LINIYA LAW FIRM PRAVA

Liniya Prava Law Firm
Business Centre «Rosso Riva», 5 floor,
4 Shluzovaya Naberezhnaya., Moscow, 115114, Russia
tel: + 7 495 937-80-00, fax: + 7 495 937-80-01
moscow@lp.ru, www.lp.ru

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RECENT UPDATES IN RUSSIAN LAW (3 QUARTER 2016)

Vadim Konyushkevich
Partner, Head of Foreign Investments practice
Liniya Prava Law Firm
Vadim.Konyushkevich@lp.ru
http://lp.ru/en/

1. ATTRACTION OF INVESTMENTS

1.1. Special Investment Contracts

Special investment contract (hereinafter – **"SpIC"**) was introduced into Russian law in June 2015, when the Federal law dated 31 December 2014 No. 488-FZ "On industrial policy in the Russian Federation" came into force. However, execution of such contracts became possible only in recent times with adoption of certain required bylaws.

SpIC constitutes a measure of governmental support aimed at stipulation of investments in establishment and modernization of industrial manufacturing in Russia at federal and regional levels.

Key difference between SpIC and other forms of governmental support lies in that the government (the Russian Federation, constituent entity and /or municipal unit) neither provides an investor with any resources, nor invests budgetary funds in the object of investments. The government provides an investor with various industrial benefits and preferences and ensures stability of business climate for implementation of project stipulated by SpIC.

Advantages of SpIC for an investor:

- favorable conditions for product manufacturing;
- customs and tax preferences;
- guarantees against adverse changes of legislation;
- public procurement benefits.

Advantages of SpIC for the government:

- support of localization of manufacturing;
- establishment of workplaces;

- development of high-technology product manufacturing.

The scope of SpIC is limited to certain industrial sectors stipulated by the decree of the Russian Government at the federal level. The list of such sectors is rather extensive and includes automotive, metallurgy, pharmaceutical, medical, electronic, consumer goods manufacturing and other industries.

Ministry of Industry and Trade of Russia (Minpromtorg) enters into a contract on behalf of the Russian Federation.

The term of SpIC is equal to the period of reaching of operating income output by the project according to the business plan, plus 5 years. However, a maximum term may not exceed 10 years.

The private partner shall invest not less than 750 mln rubles, which is subject to documentary confirmation (for example, by a loan agreement) for entering into SpIC at the federal level.

SpIC is already widely used at the regional level: more than 35 regions passed relevant legal acts stipulating terms and procedure of conclusion of regional SpIC. Thus, regions may decrease a minimum threshold of investments. For example, such minimum amount in Penzensky region is 250 mln rubles, in Ulyanovsky region – 200 mln rubles. Besides that, regions usually determine preferable industrial sectors for conclusion of SpIC taking into account their manufacturing and labor capabilities and provide for additional obligations for an investor, for example creation of certain number of workplaces.

According to the information provided by the Industry Development Fund, at the present time the SpIC providing for modernization of agricultural machinery plant in Krasnodarsky region is signed at the federal level. Moreover, some SpICs, having obtained the Commission's approval, are in the process of signing. These SpICs stipulate construction of a factory producing engines for motor vehicles in Primorsky region, a machine-tool factory in Ulyanovsky region and localization of oil-refining equipment manufacturing in Orlovsky region.

Several requests on conclusion of SpIC in automotive, machine-tool, pharmaceutical and medical industries submitted by investors from different Russian regions including Moscow region, St. Petersburg, Chelyabinsky and Kaluzhsky regions are now under consideration in Minpromtorg. According to Minpromtorg`s representatives, more than 200 potential investors expressed an interest in implementation of mechanism of SpIC in their business activity in the near future.

Relevant authorities still need to prepare a list of general and industrial benefits and preferences for investors under SpIC, which will provide for a possibility to use the benefits of this institution in full scale. Nevertheless, even now one may conclude on high potential of this form of public private cooperation.

1.2. Public Procurement Benefits for Parties to SpIC

On 1 September 2016 the Federal law stipulating benefits for parties to special investment contracts to supply goods manufactured under such SpIC on non-competitive basis as a sole supplier came into force [1]. Obtaining a sole supplier status in this case is possible under the Governmental decree (hereinafter – "**Decree**").

(1) Conditions under which investor (entity exercising production of goods at Russian territory according to SpIC) is allowed to obtain the status of sole supplier are as follows:

- investor acts as a Russia registered legal entity;
- country of origin of goods - the Russian Federation;

- investments' volume - more than 3 bn rubles (at the regional level - more than 1 bn rubles);
- SpIC stipulates the following: maximum amount of supplied goods per year - 30% from the manufactured products; in case of exceeding the above normative of supplied goods - penalty amounting 50% of the excess cost; mandatory formation and placement of the report by the manufacturer in the unified information system of public procurements.

