

Changes to laws on corporate profits tax and on personal income tax

Tax Flash Report

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What has changed?

A few days before the New Year holidays began, Federal Law No. 395-FZ of 28 December 2010 was passed, amending several chapters of the Russian Tax Code (the "Tax Code"). The changes will enter into force no sooner than 1 January 2011 and not earlier than one month after the law's official publication (except for several provisions for which the law stipulates other dates of entry into force, for example, on the date of the law's official publication, which is 30 December 2010).

The following changes are the most significant:

Personal income tax

- ❑ The law elaborates on the provisions governing individuals' transactions with securities.
- ❑ Income derived from the sale of shares and interests in the charter capital of Russian entities, provided certain conditions are met, are tax exempt.

Corporate profits tax

- ❑ Payers of profits tax are entitled to determine, at their own discretion, the useful life of certain types of intangible assets. This cannot, however, be less than two years.
- ❑ The law establishes the procedure for recognising income and expenses upon transfer of prepayments in a foreign currency.
- ❑ A 0% tax rate has been established for income derived from the sale of shares and interests in the charter capital of Russian entities, provided certain conditions are met.

These changes are discussed in more detail below.

Personal income tax

Securities transactions

Article 212.4 of the Tax Code has been amended to include a new paragraph, whereby the market value of quoted and unquoted securities is to be determined as of the execution of the deal date. Two new paragraphs have also been added to Article 214.1 of the Tax Code. Qualification of securities and derivatives as quoted or unquoted securities/derivatives must now take place as of the date of the securities' or derivatives' sale, including the receipt of a variable margin and a premium under the contract, unless this article states otherwise. It has been established that if no data is available on the average weighted security price in a Russian securities trading venue, including a stock exchange (a security's closing price calculated by a foreign stock exchange) as of the security sale date, the market quotation is to be the weighted average price (closing price) produced at the latest trading session held before the respective sale date, if trading in these securities was held at least once over the latest three months.

Tax relief upon the sale of shares and interests in Russian entities

The following paragraph has been added to Article 217 of the Tax Code, which lists non-taxable income items: Income from the sale/redemption of interests in the charter capital of Russian entities, and shares indicated in clause 2 of Article 284.2 of the Tax Code (this refers to unquoted shares, and quoted shares in companies of the innovative economy sector; below in the section titled Corporate profits tax we discuss the list of these shares in more detail), provided that on the date of sale/redemption of such shares/interests, they have been continuously held by the taxpayer on the basis of a right of ownership or another proprietary right for more than **five years**.

Corporate profits tax

Amortisation of intangible assets

A paragraph has been added to Article 258 of the Tax Code stating that the taxpayer is entitled to set the useful lives of certain intangible assets at his own discretion, but this cannot be less than two years. These intangible assets include:

- exclusive right of the patent owner to an invention, industrial sample or useful model
- exclusive right of the author and another right holder to use computer software or a database
- exclusive right of the author or another right holder to use topologies of integrated microcircuits

exclusive right of the patent owner to selection achievements

possession of know-how, a secret formula or a process, information on industrial, commercial or scientific experience.

This list does not include the exclusive right to a trademark, service mark, place of origin of goods or a brand name. In the past, the useful life of an intangible asset was determined on the basis of, for example, the patent term or term of use of intangible assets provided for in relevant contracts. A ten-year term was fixed with respect to any intangible assets whose useful lives were impossible to determine. Taxpayers were not allowed to set useful lives at their own discretion.

Prepayments in foreign currencies

New provisions have been added to Articles 271 and 272 of the Tax Code stating that, when a prepayment or advance payment is received/transferred in a foreign currency, income/expenses denominated in a foreign currency must be converted into Russian roubles at the official Central Bank of Russia exchange rate upon receipt/transfer of the prepayment or advance payment (the part attributable to the prepayment or advance payment). Corresponding changes have also been made to Article 316 of the Tax Code, which establishes the procedure of tax accounting for income and expenses. It should be noted that adoption of Federal Law No. 281-FZ of 25 November 2009, which amended Articles 250 and 265 of the Tax Code caused some uncertainty. According to the amendments above, advances received and paid in foreign currencies shall not be subject to revaluation for profits tax purposes (see Flash Report No. 2 of January 2010). However, corresponding amendments were not introduced in Articles 271 and 272. In such circumstances some taxpayers chose to follow the clarifications of the Russian Ministry of Finance (see Letters No. 03-03-06/1/215 of 2 April 2010, No. 03-03-05/83 of 21 April 2010, and No. 03-03-06/1/504 of 30 July 2010) in 2010. Now with the changes made to Articles 271 and 272 the uncertainty above has been eliminated.

Tax relief upon the sale of shares and interests in Russian entities

The law has been amended as concerns taxpayer investments. Article 284 has been amended and Article 284.2, "Application of 0% tax rate to the tax base determined for transactions in shares (interests in the charter capital) of Russian entities" has been added to Chapter 25 of the Tax Code. A 0% tax rate is applied to the tax base calculated on income from the sale or another disposal (including redemption) of shares in Russian entities (interests in the charter capital of Russian entities), provided that on the date of the sale or other disposal (including redemption) of such shares (interests in the charter capital), they have been continuously held by the taxpayer on the basis of a right of ownership or another proprietary right for more than five years. One of the following conditions must be met in order to apply 0% tax rate:

- 1) Shares of Russian entities are classified as unquoted securities over the entire period of the taxpayer's ownership of such shares.
- 2) Shares of Russian entities are classified as quoted securities, and the shares are those of the high-technology (innovative) sector of the economy over for the entire period of the taxpayer's ownership of such shares.
- 3) As of the date of acquisition by the taxpayer, shares in Russian entities qualify as unquoted securities and, as of the date of their sale by the same taxpayer or of another disposal (including redemption) by the same taxpayer, they are quoted securities and shares of the high-technology/innovative sector of the economy.

The law prescribes that the Russian Government shall determine the procedure for classifying quoted securities as shares of the high-technology/innovative sector of the economy.

The beneficial tax treatment shall apply only to securities and interests in charter capital acquired by taxpayers after 1 January 2011.

What do these changes mean for you?

- ❖ The introduction of personal income tax and corporate profits tax benefits with respect to the sale of shares/interests creates opportunities for making tax-effective investments in the capital of Russian organisations. To qualify for these tax benefits, the investments should not be of a speculative nature (shares or interests must have been held for more than five years). These benefits will apply to income from the sale of (a) interests in the charter capital of Russian entities, (b) unquoted shares of Russian entities, and (c) quoted shares of Russian entities that operate in the sphere of innovations. The Russian Government will determine the procedure for classifying shares of Russian organisations as shares of the high-technology/innovative sector of the economy (the timeframe is uncertain at this stage). The beneficial tax treatment will apply only to securities and interests in charter capital acquired by taxpayers starting from 1 January 2011.
- ❖ The uncertainty about accounting for income and expenses upon transfer of prepayments in foreign currencies has been eliminated. The tax treatment and accounting treatment of such operations is now similar, therefore.
- ❖ With respect to many types of intangible assets (excluding trademark rights), taxpayers can set the period of amortisation at their own discretion, but this period cannot be less than two years. These new provisions effectively allow to expense for profits tax purposes the cost of intangible assets at a quicker pace.

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