

DRAFT

The Russian Tax Code has been amended with regard to profit tax, VAT, the simplified taxation system and property taxes

FAO CFOs, corporate tax managers, accountants and in-house lawyers

Pepeliaev Group is commenting on the provisions of a draft law¹ that concern taxes on entrepreneurial activity and property taxation and has been submitted to the State Duma by the Russian Government.

Among these provisions is an increase of general profit tax up to 25% and VAT being introduced for those who apply simplified taxation system.²

Please take into account that the draft law may undergo changes while it is being considered.

I. Profit tax

One of the most significant and much talked about amendments is an increase of the general profit tax rate from 20% to 25%. The change only concerns the rate of the tax which is to be paid to the state federal budget. Over the period from 2025 to 2030, this will grow from 3% to 8% (to be equal to 7% subsequently). The regional part of 18% has remained unchanged (17% in 2017 to 2030).

The 25% rate will also apply to:

- companies that are engaged in the production of crude hydrocarbons at an offshore greenfield;
- companies that are controlling persons, in relation to income in the form of a CFC's profits;
- income from sources in Russia of foreign companies that do not do business in Russia through a permanent establishment (except for certain types of income).

It has been nevertheless declared that the increase of the tax burden will go hand-in-hand with additional incentives being introduced for the purpose of enhancing innovative and investment activities.

1. A new investment tax deduction is being introduced at the federal level (article 286.2 of the Tax Code). This means that the amount of profit

¹ <https://sozd.duma.gov.ru/bill/639663-8>

² The draft law provides for the progressive taxation of the income of individuals and a 'tax amnesty' for taxpayers who spilt their business. You can read our alerts about the above: <https://www.pgplaw.ru/analytics-and-brochures/alerts/nalogovaya-amnistiya-pri-droblenii-biznesa/> and <https://www.pgplaw.ru/analytics-and-brochures/alerts/izmeneniya-v-nalogovyy-kodeks-rf-po-zarplatnym-nalogam/>.

tax that is due to the federal budget will be decreased by capital expenditures made within the scope of investment projects.

The conditions for this to be applied are as follows:

- the taxpayer must record in its accounting policy the decision to exercise the right to apply the tax deduction;
- the deduction in the given period may not exceed 50% of the costs that form the value of fixed and intangible assets in the aggregate;
- the amount of the tax to be paid to the federal budget following the deduction cannot be lower than 2% (3% in 2025-2030), i.e. the effective rate after the deduction will be equal to the current 20%;
- an unused deduction can be carried forward to future periods (the Government, however, will limit the period of such carry-forward);
- depreciable assets are not to be depreciated in terms of their value which has been formed out of expenses in relation to which the right to apply a deduction has been exercised;
- when a fixed asset (intangible asset) is disposed of (other than through liquidation) before the expiry of its useful life, the amount of tax which has not been paid in connection with the deduction being applied will be reinstated and paid to the public purse, together with the corresponding default interest.

No deduction can be applied by:

- 1) foreign companies who are recognised as tax residents of Russia;
- 2) companies that are parties to an investment protection and promotion agreement (IPPA);
- 3) credit institutions;
- 4) companies that produce excisable goods (exceptions apply).

The important thing is that a taxpayer may transfer the deduction to another company of the group, which helps to regulate the tax burden within the group.

Another important specific aspect of the deduction is that the law will only define its principal provisions. Meanwhile, the Government will additionally establish the categories of taxpayers, the types of fixed assets (intangible assets) and the features of a group within which a deduction can be transferred, as well as the procedure and conditions for a deduction to be applied.

Pepeliaev Group's comment

Business associations, the Government and parliamentarians are actively discussing the substance and the conditions for a deduction to be applied. We cannot rule out that the draft law will undergo changes in this respect.

2. Multiplying coefficients have been increased from 1.5 to 2 with respect to R&D expenses according to the list that the Government has approved and in relation to expenses that form the original value of fixed assets which are classed as Russian high-tech equipment as well as intangible assets in the form of exclusive rights to computer programs and databases (which have been included in relevant registers).
3. Limitations have been removed in terms of the validity periods of incentive mechanisms: investment tax deduction (at present until the end of 2027) and regional investment projects (at present until the end of 2028) will be in effect for an indefinite period of time.
4. Currently, a 0% profit tax rate applies to IT companies. However, this legal provision expires at the end of 2024. A reduced rate of 5% has been introduced for the next 3 years (2025 to 2027), with the tax being paid to the federal budget provided that the conditions for applying such reduced tax rate remain the same.

II. Property taxes

It has been proposed that the powers of constituent entities of Russia and of municipalities be expanded in terms of establishing higher property tax rates in relation to expensive property.

In particular, the rate of tax for property of individuals and companies with regard to property that costs more than RUB 300 million can be established as 2.5% (currently, the maximum tax rate is 2%).

A general tax rate of 1.5% can be established for land plots whose value exceeds RUB 300 million and to which a preferential tax rate of not higher than 0.3% previously applied.

III. The Simplified Taxation System (the 'STS')

VAT under the STS

1. Companies and individual entrepreneurs that apply the STS will be recognised, according to the general rule, as payers of VAT.
2. However, payers under the STS will be entitled to be granted an exemption from VAT if their income for the previous tax period under the STS did not exceed RUB 60 million.³

To be granted such exemption, a taxpayer should, not later than 20th day of the month starting from which the right to the exemption is exercised, submit a notification to the tax authority according to the form⁴ which will be established by the Russian Federal Tax Service.

