

DRAFT

Amendments to the Tax Code: autumn 2023

FAO directors, financial directors, chief accountants and tax managers.

Pepeliaev Group advises of a number of amendments to the Russian Tax Code (the 'Tax Code'), which have been introduced by a law adopted in autumn 2023.¹ The majority of the amendments will apply starting from the new year of 2024, while some will come into effect later.

I. Tax restrictions in relation to transfer pricing (TP)

Significant amendments have been made in those provisions of the Tax Code which restrict transfer pricing (TP) for taxation purposes. These provisions have been in place since 2012. However, they have not been used in practice as much as expected when they were introduced. In the new landscape, the legislature has assumed that more stringent measures are required to protect the country's tax base against erosion for the benefit of foreign jurisdictions.

1. Some amendments are aimed at broadening the sources of information that are used as an objective benchmark of transaction prices.

According to the rules that apply today, if an audit has revealed transactions of a taxpayer which were consummated with independent parties on terms that are comparable with the audited transaction, then prices of such transactions must be used, and no other data is allowed. In the global practice, such sources are called internal benchmarks. According to the amendments, such benchmarks include comparable transactions with independent parties closed not only by the audited person itself but also by its related parties (for example, when the product is resold), thereby lifting the ban on using other data (article 105.6(6) of the Tax Code, here and below as amended by the Law).

An obligation is imposed on taxpayers, when they enter into transactions with foreign related parties and when the subject matter of such transactions is items of global on-exchange trade, to obtain information regarding the previous purchase or

¹ Federal Law No. 539-FZ dated 27 November 2023 (the "Law")

subsequent sale of products, i.e. the value chain (article 105.16(3)(7) and 105.16(8) of the Tax Code).

In this regard, the law does not draw a distinction as to whether the parties belong to the same group or they are related parties with a minority shareholding, when the required information may be unavailable to the taxpayer for objective reasons.

2. According to the new rules, transaction prices may be adjusted based on audit results by using the median value (articles 105.9(7) and 105.10(5) and other similar clauses relating to each pricing method) rather than threshold values (the minimum value for income and the maximum value for expenses) of the price intervals or the profit margin. This brings the new rules closer to article 40 of the Tax Code which was applied previously and may increase upward assessments of taxes. However, the taxpayer, when it individually adjusts prices for tax purposes before a tax audit, may still use the threshold value of the interval rather than the median value (articles 105.9(8) and 105.10(8) of the Tax Code, among others).

3. A secondary adjustment is being introduced which treats as dividends the difference in prices under a transaction with a foreign related party and a market assessment that the tax authority has performed (article 105.3(6.1) of the Tax Code). The secondary adjustment can be avoided if a foreign counterparty returns the difference to a Russian company to the latter's account with a Russian bank before the audit is scheduled. If the funds are returned after the deadline for paying the tax that was assessed on the transaction price, income in the form of interest will have to be additionally booked at 1/300 of the Bank of Russia's key rate per day (article 105.3(6.2) of the Tax Code). Taking into account the greater rate of tax, the tax on interest could have been not much less than the tax on dividends. Nevertheless, the return of funds is still a better option, as a fine for the non-payment of tax will be the amount of the tax based on the second adjustment (article 129.3(1) of the Tax Code). This is an equivalent of a twofold increase of the tax on dividends. For instance, if the tax rate is 15% and it is not reduced under an international treaty, then it may come to 30%.

Pepeliaev Group's comment

The fine under article 129.3(1) of the Tax Code will be levied on the taxpayer which for the purposes of dividends will be the recipient of same and in the case at hand it is a foreign party. It is unclear how the fine should be levied on a person that is not registered with Russian tax authorities. Perhaps new amendments will be adopted. However, any such amendments will be in effect later than the beginning of 2024 (which, nevertheless, does not give a reason

4. To mitigate tax risks in transactions involving items of the global on-exchange trade it is possible to enter into a pricing agreement with the Federal Tax Service. The taxpayer may benefit from this opportunity if it does not have the status of a

major taxpayer and the amount of relevant transactions does not exceed RUB 2 billion per calendar year (article 105.19(1) of the Tax Code).

