

Overview

The Russian system of taxation is divided into three levels represented by federal, regional and local taxes. General taxation rules are established at the federal level by the Russian tax code and other regulations. Regional and local authorities are empowered to regulate certain elements of regional and local taxes, namely to vary tax rates within a certain range and provide tax incentives.

In addition, different special regimes, such as, regional investments projects, special economic zones, territories of advanced socio-economic development, the free port of Vladivostok, and special administrative districts establish favorable tax conditions for investors that meet specific requirements, including the reduction of or exemption from property and land taxes, the decrease of profit tax rates and lower social security contributions.

Below is a brief overview of major taxes imposed on businesses and their key elements, such as the type of taxable income or property, tax base, tax rate and some specific regulations concerning intra-group financial operations and transfer of assets.

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Legal system

Russia and its regions operate under a civil law legal system. While the ability to implement certain laws are in the exclusive domain of the federal government, others are within the scope of the regions. The federal government has the right to regulate trade and commerce, and to establish the general principles of taxation and fees in Russia. However, the procedure for the construction of plants, establishment of tax rates and granting of tax incentives are the joint responsibility of the federal and regional authorities.

Taxation authorities

The main tax authority in Russia is the Federal Tax Service. Its territorial bodies and inspectorates oversee the accurate calculation and proper payment of all taxes and social insurance contributions.

The Federal Tax Service carries out tax supervision mainly in the form of in-house (desk) or field tax audits. An in-house tax audit is conducted on the basis of a tax return filed by a taxpayer. A desk tax audit may be performed within three months (two months for value-added tax) from the date of filing the tax return. A field tax audit may encompass up to three calendar years preceding the year when the audit is initiated. During a tax audit, a tax authority checks the computation accuracy and the proper payment of reported taxes within the audited period. For this purpose, a tax authority may exercise its power of compulsory seizure of documents and other material evidence. During field tax audits, tax authorities are also entitled to request additional documents and to check all taxes (not only those that are reported). They may also interview employees, conduct counter-inspections and audit taxpayer's counterparties.

Additionally, there is a separate form of tax audit that relates purely to the control of prices applied by interdependent companies in their transactions (based on transfer pricing regulations). A special body authorized to perform such audit checks the accuracy of tax calculations with respect to intercompany transactions, though in practice local tax authorities are actively engaged in the same checks.

Business vehicles

A non-resident may either establish a Russian entity to carry on business in Russia or operate directly through a foreign entity (with or without a Russian permanent establishment). The two types of legal entities most commonly used in Russia are the limited liability company (OOO) and the joint-stock company (AO). In addition to OOOs and AOs, Russian law also recognizes other forms of legal entities, including, but not limited to general partnerships, limited partnerships, and manufacturing cooperatives. It is also possible to use simple and investment partnerships as forms of joint-cooperation without creating a legal body. However, these partnerships are infrequently encountered in practice due to lack of limited liability and are rarely used for business purposes.

Limited liability companies

The OOO is the most popular type of company due to the relative simplicity of its formation and the flexible rules on corporate governance and raising capital. The legal form of OOOs has adapted over time, making it well suited for both wholly-owned subsidiaries of foreign investors and joint ventures.

Joint-stock company

An AO is only recommended as a legal form in cases where the shareholders are planning public placement of shares (which is not permitted for OOOs, and for the "non-public" form of an AO). If no public placement of shares is expected, an AO is generally not recommended because it is subject to cumbersome securities regulations and provides less discretion to shareholders in terms of corporate governance.

Branches and representative offices

Instead of setting up a local legal entity, foreign investors may choose to operate in Russia through a branch or representative office of a foreign company, which are not separate legal entities under Russian law and may act only on behalf of the company they are representing. This is not the preferred option for many companies, as the registration process may be cumbersome. Parent companies bear full liability for the activities of their branches and representative offices.

Branches and representative offices of foreign companies are not subject to company law requirements, but they are subject to special rules summarized as follows:

- i. They can be financed by the head office by direct transfer from between bank accounts on an "as needed" basis.
- ii. A representative office of a foreign company is not intended to undertake any commercial activity; however, a branch may undertake such activity.
- iii. The main purposes of a representative office are usually to represent the interests of the company in Russia, carry

out market research, and promote commercial relations with Russian partners. If a representative office carries out commercial activities, this is not deemed to be a direct violation of law, but requires the payment of applicable taxes in Russia.