(2) Conclusion of contract with sole SpIC supplier is subject to the following conditions:

- subject matter of the contract – the goods, manufactured under SpIC and specified in the Decree;
- the contract term may not exceed the validity period of SpIC (exception: extension for 1 year in case of fulfilment of normative (10%) of manufactured goods' export);
- maximum price of supplied goods – the value set in accordance with the procedure established by the Government of the Russian Federation.

It appears that introduction of such simplified accession to public procurements will provide certain incentives for localization of goods' manufacturing in Russia under SpIC.

Many foreign and national investors are interested in SpIC as a new form of public – private cooperation. The Ministry of Industry and Trade of the Russian Federation has already signed a SpIC with major German manufacturer of agricultural equipment. Moreover, requests for conclusion of SpICs in various industries including automotive, pharmaceutical, chemical, etc. are currently under consideration by the Ministry.

[1] Federal law dated 3 July 2016 No. 365-FZ "On amending the Federal law "On the contract system in the field of procurement of goods, works and services for ensuring the governmental and municipal needs" and certain legal acts of the Russian Federation"

2. TAX LAW

2.1. VAT Treatment of Electronic Services

On 3 July 2016 President of the Russian Federation signed the Federal law introducing amendments to the Tax Code in part of VAT treatment of electronic services provided via Internet (hereinafter – "**Law**") [1].

The place of supply of such services will be determined on the basis of a customer location. The Law states that the provision of electronic services by a non-resident company to the Russian customers shall not be considered as a permanent establishment of this foreign company in Russia.

(1) The Law determines electronic services as services provided through the Internet including:

- provision of rights to use software, databases including provision of remote access;
- provision of trading platforms;
- services related to placing proposals for the purchase of goods and services;
- data storage and processing;
- domain name services;
- provision of access to search systems;
- provision of electronic content (music, e-books, graphics, audiovisual works), including remote access to video and audio content;

(2) The Law establishes criteria of customer location for the VAT treatment purposes:

- place of residence;
- location of a bank maintaining customer`s account used for paying for services or location of electronic money operator, through which the payment is performed;
- customer's network (IP) address;
- country code of a telephone number used for purchasing or paying for services.

(3) The Law stipulates the following duties of foreign companies providing electronic services to Russian customers:

- calculating and paying VAT. This duty may also be performed by a tax agent – a Russian company acting as an intermediary involved in collecting payments from customers purchasing electronic services;
- registration with tax authorities. Application for registration shall be submitted online within 30 calendar days from the date of start of electronic services rendering.

The Law comes into force on 1 January 2017.

[1] Federal Law dated 3 July 2016 No. 244-FZ "On Amending Part I and Part II of the Tax Code of the Russian Federation"

2.2. New Initiatives on Automatic Information Exchange and Transfer Pricing Filing for International Groups

On 6 September 2016 the draft Federal Law on regulation of the International Automatic Exchange of Financial Account Information (hereinafter – "**Draft law**") was published for the public discussion [1].

The Draft law provides for two major blocks of amendments:

(1) Introduction of a separate Section VII.1 on automatic exchange to Part 1 of the Russian Tax Code

Russia has announced its intention to start automatic exchange of information from September 2018.

Section VII.1 stipulated by the Draft law will come into force on 1 January 2017. It introduces provisions on data collection by the Federal Tax Service of the Russian Federation (the FTS) for the fulfillment of international obligations.

Proposed rules refer to a number of bylaws of the FTS, the Government and the Bank of Russia, which will have to draft the appropriate lists, orders, forms, technical requirements, procedures and instructions in case of enactment of the Draft law.

Data collection and exchange will be based on the following principles:

- Financial institutions submit financial information on their clients/ beneficial owners – tax residents of foreign countries to the FTS;
- The FTS transfers acquired information to the competent authorities of foreign countries that agreed upon exchange based on tax residency criteria;
- The FTS also receives similar information from international competent authorities, which can be used during tax control (information in electronic form and paper-based records will be considered equal).

The following financial institutions will be obliged to collect financial information and submit it to the FTS:

- credit companies;
- voluntary life insurers;
- professional participants of the securities market, carrying out brokering/ asset management activity/ depositary activity;
- trustees under fiduciary management agreement;
- non-governmental pension funds;
- equity investment funds;
- managing companies of investment funds, mutual fund or non-governmental pension funds;
- clearing organizations;
- general partners of investment partnerships;
- other organizations or unincorporated structures, accepting cash or other assets to keep, manage, invest or perform transactions for the benefit of the client or at the client's expense both directly or indirectly.

Financial information includes the following data:

- information on transactions, accounts and deposits of clients;
- commitment amount of voluntary life insurer to clients or beneficiaries;
- the amount of money and the value of clients' property held by a financial institution under a brokerage services agreement or in trust;
- the value of property of clients and beneficiaries maintained by a financial institution carrying out depository activity;
- information on retirement accounts;
- undertakings of clearing organizations before their clients and beneficiaries;
- payments and transactions performed in relation to accounts and deposits, voluntary insurance agreements, property trust management agreements, brokerage and custody services agreements, pension agreements, agreements with clearing organizations and other agreements.

