

Russia proposes draft bill limiting VAT exemption for foreign entities licensing software and databases

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On 21 July 2020, the Russian State Duma (the highest legislative body) approved in the first and second readings a draft bill limiting applicability of the value-added tax (VAT) exemption upon a transfer of rights to software and databases. The proposed legislative changes would affect, inter alia, foreign companies licensing rights to software or databases to Russian companies that currently benefit from VAT exemption.

Current regulation

Currently, a VAT exemption is applicable upon the provision of exclusive rights to software and databases, as well as the transfer of rights to use such intellectual property (IP) rights under a license agreement. Many foreign e-service providers who license rights on software/databases benefit from this VAT exemption.

Proposed changes

Effective 1 January 2021, the mentioned VAT exemption would be available only to companies, providing exclusive rights or license rights to use with respect to software and databases included in the Unified Register of Russian software and databases (the Register), except for software or database allowing distribution of advertising on the Internet and accessing to marketplaces. To be included in the Register, software and databases, inter alia, should meet the following requirements:

1. Exclusive rights to software or databases belong to a Russian legal entity with the total share of direct and (or) indirect participation of the Russian legal entities, municipalities, Russian non-commercial entities or Russian citizens exceeding 50%.
2. Total amount of payments transferred under license or other agreements (under which the rights to the software or database are granted) to the foreign entities does not exceed 30% of revenue rights transfer per a calendar year.

Hence, effectively, application of this VAT exemption will no longer be available to non-Russian IP holders transferring rights to software or databases to Russian customers.

The draft bill remains under review by the State Duma and in order to become effective it must pass three hearings in the State Duma and be approved by the President. In the current version of the bill there is no transition period, accordingly, the legislative changes would become effective starting from 1 January 2021.

Businesses that may be affected by upcoming changes should consider taking the following preparatory steps:

1. Assess whether the company's software and databases may be included in the Unified Register of Russian software and databases for VAT purposes.
2. Review VAT clauses included in existing agreements with Russian customers in order to fix VAT obligations.
3. Review the calculation of VAT and invoicing procedures as well as reporting obligations if the company previously applied VAT exemption to its contracts.
4. Develop a strategy for the transition period and managing cashflows with the Russian customers considering new VAT rules.

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EYG no. 005005-20Gbl

1508-1600216 NY
ED None

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