- iv. Both a branch and a representative office are managed by their head acting on the basis of a power of attorney issued by the company. The powers of the head depend solely on the provisions of such power of attorney.
- v. The main internal document of a branch or representative office is its regulation which is approved by the company.
- vi. Taxation of a branch or representative office is defined based on “permanent establishment” rules, relevant provisions of any double taxation treaty, and often requires consideration of transfer pricing rules.

Financing a corporate subsidiary

A Russian company may be financed by equity and/or debt. Financing can be provided by a parent company, third party investors or lenders. Equity contributions may be made either in cash or in kind. Debt may be provided in the form of loans or issuance of bonds.

Equity financing

The share capital of OOOs is contributed by each participant in an OOO, and is no less than the nominal value for its share (participatory interest) and can be increased by making additional contributions by the participants (existing or new one). The share capital of AO’s can be increased by increasing the nominal value of shares or placing additional shares outside the company.

Certain types of property rights and intellectual property rights can be contributed to equity in a tax neutral way, but careful analysis and structuring is required to avoid negative tax implications for property rights. For example, a straightforward contribution of debt rights or debt forgiveness may be considered taxable income. A general participation exemption works for property contributions made by owners of more than 50% shares in the company (with some other additional criteria).

Equity contributions that do not change share capital are more often used in practice and do not require registration with the relevant authorities.

Debt financing

Corporate profit tax implications

Russian companies are permitted to borrow funds from related or unrelated third parties. “Thin capitalization” rules and “safe-harbor” tests should be applied to understand the tax implications.

Thin capitalization rules

Thin capitalization rules limit the interest deductibility on debt financing obtained from foreign direct or indirect owners of the Russian taxpayer, or affiliates of the foreign owner or if a debt is guaranteed by the foreign owner.” If the debt to equity ratio of the Russian borrower exceeds 3:1 as of the last day of the taxable (reporting) period, then:

- i. The excessive interest shall not be deductible for the Russian borrower, which leads to an increase in the tax base for profit tax; and
- ii. The excessive interest is treated, for tax purposes, as dividends payable to a foreign lender.

In practice, financing structuring in Russia deals with a number of complex, multi-factor tax issues, including general anti-avoidance rules, potential risks of requalification of debt financing into capital and limitation of benefits provided under a double taxation treaty. Thus, taxpayers should pay extra attention to this point.

Corporate income/profit tax

Income/profit tax rate

The profit tax rate is 20%. Many regions have adopted tax incentives for investors, such as a lower profit tax rate.

However, as of 2019 a region's authority to reduce the profit tax rate is limited to cases directly specified by the Russian tax code. All other regional profit tax incentives will be cancelled starting in 2023.

Computation of taxable income

Taxable base

The profit tax base is equivalent to the taxable profit calculated as sales revenue and other income, less economically justifiable expenses supported by documents. In practice, the requirements for providing documentation in Russia are stricter than those of other countries.

Loss carry-forward

As a general rule, a company may carry forward prior year tax losses in chronological order with the limitation that only 50% of each annual profit tax base may be reduced every year until the end of 2021. Starting 2022 such limitation will expire and there will be no limit on the amount of taxable profit that can be reduced by a loss. Furthermore, there is a direct prohibition in the Tax Code for a non-profitable company to deduct accumulated losses if the tax authorities prove that the principal purpose of the transaction was to minimize taxes.

Income tax reporting

Taxpayers are required to file quarterly and annual profit tax returns. Quarterly profit tax returns must be filed within 28 calendar days of the quarter-end. Annual profit tax returns must be filed within three months of the calendar year-end.

Special incentives

Special incentives are envisaged for taxpayers that are residents of special economic zones, territories of advanced socio-economic development, the free port of Vladivostok, Innovation Center Skolkovo and for participants of regional investments projects or other special regimes. The profit tax rate may be reduced up to 0%. The amount of tax benefits, terms of its application and other conditions depend on the regime and region.

