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Significant Changes Introduced to the Russian Tax Code

Even though the worldwide sharp economic downturn seems to be drawing to a close, Russian legislators continue to adopt “anti-crisis” measures, especially in the area of tax legislation. In this context, on 27 July 2010, Russia’s President signed the Federal Law “*On the modifications to part I and part II of the Russian Tax Code and other legislative acts of the Russian Federation, as well as on recognition of certain legislative acts of the Russian Federation as ceased in force in relation to settlement of arrears in taxes, duties, fines and penalties and certain other questions of tax management*” No. 229-FZ (the “**Law**”).

The Law, with most of its provisions set to enter into force one month after the day of its official publication¹, is mainly aimed at reviving the provisions of the Russian Tax Code (part I dated 31 July 1998, No. 146-FZ, part II, dated 5 August 2000, No. 117-FZ) (the “**Tax Code**”) concerning the ability to arrange a tax rescheduling. In principle, these rules, which are currently inoperative, are most relevant in times of crisis. For this reason, some commentators say that this Law, adopted in the first reading last year, is rather belated. However, it is noteworthy that the Law is complex and, besides changing the terms for tax payment, concerns several other important areas of tax legislation.

We devote the present Tax Outlook to four areas of the modifications that are believed to be the main focus of the Law. We consider it crucial for clients to pay attention to these amendments in order to optimise costs, modify tax policy, plan further investments and in concluding contracts with partners.

New limits for deductibility of interest on loans

According to Russian tax legislation, certain expenses incurred by companies are subject to limitations in tax deductibility for corporate profits tax purposes. One such limitation relates to interest on loans and other borrowings charged at a rate which is more than 20% above the average rate charged for comparable loans made in the same quarter. Thus, according to the **general rules currently in force**, in the absence of comparable data or at the taxpayer’s choice, the maximum rate of interest on a loan is:

- for rouble loans, the refinancing rate of the Russian Central Bank (as of 1 June 2010, 7.75%) at the date the loan is advanced, multiplied by 1.1; and
- for foreign currency loans, 15%.

However, it is important to note that during the period from 1 January 2010 to 30 June 2010, for interest expense on debt obligations arising before 1 November 2009, the applicable rates were: a maximum of the refinancing rate of the Russian Central Bank multiplied by 2 for rouble loans and a maximum of 15% for foreign currency loans. These rules were treated as “anti-crisis” rules, and for this reason had a provisional character.

The Law introduces **new provisional rules** stipulating that:

- for the period **from 1 January 2010 to 31 December 2010**, the deductibility limit for rouble loans is **1.8** of the refinancing rate of the Russian Central Bank (i.e. **13.95%** given the current refinancing rate), and **15%** for loans in foreign currency. These new rules have a **retroactive effect**. Please also note that the provisional rules for debt obligations arising before 1 November 2009 (as discussed above) are still in force;
- for the period **from 1 January 2011 to 31 December 2012**, the deductibility limit for rouble loans will still amount to **1.8** of the refinancing rate, and the limit for foreign currency loans will be equal to **0.8** of the refinancing rate only. This means that given the current refinancing rate, the deductibility limit on

¹ The Law’s official publication must be completed prior to 3 August 2010.

foreign currency loans interest will amount to **6.2%**, which will obviously significantly decrease the interest of companies in foreign currency loans.

These changes in interest deductibility limits (and, in particular, with respect to foreign currency loans) make it important for companies to review loan policies. In particular, you may consider concluding new loan contracts in roubles (which seems to be one of the purposes of the Law) and/or to try and use comparable data (if any) for loans in foreign currency to apply a threshold higher than 6.2%. However, in the latter case, please note that it may be quite difficult to prove the comparability of conditions under which the two loans have been advanced, and numerous criteria must be taken into account in this case.

New rules for tax rescheduling

As discussed above, one of the main purposes of the Law is to revive the rules of the Tax Code relating to the possibility to change the term of tax payments.

In general, there are three possible methods of tax rescheduling in Russia: delay (*отсрочка*), deferral (*рассрочка*) and investment tax credit (*инвестиционный налоговый кредит*).

In terms of delay and deferral, the Law clarifies that these forms of rescheduling can now be granted to a person whose financial position does not allow him to pay tax in the fixed term, but where there are sufficient grounds to assume that the ability to pay tax will arise during the term of delay (or deferral), and where at least one of the following conditions is met:

- damage due to a *force majeure* event;
- non-assignment of budgetary funds;
- potential possibility of insolvency in case of non-recurrent payment of taxes;
- poor financial position of an individual, leading to the impossibility of non-recurrent payment of taxes;
- production and/or sale of goods, works and services on a seasonal basis; or
- other conditions provided for by the customs legislation are met (e.g. import of goods subject to rapid spoilage, delivery of goods under intergovernmental agreements, etc.).

