

Russia: Upcoming clarification of VAT rules on e-services

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The Russian Tax Authority recently met with both tax and industry professionals to discuss the application of Value Added Tax (VAT) rules on electronic services (e-services). Following this meeting, the FTA prepared a draft position paper (the guidance) that they plan to officially issue this month. The guidance is intended to clarify certain issues regarding the obligations of foreign suppliers of e-services in Russia in light of the new VAT payment mechanism applicable to business to business (B2B) supplies as of 1 January 2019.

EY Russia attended the meeting and obtained clarification on a number of key points that were not clear with respect to interpretation.

As background, prior to the implementation of the B2B e-services rules on 1 January 2019, when nonresidents made B2B supplies of e-services into Russia, the customer was responsible for paying VAT directly to the tax authority via the withholding (tax agent) method.

The change in the VAT payment rules for e-services, effective from 1 January 2019, means that Russian customers now pay Russian VAT directly to the nonresident supplier, who is in turn obliged to VAT register in Russia and pay VAT to the tax authority via its own quarterly VAT return.

This change has given rise to certain transitional issues (such as the need for underlying contracts to be amended to reflect the new VAT payment mechanism) and uncertainties, particularly over a potential scenario in which,

despite the new rules, a Russian customer continues to pay VAT directly to the tax authorities under the old withholding method after 1 January 2019. A number of questions arise in this situation, such as:

- ▶ How does the overseas supplier report this in the VAT return? The supplier has not received VAT from the customer, but failing to remit VAT could be construed as under-declaration. However, the tax authorities have received the VAT and are not out-of-pocket, so any assessment would lead to double payment of tax.
- ▶ Can the customer recover input tax? The customer has received the supply and paid the VAT, but there is still a risk of input tax recovery being challenged on the basis that the customer paid it voluntarily instead of applying the new rules and transferring it to the supplier.

As a result of the meeting with the Russian Tax Authority, it was confirmed (first orally and then in its draft position paper) that if a service provider did not charge a customer Russian VAT, including, for example, by reason of not being VAT-registered in Russia, and the customer applied the withholding mechanism (voluntarily, since there is no obligation to do so) and reclaimed VAT, then:

- ▶ The overseas supplier would be excused from any under-declaration penalty, as VAT cannot be assessed and paid a second time. The overseas supplier could then leave that transaction out of the VAT return, but would still be obliged to submit a VAT return even if there were no transactions to declare in the tax period (a nil VAT return).
- ▶ The customer would not be required to recalculate its VAT obligations.

This clarification (which is in draft form only) confirms that the registration requirement for service providers remains in place, and has not been abolished. Furthermore, the obligation to calculate VAT due lies primarily with the service provider and the customer cannot be obliged to apply a reverse charge (and cannot be penalized for not doing so). Failure to register would trigger practical risks for a foreign supplier of e-services in Russia, since the relevant penalties are still in place.

From a practical standpoint, suppliers should discuss with their customers what evidence they are ready to provide that VAT has been remitted via the previous withholding (tax

agent) method. It is expected that obtaining such confirmation is easier in practical terms in the case of intra-group supplies, meaning that the application of the withholding method might be more feasible for companies purchasing e-services from other companies in the same group.

It is worth noting that the draft paper prepared by the tax authorities does not clarify the VAT payment mechanism applicable where a foreign supplier of e-services provides other, non-electronic, services that are subject to VAT in Russia. At the same time, we are aware that the draft of the amended VAT return for foreign suppliers of e-services requires suppliers to report supplies of both electronic and non-electronic services in the same return. Thus, there is still no specific guidance on this issue and many practical questions remain.

It is important to bear in mind that the tax authorities' position is still only in draft and is subject to change.

Given the practical issues and uncertainties surrounding the VAT treatment of e-services supplied in Russia, taxpayers should consider the taking the following action with their local tax professional:

- ▶ Analyzing whether services may be classified as e-services for Russian VAT purposes (or reviewing the conclusions of an internal classification) and determining whether they qualify for VAT exemption
- ▶ Addressing the guidance and practical recommendations regarding the need for modifications to existing contracts and internal systems to comply with the new VAT payment mechanism
- ▶ Reviewing invoices issued by suppliers of e-services to Russian customers
- ▶ Identifying and examining possible risks for the supplier where it supplies non-electronic services or goods subject to VAT in Russia
- ▶ Registering with the tax authorities in Russia for VAT purposes
- ▶ Preparing and submitting quarterly VAT returns
- ▶ Communicating with the Russian tax authorities when queries are made to the supplier, including in the course of a tax audit of VAT returns

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