Dividends

As a general rule, dividends payable to companies recognized as Russian tax residents are subject to a corporate profit tax rate of 13%. Under certain conditions (i.e., minimum 50% shareholding within the period of not less than 365 days) incomes received from subsidiaries (including dividends) may be fully exempt from taxation through "participation exemption". For foreign subsidiaries, the "participation exemption" works if the country of incorporation is not black-listed by the Ministry of Finance.

Controlled foreign corporations (CFC)

As a general rule, a Russian tax resident is deemed to control a foreign company, if such person/ legal entity (a) owns more than a 25% interest in the company or (b) 10% interest in the company provided that more than 50% interest is owned by Russian tax residents and (c) by other means determines (exerts significant influence on) or may determine corporate decisions for this company concerning distribution of income among its equity holders. A controlling individual/entity should pay a tax at a rate of 13%/20% on income earned by a CFC in proportion to that person or legal entity's share in the company. The income is taxed if the CFC does not pay out the full amount of its net income as dividends to its equity holders by the end of a calendar year following the calendar year in which a reporting period comes to an end. CFC rules are also applied to trusts and other similar structures.

CFC rules exempt from taxation active business companies, as well as companies with an effective tax rate exceeding 3/4 of the effective Russian tax rate.

Cross-border payments

Transfer pricing

Certain types of transactions, known as "controlled transactions," should be conducted at arm's length under the threat of a pricing adjustment for taxation purposes. These include:

- i. Transactions with foreign related companies exceeding an annual threshold of RUB 60 million
- ii. Transactions between two Russian related companies with total revenues reported under these transactions by both parties exceeding RUB 1 billion, if the parties to the transactions apply different profit tax rates, or if one of the parties is a minerals extraction taxpayer and the subject of the transaction is mined minerals, or if some other specific condition is met.
- iii. Other transactions above a RUB 60 million threshold, with formally unrelated parties, may also be considered controlled transactions:
 - Transactions with conduit companies – intermediaries with related companies;
 - Transactions with companies from the Ministry of Finance's black list of jurisdictions;
 - Foreign trade transactions for goods traded at the stock exchange.

Certain exemptions and additions to the above mentioned rules are revised periodically, so we recommend to carefully check required compliance actions. The Russian transfer pricing model is mainly based on the Organisation for Economic Co-operation and Development (OECD) guidelines and contains country-by-country reporting requirements. At the same time, local practices and rules should be carefully considered. Generally, a master file prepared at the group level is not enough to cover Russian transfer pricing issues.

Withholding tax on passive income

Interest, royalties and dividends payable by Russian companies to foreign companies are subject to withholding tax, unless the respective double taxation treaty provides otherwise. The withholding tax rate is 20% for interest and royalties, and up to 15% for dividends. The 30% rate may be applied to income from securities (save for dividend income) in some cases with nominal holders of securities, where a beneficial owner is deemed to be unknown.

Freight and similar income is taxed at a 10% rate. Most other types of foreign company incomes taxable at the 20% rate include income from the sale or rental of real estate located in Russia, income from the use of intellectual property rights in Russia, and income from the sale of shares of entities, if more than 50% of their assets comprise real estate located in Russia.

As foreign companies are not registered with Russian tax authorities, the above tax should be calculated, withheld and paid by a tax agent (Russian source of income). Lower rates under a double taxation treaty are allowed. At the same time, anti-abuse rules require the taxpayer to obtain not only a certificate of residency of recipient, but also to get evidence of economic beneficiary of income.

Withholding tax on active income

There is no withholding tax on active income. It is generally taxable in Russia through a "permanent establishment" setup. The concept of a permanent establishment is basically similar to the OECD standard.

Payroll taxes

Personal income tax (PIT)

Russian companies are required to compute and withhold personal income tax from salaries and other income paid to employees and other individuals. A 13% rate applies to many types of income received by Russian tax residents (regardless of the source of such income). A 30% rate applies to income received by non-residents from Russian sources, with the exception for highly qualified foreign specialists, who under certain conditions are eligible for the 13% rate.

Social insurance contributions (SIC)

The SIC is 30% of the annual income of an employee within established thresholds, with subsequent reduction to 15.1% on remuneration above the thresholds. Lower preferential rates apply to some companies, such as IT companies complying with certain requirements.