The amount of the tax payable which is delayed or deferred may not exceed the sum of net assets for legal entities, and the cost of property (except for property, on which execution cannot be levied) for individuals. The Law also lists the documents needed for a tax delay (or deferral).

As for an investment tax credit (a tax rescheduling arrangement under which a company is allowed to reduce its tax payments in respect of profits tax, regional and local taxes for a certain period of time and to a certain extent with a subsequent gradual credit and accrued interests' payment), **the Law now provides for an investment tax credit in the amount of 100% (instead of the former 30%)** of the value of equipment acquired by a company and used for the purposes of energy efficiency, scientific research, experimental development, etc.

Finally, all rules on changing the term for tax payments now cover **not only taxes and duties, but also fines and penalties.**

Obviously, the new rules for tax rescheduling do not modify fundamentally the main concepts and procedures in this sphere, but do specify their conditions. This will probably allow companies in difficult financial situations to apply these mechanisms more effectively.

New rules for tax arrears write-offs by the tax authorities

In general, Russian tax legislation allows the write-off of tax arrears, fines and penalties treated as “**bad debts**”, if their collection becomes impossible. However, the wording of the Russian Tax Code was quite unclear, and to date has not really allowed tax arrears write-offs to be made successfully in practice. For example, the reasons to treat arrears as “bad debts” were formulated as “economic, social and/or legal”, which, of course, led to problems in interpretation.

The Law refers to the rules mentioned above and stipulates that the tax authorities are entitled to recognise tax arrears, penalties and fines as “bad debts” and to write them off if collection is impossible due to the following reasons:

- company liquidation;
- insolvency of an individual entrepreneur;
- death of an individual (without limitation with respect to federal and regional taxes, and with respect to local taxes – in the amount exceeding the value of the hereditary estate);
- adoption of a court decision on the expiration of the term of the tax arrear, fine or penalty collection; and
- other reasons stipulated by the Russian tax federal legislation and/or by regional or municipal legislative acts if regional or local taxes are concerned.

Moreover, the procedure of write-off was previously quite burdensome due to the fact that only the Government of the Russian Federation and regional and municipal executive authorities were entitled to write-off “bad debts” on federal, regional and local taxes, respectively. In order to simplify and expedite the procedure, **the Law has conveyed the right to write-off “bad debts” to ordinary tax inspections and customs authorities.**

Finally, please note that the Federal Tax Service and Federal Customs Service will adopt specific rules for “bad debts” write-off, as well as the lists of documents an applicant is required to file with the tax inspectorates/customs authorities for a write-off. However, the aforementioned authorities have not yet set dates to adopt these rules.

Increase in fines for tax violations

The Law stipulates significant increases in the penalties for many types of tax legislation violations, including the following:

- the minimum fine for the violation of the term for filing a tax return (applicable, for instance, to a “zero” tax return) has been increased from RUR 100 (approx. EUR 2.5²) to RUR 1,000 (approx. EUR 25);
- the fine frequently used by the tax authorities for non-submission of documents necessary for a tax audit has been increased from RUR 50 (approx. EUR 1.3) to RUR 200 (approx. EUR 5) per document;
- illegal non-communication of information to the tax authorities will now entail a fine of RUR 5,000 (approx. EUR 127.2) instead of the former RUR 1,000 (approx. EUR 25), and in case of repeated violations in the course of one year – a fine of RUR 20,000 (approx. EUR 509) instead of the former RUR 5,000 (approx. EUR 127.2);
- non-execution by a bank of the tax authority’s demand to suspend operations of a client bank account will now be subject to a fine of RUR 20,000 (approx. EUR 509), instead of the previous RUR 10,000 (approx. EUR 254).

² We have used the following exchange rate in the present Tax Outlook: EUR 1 = RUR 39.3.

- a new fine in the amount of RUR 200 (approx. EUR 5) for the violation of rules on filing a tax return in electronic form has been introduced.



If you have any questions on the matters referred to in this **RUSSIA TAX OUTLOOK**, please do not hesitate to contact Dominique Tissot, Partner, or Anastasia Prozor, Associate, or your regular contact at CMS, Russia.

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