax base should be documented in the accounting policy and may not be changed during the period in which RIP participant status is valid (this applies both to RIP participants that need to be included on the register and to participants for which there is no restriction on the application of the preferential profits tax rate for RIP participants that need not be included on the register of RIP participants). If the difference between the tax amount calculated at the rate of 20% and the tax amount calculated using reduced tax rates exceeds the amount of capital investment made, then the last tax period for applying the preferential rate will be the period in which this excess occurred.

The excess amount is payable to the budget based on the results of the tax period in accordance with the standard procedure.

The new provisions regarding the status of “single technological process” will apply to investment projects under contracts concluded after 1 January 2020. Thus, the innovations will not affect investors that are already implementing investment projects at the time the relevant amendments are adopted.

The provisions regarding the right to choose the method for determining the profits tax base for applying the preferential rates introduced for RIP participants will come into force on 1 January 2020, however not earlier than one month after publication of the federal law. These changes will require investors to carefully analyse their planned investment projects to ensure they keep separate accounts, develop an appropriate methodology and document it in the accounting policy, and assess the project in terms of its compliance with the definition of a single technological process (if applicable), etc.

Corporate property tax

The approved amendments to the Tax Code:
— have changed the definition of the term “property subject to the corporate property tax”. In particular, the criterion of recognition as a fixed asset now applies only to real estate taxed using its average annual value;

— have specified that the tax is payable by corporate taxpayers no later than 1 March of the year following the expired tax period. Advance tax payments are due no later than the last day of the month following the expired reporting period;

— have specified that the cadastral value will be used for taxation, in particular, of items belonging to the organisation based on the right of economic management (point “a”, paragraph 69 and point “b”, paragraph 70 of Article 2 of the Draft Law);

— have, in fact, extended the list of real estate items taxed using their cadastral value: amended subparagraph 4 of paragraph 1 of Article 378.2 includes the following real estate items on the list of items for which organisations will apply the cadastral value to pay the tax on all types of property subject to the personal property tax: residential buildings; apartments, rooms; garages and parking spaces; single immovable complexes; construction in progress; other buildings, structures, facilities, and premises (point “a”, paragraph 70, Article 2 of the Draft Law).

These amendments will take effect on 1 January 2020.
Land tax

The approved Draft Law:
— has set a new deadline for paying land tax: organisations will pay land tax no later than 1 March of the year following the expired tax period (currently the deadlines for payment of this tax by organisations are determined by representative bodies of municipalities and the constituent entities of the Russian Federation);
— has specified that advance tax payments are due no later than the last day of the month following the expired reporting period.

The new procedure will come into effect on 1 January 2021.

Sales levy

The Draft Law has set up a procedure for notifying the tax authorities by the payer of the sales levy when the payer ceases to use a sales facility, as well as notifying about changes to the indicators of the sales facility leading to a change in the amount of the sales levy. For example, if the notification of deregistration of the taxpayer is filed late, the taxpayer will be deregistered from the date of notification.

A new article, Article 417.1, has been added to Chapter 33 of the Tax Code devoted to the sales levy. This article covers the payment of the sales levy under intermediary agreements (it will come into effect on 1 January 2020) and stipulates that if a type of entrepreneurial activity subject to the sales levy is carried out under a simple partnership agreement (joint venture agreement):
— partnership participants using the item of movable and/or immovable property to carry out the specified activity are recognised as payers of the levy;
— the amount of the levy in relation to this item of property is calculated by each participant as the levy rate for the type of entrepreneurial activity carried out and the actual value of the physical indicator of the corresponding sales facility determined in proportion to the value of the partners’ contributions (property shares contributed by the partners) to the common business or established (allocated) in relation to each partner by the joint venture agreement or by an additional agreement of the partners.
— if an entrepreneurial activity subject to the sales levy is carried out:
  — under a commission agreement, the obligations of the payer of the levy specified in the said Chapter are imposed on the commission agent;
  — by the agent on behalf and at the expense of the principal under an agency agreement, the obligations of the payer of the levy specified in the said Chapter are imposed on the principal;
  — by the agent on its own behalf but at the expense of the principal under an agency agreement, the obligations of the payer of the levy specified in the said Chapter are imposed on the agent;
  — under a mandate agreement, the obligations of the payer of the levy specified in the said Chapter are imposed on the mandator;
  — under a trust agreement, the obligations of the payer of the levy specified in the said Chapter are imposed on the trustee.
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