



Doing Business in Russia

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The current economic situation shows that Chinese companies will be actively expanding their presence on the world market in the next 10 to 20 years, and one of the possible destinations is the Russian market, which is actively seeking investment. However, Chinese businesses are not yet well aware of the specifics of the Russian market.

Making decisions about foreign operations is a complex task that requires knowledge of a country's commercial and tax climate, bearing in mind that the Russian business and regulatory environment continues to develop on multiple fronts. Below is a brief overview of the Russian tax system which could be useful in the case of expanding into the Russian market.

Russian Tax System

The list of the Russian taxes regulated by the Tax Code includes the following taxes and levies:

- Federal taxes and levies: VAT, excise duty, personal income tax, corporate profits tax, mineral extraction tax, water tax, levies for the use of fauna and for the use of aquatic biological resources, state duty
- Regional taxes: assets tax, gambling tax, transport tax
- Local taxes: land tax, assets tax on individuals

Below we provide comments on the main (usually most material) taxes, including corporate profits tax, VAT, assets tax (including tax on real estate), and personal income tax. Also, we comment on potential tax incentives and treaty benefits that can be enjoyed by Chinese investors.

Corporate Profits Tax ("CPT")

CPT payers are (i) Russian companies and (ii) foreign companies that carry out activities in Russia through permanent establishments and receive income from sources in Russia. The taxable profit of Russian companies is calculated as gross taxable income earned less tax-deductible expenses incurred.

The taxable profit of a foreign company is defined as (i) income received through a permanent establishment ("PE") reduced by expenses that it incurred in relation to the PE's activities and (ii) certain types of income received from other sources in Russia.

The general corporate profits tax rate is 20 per cent. Regional authorities may reduce their component of the tax rate (which is 18 per cent of the 20 per cent) to 13.5 per cent. Income from the rental or sublease of ships and aircraft and/or means of transport and containers used in international traffic is subject to a 10 per cent tax rate.

Generally, unless specifically disallowed by the Tax Code, expenses are considered to be deductible for profits tax purposes if they are “economically justified” and supported by proper documentation. The Tax Code contains a list of tax-deductible expenses, but this list is explicitly open and is secondary to the primary business purpose criteria.

Interest income and interest expenses (which are supported by documents and economically justified) can be recognised for Russian profits tax purposes in an amount based on the actual interest rate. Dividends received by Russian companies are subject to a 13 per cent tax rate.

Tax losses may be carried forward for 10 years on a first-in, first-out basis. Tax losses may not be carried back or surrendered to related companies.

Taxpayers must submit monthly or quarterly tax returns for each reporting period and annual returns for the calendar year.

Foreign companies that receive income from sources in Russia that does not relate to the business activities through a PE are subject to profits tax in Russia at the source of payment. Russian-source income includes dividends and other similar forms of distributions from Russian companies, interest, royalty payments, income from the sale of shares in the Russian companies, gains from the sale of immovable property located in Russia, and other similar income. Russian rules on the taxation of Russia-source income are very similar to European regulation provisions.

Transfer Pricing (“TP”)

Comprehensive transfer pricing provisions, which are substantially in the line with OECD principles, apply in Russia. The Russian TP rules primarily focus on related-party transactions, but certain third-party transactions are also subject to TP control.

For the purposes of the TP Law, the main condition for two entities to be regarded as related parties is a 25 per cent ownership threshold. All cross-border transactions between related parties are subject to TP control. Domestic transactions between Russian companies are subject to TP control if their volume exceeds one billion roubles (approx. 15.5 million US dollars).

Taxpayers should submit notification about all controlled transactions annually. The tax authorities may request TP documentation proving that the transfer prices were established following the arm’s length principle.

Deoffshorisation

Starting from 1 January 2015, Russia introduced a number of rules aimed at preventing tax evasion and capital flight:

- Controlled foreign company (“CFC”) rules extending the scope of Russian tax to the profits of such companies
- The beneficial ownership concept to limit the availability of treaty benefits
- A Russian tax residence concept for foreign companies based on the place of effective management test

The practical implementation of these new rules is still in progress.

Value Added Tax (“VAT”)

The general VAT rate in Russia is 18 per cent and applies to taxable supplies, which include the majority of domestic sales of goods, works, and services as well as the transfer of property rights in the territory of Russia. Certain basic food products, children’s goods, medical products, medicines, drugs, newspapers, and magazines are subject to a reduced rate of 10 per cent.

It should be noted that presently there is no separate

registration for VAT purposes. All Russian VAT payers are subject to tax registration, which covers all taxes, including VAT. As a general rule, taxpayers file VAT returns on a quarterly basis.

Certain supplies are VAT exempt. Such exempt supplies include the provision of financial, insurance, educational, cultural, and medical services and the provision of certain medical equipment, prosthetics, and facilities for disabled persons.

