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RUSSIA

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Recent important changes in Russian domestic tax law

In recent months Russia has enacted a series of amendments to domestic tax provisions, including significant changes to its domestic transfer pricing regulations. The most important amendments are summarized below.

Amendment of the transfer pricing rules

Significant amendments to transfer pricing legislation were introduced in July 2011. They will become effective January 1, 2012.

Key points: Compared to the current Russian transfer pricing rules, the new rules appear more technically elaborate and, to a certain extent, better aligned with the international transfer pricing principles developed by the Organisation for Economic Cooperation and Development (OECD). The main changes are as follows:

- significant reduction in the list of transactions for which the Russian tax authorities may control prices for tax purposes;

- expansion of the list of related parties;

- The Russian tax authorities must prove that prices of controlled transactions do not correspond to the market;

- introduction of the arm's length principle as the fundamental principle of Russian transfer pricing rules;

- abolishment of the "safe harbor" provision (which currently allows a 20% fluctuation of controlled transaction prices from market prices);

- expansion of the sources of information list for determining market prices;

- formal introduction of a functional analysis as one of the comparability factors;

- introduction of new methods for determining market prices, i.e., transactional net margin and profit split methods;

- introduction of reporting and transfer pricing documentation requirements;

- introduction of Federal Tax Service special transfer pricing audits;

- introduction of penalties for non-compliance with reporting and transfer pricing documentation requirements. However, for the transitional period of 2012-2013, no penalties will be assessed for transfer pricing adjustments;

- introduction of unilateral and multilateral Advance Pricing Agreements (APAs) for Russian companies registered as "largest" taxpayers.

Are new rules in line with OECD transfer pricing principles?: Although, to a certain extent, the new rules are aligned with OECD guidelines, there are still many differences:

- there is a two-level hierarchy of information sources for determining the arm's length price levels;

- information from foreign company financial statements could be applied to determine arm's length profitability ranges only if the respective ranges cannot be calculated based on Russian comparable data;

- data on the market level of prices and market quotations, as well as pricing agencies' information on market prices of identical / similar goods, can be used to apply the resale minus and cost plus methods. This approach differs from the mechanism of applying the aforementioned methods under the OECD transfer pricing principles;

- current provisions on the profit split method contain inconsistencies that could create difficulties when attempting to apply this method;

- the concept of cost contribution / cost sharing arrangements is not explicitly provided in the bill although this concept is widely applied by multinational corporations. However, cost contribution / cost sharing arrangements could be introduced by a future bill;

- self-determined adjustments to decrease the taxable base are not allowed.

US and international groups with Russian subsidiaries should carefully examine the potential impact of the new measure. In particular they should analyze whether their existing global transfer pricing policies should be changed in order to comply with the new rules for 2012 and beyond.

Enforcement: New provisions are due to become effective January 1, 2012. Since changing intra-group pricing policies can be a time consuming process, taxpayers with a Russian presence may want to begin the process well before January 2012.

Capital gains tax exemption for non-residents

On June 7, 2011, the President of Russia signed the Federal Law amending the Tax Code to provide for an exemption from capital gains tax for non-resident investors on the sale of certain shares.

Previously, Russian capital gains tax applied only to gain derived by non-residents on the sale of shares of Russian real estate property companies (i.e., companies where more than 50% of the company's assets are Russian immovable property).

Based on the new regulations, gain from the sale of shares issued by Russian real estate companies should not be subject to capital gains taxation in Russia if the shares qualify as publicly listed securities, i.e., they are traded on the organized securities market. In order to be considered as traded on the organized securities market:

-   a security must be listed on at least one domestic stock exchange;

-   the security's prices or quotes must be either published in the mass media (including electronic) or by a stock exchange or its authorized entity within three years from the date of a transaction with such security; and

-   the most recent market quotation must be calculated within the last three months preceding the transaction date.

Though tax exemption for capital gains from disposals of shares in Russian companies became effective June 8, 2011 (the Law's official publication date), the new regulations apply to all transactions executed since January 1, 2011. Therefore, foreign investors that bought and sold equity shares in Russian real estate companies in 2011 should assess their options for obtaining tax refunds related to transactions under the "old" rules.

Dividends tax exemption

Beginning in 2011, Russian companies may apply a 0% profits tax rate on dividends received from their investments, provided that all of the following conditions are met:

-   the owner (recipient of dividends) owns at least 50% of the dividend payer's capital or owns depository receipts entitling it to receive at least 50% of the total amount of paid dividends;

-   the share or depository receipts have been owned for at least 365 calendar days on the day the dividends are declared;

-   the company-payer of dividends is not residing in 'offshore' zones with preferential tax regimes, the list of which is established by the Ministry of Finance.

Tax deductibility of interest paid under loan agreements in foreign currency

In years 2011-2012, interest incurred under loan agreements denominated in a foreign currency can be deducted for profits tax purposes within the threshold of the refinancing rate of the Central Bank of Russia (the rate was established as 8.25% effective May 3, 2011) multiplied by 0.8.

Research and development (R&D) expenses

The following amendments to the R&D regime were introduced on June 7, 2011:

- expenses will be recognized for tax purposes in the reporting (tax) period when the relevant R&D work (or work stage) is completed;

- special reporting is introduced for taxpayers that deduct R&D expenses using a coefficient of 1.5;

- the amendments provide a right to establish a provision for future R&D expenses

The amendments are effective on January 1, 2012.

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