Indirect taxes

Value-added tax (VAT)

Taxable operations are supplies of goods (works, services), property rights and construction works for a taxpayer's own needs. Financial and similar operations (insurance, loans, circulation of securities, etc.) are generally exempt from VAT. There are some other notable exemptions, such as the transfer of intellectual property rights for patents, software and trade secrets.

VAT rate

As of January 1, 2019, the standard VAT tax rate is 20%. Reduced 10% and 0% VAT rates apply to certain goods, works and services. VAT for the export of goods is 0%.

Foreign providers of "electronic" services to Russian clients (both B2B and B2C) need to register for VAT purposes in Russia. The list of such electronic services includes (among others):

- i. Granting access to use computer programs and databases via the Internet
- ii. Advertising services via the Internet
- iii. Assigning domain names
- iv. Web-hosting services
- v. Granting access to use e-books and other content via the Internet.

VAT agents

If a foreign company without presence in Russia (i.e., not registered with the Russian tax authorities) makes VAT-eligible sales, the tax agents will be required to calculate, withhold and pay VAT on behalf of this company. In general, VAT tax agents could be goods or services purchasers registered in Russia or payment intermediaries registered in Russia.

VAT recovering

A purchaser of taxable goods, works or services has the right to recover input VAT in the full amount provided that necessary supporting documents are in place and the acquired goods, works or services are intended for operations subject to VAT (irrespective of the actual output VAT accrued). Starting July 1, 2019, companies are allowed to recover input VAT even if they provide services outside of Russia (not VATable in Russia). If acquired goods, works or services are used for both taxable and non-taxable operations, input VAT is recoverable pro-rata. Internal controls for bona fide suppliers are a key element to support VAT deductibility. A three year eligibility limitation should be taken into account in claiming expenses of past periods.

Excise duties

Goods subject to excise duties are mainly alcohol, tobacco, cars, motorcycles and fuel. The base is either a quantity or a value of goods produced (reworked or refined) depending on the type of goods. The rate of excise tax varies depending on the kind of taxable goods being referenced.

Other notable taxes

Property tax

Property tax is payable by (a) Russian companies and foreign companies that conduct activities through a permanent establishment in Russia for immovable property reflected in their accounts as fixed assets; and (b) foreign companies that do not have a permanent establishment in Russia for their immovable property. Land plots and some other properties are not subject to property taxation. Different and complicated approaches to define movables and immovable often create uncertain tax positions.

Generally, the tax base is determined as the net book value of taxable assets on the basis of the taxpayer's statutory

accounting records. However, for some commercial buildings such as office buildings, hotels or shopping malls listed by the regional authorities, the tax base is defined as the cadastral value of the object of immovable property as approved by the respective regional authorities where the property is located.

The tax rate may not exceed 2.2%. The exact rates are set within this limit by regional authorities. Buildings taxed at the cadastral value are subject to a slightly lower property tax rate (up to 2%). The property tax rate may be reduced to 0% on new property, which is a part of an investment project, implemented under special regimes mentioned in Section 6.4 above, or by other decisions made by regional authorities.

Land tax

Land tax is a local (municipal) tax. A land plot that is owned by a taxpayer is recognized as an object of taxation. The tax base is the cadastral value of the land plot. The annual rates vary with a maximum of 1.5% depending on the type of permitted use of a particular land plot. The rates are set by local authorities.

Transport tax

Transport tax is levied on motor vehicles (cars) and other technical means of transport, such as boats, bikes and planes owned by a taxpayer. The rates are determined by regional authorities and depend on the technical features of each particular transport vehicle (i.e., engine capacity).

Customs duties

Customs duty is a mandatory payment levied by the customs authorities when a taxpayer is moving goods across the customs border of the state. Customs duty rates are determined by the Russian government and vary depending on the type of imported or exported taxable goods.

Minerals extraction tax

A minerals extraction tax is payable by companies involved in mining activities. The tax is established as the value of extracted minerals or as a multiple of the quantity of extracted minerals and a certain fixed tax rate subject to a coefficient. The value of extracted minerals may be defined based on costs or revenues, and the majority of practical issues in the tax deal with the correctness of specific methodology chosen.

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