Certain activities aimed at the development and modernisation of innovative products and technologies are also exempt from VAT in order to support companies engaged in innovative and R&D activities. There is no right to offset input VAT on VAT-exempt supplies.

Imported goods are subject to import VAT levied at the customs border. VAT on imports is generally collected at customs and is payable on the total value of the goods, including import duty and excise tax where applicable.

When Russian companies acquire goods, work, or services from foreign companies that are not registered for tax purposes in Russia and the place of the supply of the goods (works, services) is in Russia, the tax base is determined by the buyer of services acting as a tax agent. The tax agent should withhold VAT from the payment to the foreign company and pay it to the state. VAT withheld from payments to foreign companies is generally recoverable by the Russian buyer.

Assets Tax

Assets tax has to be paid by Russian companies and foreign companies that carry out activities in Russia through a PE or own real estate in Russia. For Russian Legal Entities (“RLEs”) and Foreign Legal Entities (“FLEs”) carrying out activities in Russia through a PE, assets tax is levied on immovable property (and movable property received by taxpayers before 1 January 2013), which is recorded as fixed assets in

their accounts maintained under Russian accounting principles. The tax base is the average annual value of assets, calculated on the basis of the net book value of the fixed assets period by period (the first three months, six months, and nine months of a year, and the calendar year).

Since 2014, the tax base may also be determined by the regional authorities as the cadastral value for the following types of immovable property (recorded in the official cadastral valuation report): administrative-business/shopping centres; non-residential premises designed or actually used for offices, retailing, public catering facilities, and consumer services; property owned by FLEs without a PE in Russia or which is not related to their activities through a PE.

The new rules of taxation based on cadastral value have been partially enacted in certain Russian regions.

The assets tax rate for movable and immovable property not taxed on the cadastral value is determined by the regional authorities but cannot exceed 2.2 per cent. As for assets taxed on the basis of their cadastral value, the tax rate is 2 per cent.

Certain assets are excluded from the tax base, in particular land plots and other natural resource sites and certain historical and cultural monuments.

Taxpayers should complete quarterly tax returns estimating the cumulative tax due for the current calendar year less the quarterly settlements already made.

Personal Income Tax

Russia currently has a flat standard 13 per cent personal income tax rate, one of the lowest personal tax rates of any non-tax-haven country in the world. Individuals who are not tax residents are taxed on their Russian-source income.

Tax Incentives for Investment in the Russian Economy: Synergy with the “One Belt, One Road” Initiative

The idea of One Belt, One Road (“OBOR”) was first raised by Chinese President Xi Jinping in 2013. OBOR runs through more than 60 “roadside” countries in Europe, Asia, and Africa and is aimed at promoting cooperation in policy coordination, facilities connectivity, unimpeded trade, financial integration, and people-to-people bonds. The collaborations in infrastructure construction, energy, cultural tourism, high-technology industries, and finance are particularly positive.

The OBOR initiative fuels China’s “going out” momentum, encourages investment in infrastructure, and strengthens China’s relations with its neighbours. Russia, with its rich natural resources and huge consumer market, looks an attractive investment destination for Chinese companies.

As part of the OBOR strategy, progress is being made on several major infrastructure projects in Russia. In May 2015, President Xi Jinping visited Russia, and during his visit, the two sides issued a joint statement regarding the connection and development of the special economic zone of the Silk Road and the Eurasian Economic Union. President Xi Jinping said China would promote the facilitation of mutual investment and cooperation in capacity transition and build industrial parks and cross-border economic cooperation zones. China and Russia will enhance their interconnection in logistics, transport infrastructure, multimodal transport, and other areas, and the two countries will also strengthen their financial cooperation and achieve currency swap to promote regional economic integration. According to forecasts by the Russian Ministry of Economic Development, Chinese outbound investment in Russia will rise six-fold by 2020. With the acceleration of the implementation of

the OBOR strategy, there are reasons to foresee further developments in bilateral cooperation.

Responding to the OBOR initiative just in time, Russia has already taken steps in this direction by introducing 17 special economic zones for business. Additionally, there are plans to set up 14 advanced development zones in Russia, which are meant to drive Asian investment into the region.

The principal types of tax incentives available to investors in Russia include the following:

- Reliefs granted to residents of priority social and economic development areas (“SDAs”)
- Tax exemptions established at a federal level which are granted to companies engaged in regional investment projects in certain regions of Russia
- Exemptions granted to residents of special economic zones (“SEZs”)
- Tax reliefs granted to residents of industrial parks and technology parks
- Regional investment tax reliefs provided for in regional laws

Below, we present a brief overview of the main aspects of these special types of tax incentives.

Reliefs Granted to Residents of SDAs

Although SDAs were not specifically introduced to support OBOR, OBOR is clearly one of the main beneficiaries of the new regime that promotes business development in the region neighbouring China by way of providing a tax regime to businesses in that region that was never available in previous years.

