

Russia's Government submits major Tax Code Amendment Bill to State Duma

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Executive summary

On 29 May 2019, the Russian Government submitted a bill proposing large-scale amendments to the Tax Code to the State Duma. According to the explanatory note, the purpose of the bill is to implement the provisions of the Presidential Address of 20 February 2019 and the Key Budget, Tax and Customs Tariff Policy Objectives for 2019 and the 2020-2021 Planning Period. The bill is currently undergoing a preliminary review by the State Duma Council.

The bill is based on the draft legislative amendments proposed by the Finance Ministry in February. Further details about the February draft may be read in a previous EY alert. The bill now being reviewed by the State Duma covers the following issues:

- ▶ More thorough regulation of the mutual agreement procedure (MAP) conducted on the basis of double taxation treaties
- ▶ Amendments relating to the determination of market prices under the transfer pricing rules where intangible assets are involved
- ▶ Changes relating to the profits tax
- ▶ Amendments concerning the payment of valued added tax (VAT) in the context of business reorganizations
- ▶ Adjustments to excise duty provisions

- Changes relating to tax administration and tax control
- Other amendments to certain provisions of the Tax Code

It is important to note that some of the changes previously proposed by the Finance Ministry are not found in the latest bill. These include:

- Procedures and considerations relating to the conduct of tax audits in the context of a MAP
- A provision clarifying the date to be considered as the transaction date when applying the comparable market prices method based on exchange prices

The key changes included in the bill are discussed below.

Detailed discussion

Mutual Agreement Procedure

The bill proposes the inclusion in the Tax Code of a new Chapter 20.3 devoted to the conduct of the MAP. The decision to initiate a MAP would be made by the Finance Ministry based on an application from the taxpayer. The period within which such an application may be made is limited to three years from the date of receipt of a tax audit report which the taxpayer believes to be at odds with a tax treaty.

The Finance Ministry must make a decision to initiate or refuse to initiate a MAP within 90 days of receiving the taxpayer's application. Should the Ministry request further information and/or documentation from the taxpayer, the period of time allowed to make the decision would be extended by the amount of time given to comply with that request.

To make a decision based on a MAP, the Finance Ministry must obtain a reasoned opinion from the Federal Tax Service. For this purpose the Ministry would forward the taxpayer's application and related documents to the Tax Service. The opinion must be prepared within three months, although this time limit may be increased if the Tax Service requests additional information and/or documents from the taxpayer.

The Finance Ministry may refuse to conduct a MAP in two cases:

- If the taxpayer is found to be acting with the express intention of avoiding or evading taxes
- If a court decision has been issued in relation to the tax audit report which the taxpayer believes to be at odds with a tax treaty

Changes to transfer pricing rules regarding the use of intangible assets

There are a number of amendments devoted to transfer pricing rules. In particular, there are proposed additions to the list of functions and risks of transacting parties that is used in comparing the conditions of transactions. The list of functions is expanded to include the development, improvement, maintenance, protection and use of intangible assets.

The bill also proposes the insertion in the Tax Code of a provision specifying the characteristics of intangible assets that should be considered in assessing the comparability of transactions. These include the type of intangible asset, its exclusivity, the extent and duration of legal protection, the geographic scope, and anticipated benefits from the use of the asset.

In addition, the bill extends the scope for applying the profit split method. Under the proposed changes, the method could be used not only when the parties to a tested transaction possess rights in an intangible asset that materially influences the level of the profit margin, but also when one of the parties controls the use of that intangible asset. This is broadly in line with the OECD approach.

Profits tax changes

The bill makes a number of amendments to Chapter 25 of the Tax Code, which deals with the profits tax. The proposed changes include the following:

- Tighter conditions for recognition of a predecessor company's losses in the context of mergers and acquisitions. Under the new rules, successor companies would only be able to reduce the tax base by losses relating to tax periods in which the companies involved in the reorganization were related on the first day of the period.
- Changes are made to the criteria for classifying a fixed asset as depreciable. One of the existing criteria, namely the requirement for the asset to have a historical cost of more than 100,000 rubles, is removed from clause 1 of Article 257 of the Code. The only criterion that would remain in place under the bill is the requirement for the asset concerned to be used over a prolonged period, i.e., more than 12 months.
- Under the bill, results of intellectual activity and other items of intellectual property with a useful life of over 12 months and a historical cost exceeding 100,000 rubles would be classed as amortizable assets.

- ▶ The bill proposes stricter conditions for changing the depreciation method. Currently, taxpayers are allowed to switch from the non-linear to the linear method no more than once every five years. Under the proposed changes, that restriction would be extended to cover the reverse situation, i.e., changing from linear to non-linear depreciation.
- ▶ The list of non-tax-deductible expenses would be amended to include amounts of depreciation on fixed assets that a taxpayer transfers for use free of charge, except where such transfer is required by law.

VAT in the case of reorganizations

The bill proposes amendments to Chapter 21 of the Tax Code aimed at preventing abuses and introducing clarity in situations where, following a reorganization, a taxpayer transfers goods, work and services to a successor company which in turn adopts a special tax regime such as the simplified taxation system or the unified tax on imputed income. In this situation, VAT reclaimed on those purchases by the reorganized company would have to be returned by the successor company in the quarter in which it begins applying the simplified taxation system or unified tax.

VAT would likewise have to be paid back in situations where a taxpayer (including a successor company) applies the unified tax on imputed income only in relation to some activities. This would have to be done in the quarter in which goods, work, services or property rights began to be used in activities in relation to which the taxpayer applies the unified tax.

Excise duty amendments

Definitions of electronic nicotine delivery systems and liquid for electronic nicotine delivery systems are provided for excise duty purposes.

Changes relating to tax administration and control

The bill makes changes to the current system of taxpayer administration and tax control, including the following:

- ▶ Amounts of overpaid taxes that could be refunded without regard to their classification as federal, regional or local taxes. The restriction would be lifted from 1 January 2022. This means that overpaid tax would be refundable if no arrears are owed on any kinds of taxes.
- ▶ The bill clarifies the point at which an obligation to pay tax is deemed fulfilled if a tax audit shows that a tax agent has unlawfully failed to withhold tax. It is defined as the moment when the tax agent presents a tax order to a bank for the remittance of tax to the budget.
- ▶ The bill establishes the procedure for the tax registration of foreign banks where a correspondent account is opened for them with a Russian bank.

Other changes to the Tax Code

Other changes envisaged in the bill include the following:

- ▶ Amendments are made to the rules regarding regional investment projects. In particular, the bill provides definitions of the terms “unified manufacturing process” and “investment project,” thereby clarifying the requirements for participants in regional investment projects.
- ▶ State land supervision and municipal land control authorities will be obliged to inform the tax authorities of any inappropriate use of lands designated for agricultural use. Land tax rates would increase for taxpayers found guilty of inappropriate use.

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