5. The term of the pricing agreements has been specified: they apply to the current year in which the application has been made to enter into such agreement as well as two years back and/or forward (article 105.21(1) of the Tax Code).

6. Previously, the Russian Ministry of Finance (the 'Finance Ministry') extended the blacklist of jurisdictions with residents of which transactions will be treated as equal to transactions with related parties to cover hostile countries (Order No. 86n dated 5 June 2023). The Finance Ministry then clarified that the extension will apply, subject to article 5 of the Tax Code, starting only from 1 January 2024 (Letter No. 03-08-13/104225 dated 1 November 2023).

The amendments exclude from controlled transactions a transaction with a person from a country with which the international double taxation treaty has been suspended if the transaction had been consummated before 1 March 2022, its pricing terms did not change from that date and it was not a controlled transaction on the date (article 105.14(4)(11) of the Tax Code).

Nor will transactions be treated as controlled when entered into with banks and export and credit agencies of countries with which international treaties have been suspended provided that there are no other grounds for such transactions to be recognised as controlled ones (article 105.14(1)(9) of the Tax Code), or transactions with marketable bonds (articles 105.14(1)(10) and article 310(2)(8) of the Tax Code).

7. From 2024, intervals of interest on debt obligations will grow narrower as compared with the temporary intervals that have been established for 2020-2023 (article 269(1.2) of the Tax Code). The intervals will be more flexible than they would have become in 2024 owing to the rules that were adopted previously. However, the zero interest rate will be available only to Russian related parties (article 105.14(4)(7) of the Tax Code, the wording of which is not being amended). For the rest of transactions, the rate of rouble borrowings cannot be now less than 1/10 of the key rate of the Bank of Russia and greater than 1.5-times its value. The minimum rate for currency debts will be 1%.

8. The rule might appear evidently cumbersome for those international groups that continue their operations in Russia whereby payment by a Russian customer for work or services of a related foreign company is to be recognised as income from which tax at source should be withheld (article 309(1)(9.4) of Tax Code). If the legislature treats such income as equal to dividends, the tax rate will be 15%. This will affect payments to countries with which there is no international taxation treaty or where such treaty has been suspended or allows for such income to be taxed.

Pepeliaev Group's comment

The cost of work (services) may still be booked as expenses for profit tax purposes if the transaction is genuine, supported with documents, is not refuted by other circumstances and the costs are economically justified. Therefore, one cannot claim that the amendments create an irrebuttable presumption of the absence of work (services). However, if work (a service) is genuine, this concerns active rather than passive income; therefore, the new rule mostly changes the concept of tax at source being withheld.

II. Cushioning the consequences of double taxation treaties being suspended

A number of amendments mitigate the consequences of certain provisions of international double taxation treaties (DTTs) with hostile countries being suspended.

Benefits for which DTTs provide that have been suspended are being preserved for certain types of income for a certain period (until the end of 2025) through a zero tax rate and an exemption from the tax at source or reduced rates. The amendments can be applied retroactively to income which was paid starting from 8 August 2023.

To apply the relief, similarly to benefits under a DTT, a taxpayer will be required to prove tax residence and the actual receipt of income in the country with which the DTT was concluded but is suspended.

No relief will apply to transactions between related parties.

Pepeliaev Group's comment

It is not expressly stated whether the condition that a related-party relationship is absent should be met only on the date on which income is paid or also on the date on which the agreement was concluded with a foreign company. In our opinion, tax authorities may demand that the condition should be met on both dates.

1. In terms of its scope, the relief is most broad for royalties (paras 4 and 5 of article 310(2)(11) and article 310(3.1)(3-4) of the Tax Code) relating to:

- IP used by TV channels;
- copyright, related rights, patent rights and know-how.