An SDA is a part of a Russian region, including a closed administrative-territorial entity, in which a special legal regime for entrepreneurial and other activities has been established in accordance with a government decision

with a view to bringing about favourable conditions for attracting investments, promoting accelerated social and economic development, and facilitating the day-to-day activities of the population. These favourable conditions may be enjoyed by the residents of an SDA, that is, private entrepreneurs or commercial organisations which have concluded an agreement on the conduct of activities in the SDA and have been included in the register of SDA residents (subject to certain conditions being met).

During the first three years, SDAs are to be established only in regions of the Far Eastern Federal District and certain mono-industry towns with a highly complex social and economic situation. As from 1 January 2016, it is possible for SDAs to be created in closed administrative-territorial entities, and after three years, they may be created in any other regions. The first three SDAs were established in the Far Eastern Federal District at the beginning of 2015: the “Khabarovsk” SDA and the “Komsomolsk” SDA in the Khabarovsk Region and the “Nadezhdinskaya” SDA in the Primorye Region. Documents have also been submitted to the government for the creation of a further six SDAs.

Provided that certain conditions are met, the residents of an SDA may enjoy the following tax reliefs:

- The aggregate rate of profits tax may be reduced to 5 per cent in the first five years starting from the period in which the first profit is earned and to 12 per cent in the following five years. If no profit is earned in the first three years starting from the period in which the company was included in the register of SDA residents, the reduced rate will begin to apply from the fourth tax period counting from that period.
- With regard to mineral extraction tax, a special coefficient has been introduced which enables that tax to be reduced to zero until the first profit begins to be earned and for two years thereafter. During the next few years, the coefficient is increased to 1.

- For 10 years after a company acquires the status of an SDA resident, it may apply reduced rates of insurance contributions to the Pension Fund, the Social Insurance Fund, and the Compulsory Medical Insurance Fund: 6, 1.5, and 0.1 per cent, respectively. These reduced rates are available for residents which acquire that status within three years of the creation of an SDA.
- SDA residents are exempt from land tax and assets tax.
- The claim-based procedure for VAT reimbursement may be applied (only if the management company stands surety).

Even though SDAs are a relatively new type of tax incentive, they are developing rapidly and there are already practical examples of businesses enjoying the benefits of being SDA residents.

Tax Reliefs for Companies Engaged in Regional Investment Projects

In addition to the tax reliefs provided for residents of SDAs, the programme for the development of the Russian Far East has established federal-level tax reliefs for companies engaged in regional investment projects in certain regions within the Far Eastern and Siberian federal districts. The concept of a regional investment project and the reliefs available for companies engaged in such projects were introduced in the Tax Code with effect from 1 January 2014.

A regional investment project is a project whose purpose is the manufacture of goods (with certain exceptions) which meets the requirements specified by tax law. A participant in a regional investment project is entitled to tax reliefs subject to certain conditions being met.

The principal tax relief granted to such taxpayers is the right to apply a lower rate of profits tax:

For tax due to the federal budget – zero per cent for 10 tax periods starting from the period in which the first income from the execution of a regional investment project is received;

For tax due to regional budgets - no more than 10 per cent for five tax periods starting from the period in which the first income from the execution of a regional investment project is received (we should add that in the next five tax periods the rate must be not less than 10%)

Exemptions Granted to Residents of SEZs

Certain exemptions are also granted to residents of SEZs, which were created for the purpose of developing regions by attracting Russian and foreign investment in high-technology sectors, import substitution industries, shipbuilding, and tourism. There are a number of industrial production, technology development, tourism and recreation, and logistical SEZs in operation in Russia at present.

Every SEZ is vested with a special legal status which gives SEZ investors a number of tax reliefs with respect to profits tax, assets tax, land tax, and transport tax (depending on the region of Russia in which the SEZ is situated). Residents of SEZs are also granted customs reliefs and access to engineering and transport infrastructure.

Reliefs Available to Residents of Technology and Industrial Parks

Favourable investment conditions are also made available to residents of technology and industrial parks. So far, the majority of such sites have been established in Moscow and the Moscow region. In Moscow, for example, there are at present around 17 technology parks in operation, and according to public information sources, a further 30 such sites are planned by the end of 2016. New industrial parks will also be created in the

Moscow region, such as the one in Reutov.

At the same time, technology parks are also being created in other regions, such as “Khimgrad” in Kazan, “ACADEMPARK” in Novosibirsk, and the “West Siberian Innovation Centre” in Tyumen.

Residents of such sites are also granted tax reliefs. In particular, in Moscow they are permitted to reduce the aggregate profits tax rate to 15.5 per cent and the assets tax rate to zero per cent for 10 years after acquiring the status of resident of such a site. Certain assets tax and land tax reliefs are also available to the management companies of Moscow’s technology parks and industrial parks.