If, during a tax period, income has surpassed RUB 60 million, the payer under the STS will lose its right to an exemption, starting from the first day of the month in which the excess came into being.⁵

³ Article 145(1) of the Tax Code

⁴ Article 145(7) of the Tax Code

⁵ Article 145(5) of the Tax Code

3. Payers under the STS that will not apply the VAT exemption will be able to choose any of the following VAT rates:⁶

- ✓ 5% if the annual income is up to RUB 250 million. If, during a tax period, income exceeds RUB 250 million, then starting from the first day of the month in which such excess came into being the right to apply the 5% rate will be lost;
- ✓ 7% if the annual income is up to RUB 450 million. If, during a tax period, income exceeds RUB 450 million, then starting from the first day of the month in which such excess came into being the right to apply the 7% rate will be lost.

To apply the above rates, an application will have to be submitted to the tax authority not later than 20th day of the month following the quarter starting from which the payer under the STS wishes to apply the relevant rate.

The limits of the VAT rates to be applied will be indexed annually by using a deflator coefficient.

The VAT rates will be applied continually for 12 tax periods (i.e. 3 years) unless the right to apply them is lost, or unless the right to apply the STS is lost.

Pepeliaev Group's comment

Although it is not evident at first sight, it follows, in our opinion, from the new wording of article 164(8) of the Tax Code that a payer under the STS may choose the rate of 7% rather than 5% irrespective of the amount of its income.

- ✓ general tax rates of 10/20%. They will apply if the taxpayer under the STS:
 - does not submit an application for an exemption, or submits the application opting for either the 5% or 7% tax rate;
 - or loses the right to apply the 5% or 7% tax rates.

4. Payers under the STS with VAT rates of 5% or 7% will not be eligible to apply VAT exemptions.⁷ Amounts of VAT that are not subject to an exemption will not be included in the cost of goods (work or services). Companies and individual entrepreneurs that apply the STS will be entitled to deduct such VAT amounts as expenses under article 346.16 of the Tax Code if 'income less expenses' constitutes a taxable item.

5. Payers under the STS that apply the general rates of the VAT will be eligible for deductions.

6. In switching to the STS, the amounts of taxes that the taxpayer deducted previously should be reinstated in the first tax period starting from which sale

⁶ Article 164(8) of the Tax Code

⁷ Articles 170(5.2) and 171 of the Tax Code

transactions will be subject to taxation by applying the rates of 5% and 7%.⁸

Pepeliaev Group's comment

The VAT-related new developments we are commenting on seem revolutionary. The total number of VAT rates is growing from three (0%, 10% and 20%) to five. For the first time, taxpayers are given the right to choose the VAT rate or elect not to pay the tax. The choice is, however, limited by income caps. On the whole, the STS ceases to be a 'simplified' taxation system and will require payers to scrutinise their actions and the relevant tax consequences.

Changes in the criteria for applying the STS

1. It has been proposed that the threshold amount of income be changed from RUB 112 million to RUB 337.5 million to switch to the STS. The threshold amount will be determined without the following income being taken into account: a positive exchange difference; subsidies; and income earned when property (property-related rights) is (are) transferred into state and/or municipal ownership free of charge.⁹

2. Limitations are being relaxed for applying the STS in terms of headcount, the book value of fixed assets and the amount of income to apply the STS:¹⁰

- the headcount: now 100, will be 130 people;
- the book value of fixed assets: now RUB 150 million, will be RUB 200 million;
- income: now RUB 200 million, will be RUB 450 million.

The book value and the threshold income will be indexed annually by using the deflator coefficient.

3. Increased/interim rates will be abolished:¹¹

- 8% for the taxation regime of 'income';
- 20% for the taxation regime of 'income less expenses'.

Only two base rates will apply starting from 2025: 6 and 15% respectively.

What to think about and what to do

The amendments that are being made to the Tax Code affect various aspects of taxpayers' business activities. The draft law provides that the amendments will come into effect in 2025.

⁸ Article 170(3)(2) of the Tax Code

⁹ Article 346.12(2) of the Tax Code

¹⁰ Sub-clauses 15 and 16 of article 346.12(3) and article 346.13(4) of the Tax Code

¹¹ Article 346.20 of the Tax Code

It is most likely that the main changes that we have dwelled upon above will be preserved in the future law. Therefore, we recommend that you examine the amendments right now to identify any unclear points or inconsistencies which pose risks for the company as well as improvements that create new opportunities to lawfully reduce the tax burden.

We specifically recommend that you pay attention to amendments relating to taxpayers who apply the STS. It is advisable that you should analyse these in conjunction with the analysis of the 'tax amnesty'.

We cannot, however, rule out the possibility that the draft law will undergo changes, at least in relation to how the federal investment deduction will be applied with regard to profit tax. Provision may also be made for a tourist tax to be introduced.

Help from your adviser

Pepeliaev Group's lawyers are well versed in advising their clients on the risks associated with changes in legislation and in protecting their clients' interests when they challenge the claims of tax authorities.

We are ready to advise you on any issues relating to the forthcoming amendments to the Tax Code.

Contact details



Sergey Sosnovsky
Partner, Head of Tax
Practice

Tel.: +7 (812) 640 60
10
s.sosnovsky@pgplaw.ru



Rustam Galiyahmetov
Senior Associate

Tel.: +7 (812) 640 60 10
r.galiyahmetov@pgplaw.ru



Nikita Kononov
Associate

Tel.: +7 (812) 640 60
10
n.kononov@pgplaw.ru