No requirement for the date when agreement is entered into applies to such income: the relief applies also to agreements which were concluded after the DTT had been suspended.

No relief is provided in relation to such means of identification as a trademark other than when used by TV channels.

Pepeliaev Group's comment

The wording of the list of exempted items lacks general rules, similarly to international treaties, which requires a careful analysis of whether relief applies to a particular situation. For example, the Tax Code does not directly cite databases; however, by virtue of the Civil Code, databases are covered by copyright (as compiled works) and related rights and, hence, they should be exempt.

2. Relief in the field of transport will apply to income from:

- leasing out aircraft under agreements with international companies that were concluded before 5 March 2022 to the extent of the payments for which the agreement provides as at the date on which the DTT was suspended provided that such aircraft have been or must be registered with the Russian register (para 3 of article 310(2)(11) and article 310(3.1)(2) of the Tax Code);
- leasing out sea vessels under agreements concluded with foreign companies before the relevant DTT was suspended (para 9 of article 310(2)(11) of the Tax Code);
- international haulage under agreements concluded with foreign companies before the relevant DTT was suspended (para 8 of article 310(2)(11) of the Tax Code);
- the buyout of aircraft which were leased under agreements with international companies that were concluded before 5 March 2022 provided that such aircraft have been or must be registered with the Russian register (article 284(2)(3) of the Tax Code);
- the buyout of sea vessels which have been registered with the Russian Maritime Register of Shipping and are located in Russia (para 7 of article 310(2)(11) of the Tax Code).

Pepeliaev Group's comment

The restriction with aircraft by the date of 5 March 2022 can be explained by the guidelines issued by the Federal Air Transport Agency on that day whereby Russian airlines whose aircraft were registered in a foreign state suspended their flights abroad.

3. There are certain relaxations in relation to interest which is paid to a foreign bank or an export and credit agency under contracts which had been concluded before the relevant DTT was suspended (para 3 of article 310(2)(11) and article 310(3.1)(1) of the Tax Code).

According to the text of the legal provision, the relief will apply only to interest rather than other income of foreign creditors, such as fees for issuing bank guarantees, fines and default interest.

Pepeliaev Group's comment

If the terms and conditions of the agreement were amended after the DTT was suspended (on 8 August 2023 and subsequently): for instance, the interest rate is either increased or reduced, then, according to the law, the relief should be preserved. However, if construed literally a contrary approach is also possible.

The amendments do not change restrictions on payments to foreign creditors under the Russian President's Decree No. 95 dated 5 March 2022.

To confirm the tax residence of banks, it is sufficient to derive information from publicly available sources and no certificate is required to be obtained.

III. Other amendments

In addition to the above, a large number of other amendments are being introduced in the Tax Code. The following may come into common use:

- the obligation to submit a notification of the amounts of tax assessed on income of individuals and to pay the tax not once but twice a month (para 3 of article 58(9) and article 226(7) of the Tax Code, among others);
- the obligation for an intermediary to pay VAT and excise tax when goods are imported from member states of the Eurasian Economic Union which applies to goods to be entered into the books starting from 1 January 2025 (article 151(4) and para 3 of article 186(1) of the Tax Code).

What to think about and what to do

A number of amendments relating to transfer pricing increase the risks of upward assessments in transactions with related parties and with residents from hostile states. This will require the business to finetune pricing terms of the transactions and to update the compliance procedures.

The relief relating to the DTTs being suspended will be in effect until the end of 2025. To decide whether such relief can be applied will require thorough analysis. Strategic solutions that provide for an increase in the tax burden are required to be devised for future.

Intermediaries that import goods from EAEU member states may consider opening Russian branches for their foreign counterparties. However, this will also require a new model of cooperation to be analysed, including account being taken of the exchange differences which are entered into the books when payment to suppliers is deferred.

Help from your adviser

We are ready to advise you on any practical issues related to the amendments to the Tax Code that we have considered above.

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