Regional Investment Tax Reliefs

Various regions also make regional tax reliefs available to companies which are prepared to invest in the construction of certain facilities in the territory of a region and thereby contribute to the development of the region’s economy. The tax reliefs and the conditions for applying them and the requirements imposed on investors may vary significantly from region to region. In order to obtain the reliefs prescribed by regional legislation for such investors, a taxpayer must satisfy a number of requirements, prepare certain documents, and sign an investment agreement with regional authorities.

In the Moscow region, for example, the receipt of such tax reliefs is regulated by the law “Concerning Tax Concessions in the Moscow Region”. This law enables investors to apply reduced rates for profits tax payable to the regional budget and for assets tax. The right to apply lower tax rates is generally granted to participants in investment projects in the Moscow region subject to certain conditions being met and depending on the amount invested in a project and the taxpayer’s sphere of activity.

Another example of the regional investment tax reliefs is the recent federal law on developing the federal port of Vladivostok (FPV) and the Far East Region's business potential that provides tax and legal benefits to foreign investors. Under the law, the city of Vladivostok and 15 surrounding municipalities received free port status for 70 years. The tax Benefits for FPV residents include the following:

- Free customs zone – duty and tax-free imports, duty and tax-free import and export of equipment, storage and consumption of foreign goods
- Benefits to insurance contributions to social funds will apply for a period of 10 years
- Profits tax benefits:
 - o Federal profits tax: zero per cent (standard rate is 2 per cent) for five years, beginning with the tax period in which the first profit is earned from operations in the FPV
 - o Tax payable to the regional budget is a maximum of 5 per cent (standard rate is 18 per cent) in the first five years, beginning with the period in which the first profit is earned, and a minimum of 10 per cent in the following five tax periods
 - o FPV residents qualify for tax benefits only if their income from activities carried out in accordance with the terms of agreement with the local authorities is at least 90 per cent of their total income and if they perform separate accounting for income (expenses)
- Simplified visa procedure for foreigners who enter Russia at checkpoints in the FPV and will leave the country within eight days
- Special VAT refund regime
- Legal protection – the management of a company of the FPV has the right to present and protect residents in court
- Other benefits

International Taxation Matters

Double tax treaties (“DTTs”), including those concluded by Russia and those to which the former USSR was a party, may provide relief in the form of reduced or zero rates of withholding tax. The most interesting for Chinese companies are the DTTs concluded with China and Hong Kong.

DTT with China

Russia and China have signed a new DTT, which will apply from 1 January 2017. The new treaty encourages investments between the two states and reflects developments over the last 20 years in the terms and application of bilateral DTTs, including, for example, the recognition of the need for greater information exchange between states on tax matters.

Withholding tax rates with respect to dividends, interest, and royalties will be as follows:

- Dividends may be taxed at a 5 per cent rate if the beneficial owner holds at least a 25 per cent equity interest in the distributing company and this holding amounts to at least 80,000 euros. In all other cases, taxation at source will be capped at the current level of 10 per cent.
- Interest may be taxed in the contracting state in which it arises at rate not exceeding 5 per cent (the limit is 10 per cent per the current treaty).
- Royalties may be taxed at a 6 per cent rate (10 per cent per the current treaty).

PE provisions include two notably beneficial provisions. First, the time limit beyond which a building site, construction, or installation project or the supervisory activities therewith trigger a PE is to remain 18 months.

An unusual exclusion for services is also retained, but in this case, the 18-month time limit is to be replaced with a limit of an aggregate of 183 days of activities of

a resident of a contracting state in the other contracting state in any 12-month period.

DTT with Hong Kong.

The DTT between the Russia and the Government of Hong Kong was signed in Hong Kong and is expected to be ratified by the parties in 2016.

This DTT provides that the business profits of a person of one contracting party may be taxed in the other state if the person concerned carries on business in that other state through a PE situated there. As far as activities on a building site or an installation project are concerned, it is established that such activities, including supervision, give rise to a PE if the project lasts for more than 12 months. Similar to the DTT with China, services give rise to a PE if they continue for a period or periods aggregating more than 183 days in any 12-month period.

Income from immovable property and the alienation thereof and from the alienation of company shares deriving more than 50 per cent of their value directly or indirectly from immovable property may be taxed in the country where that immovable property is situated. The profits of an enterprise of a contracting party from the operation of ships or aircraft in international traffic are taxable only in that contracting party.

Withholding tax rates with respect to dividends will be as follows:

- a) 5 per cent of the total amount of the dividends if the beneficial owner directly holds at least 15 per cent of the capital of the company paying the dividends
- b) 10 per cent of the total amount of the dividends in all other cases

Withholding tax on interest payments is set as zero per cent. The withholding tax on royalty income shall not exceed 3 per cent of the total amount of that income. **T**