The exact information list will be established by the Russian Government.

Financial institutions will be entitled to request information from the client, analyze it, take measures to determine tax residency of clients, beneficiaries and persons controlling them directly or indirectly, including validation and verification of completeness of data provided by the client.

In case a client (potential client) refuses to provide the requested information, a financial institution has a right to:

- refuse to conclude a financial service contract with such person;
- decide to refuse performing transactions in interest of the client or at the direction of the designated person or to terminate an agreement with the client unilaterally.

Similar implications may arise if a financial institution in the course of verification of information provided by the client finds it incorrect or contradictory to available data.

Proposed by the Draft law liability:

- a fine of RUB 500,000 – for failure to provide information by a financial institution or violation of procedure or timelines for providing information;
- a fine of RUB 300,000 – for failure to take measures to establish tax residency of clients, beneficiaries and persons, controlling them directly or indirectly.

(2) Supplementing Section V.1 on transfer pricing by requirements on filing of country data for members of international groups

International group is recognized by the Draft law as the group of organizations and/or unincorporated structures affiliated by participation or control, if two conditions are met:

- the group embraces at least one organization (structure), which is a resident of Russia (or an international organization with a permanent establishment in Russia) or at least one organization, which is a non-resident of Russia;
- a consolidated financial statement is prepared for the group or such statement would be prepared in accordance with the requirements of stock exchanges for the purposes of listing.

Country data includes three-tire documentation:

- Global documentation for an international group (Master File), which is filed with the FTS by a parent company or a group member only in case they are tax residents of Russia;
- National documentation of a member of an international group (Local file) – provided upon the request of the FTS by a group member – tax resident of the RF;
- Country report of an international group member (Country-by-Country Report) – it is filed within 12 months since the end of financial year by a parent company or an authorized group member if they are tax residents of Russia. The Draft law also stipulates cases when an obligation to file the report shall be performed by other Russian member of a group.

The FTS will be entitled to transfer country reports to the competent authorities of foreign countries (territories) as part of the exchange of information under international treaties.

Such approach is developed in accordance with the OECD transfer pricing guidelines (Action 13 of the BEPS Action Plan).

According to the Draft Law the obligation to provide country data will apply to financial periods starting in 2017.

The Draft law also proposes to introduce an obligation to file a notification on the company's membership in an international group.

International group members whith annual consolidated revenues for a preceding financial year lower than RUB 50 bln (at the official exchange rate at the end of the financial year) will be exempt from the requirement to provide country data and notification on membership in a group.

According to the Draft Law failure to file notification on membership in an international group will be punished by a fine of RUB 50,000. Failure to file country data will be punished by a fine of RUB 100,000 in relation to each type of information.

[1] Federal Law "On amending the Part One of the Tax Code of the Russian Federation (in Connection with the International Automatic Exchange of Financial Account Information and Documentation for International Groups)"

2.3. Regulation on Controlled Foreign Companies

(1) Obligatory notification

On 1 January 2015 amendments to the Tax Code of the Russian Federation in relation to taxation of profits of controlled foreign companies (hereinafter – "**CFC**") came into force [1].

Russian residents shall file with the tax authorities the first notification on their participation in (i) any foreign company (foreign structures with no separate legal identity) and (ii) CFC in which they are controlling persons no later than 20 March 2017.

Controlling persons are individuals and legal entities - Russian tax residents owning directly or indirectly a share in CFC (jointly with their spouses and minor children - for individuals):

- in 2015: more than 50%;
- as of 2016: more than 25% or 10% (if more than 50% of the company`s capital is owned by Russian tax residents)

The share in CFC during 2015 is determined as of 31 December 2016.

Failure to provide notification on CFC participation results in a fine amounting to 100,000 RUB in relation to each CFC.

(2) Tax return

If CFC earned profit not paid to the shareholders as dividends, such profit is subject to taxation in Russia as income of a controlling person starting from 2015.

Beginning from 2017 a controlling person is required to declare such income by submitting the relevant corporate income tax return to the Russian tax authorities and pay the tax owed to the Russian budget.

For taxation purposes, CFC's financial statements and audit report complying with the specified requirements shall be prepared and translated into Russian. Moreover, it is necessary to analyze the applicability of available exemptions from taxation of CFC's income in advance.

(3) Lack of knowledge

If taxpayer being a Russian resident owns more than 10% of shares in a foreign entity, in which 50% of the company's stock capital is owned by Russian tax residents, it is considered acceptable that such person may not know about the fact that he is a controlling person of CFC.

If such person receives request from the tax authority and provides notification of CFC within the term set forth in such request), such person is exempted from the liability both for late provision of notification of CFC and non-payment of the tax. Besides, the person may provide explanations and evidences confirming that he in good faith did not know on his controlling status in the relevant year.

[1] Federal Law dated 24 November 2014 No. 376-FZ "On amending Parts 1 and 2 of the Tax Code of the Russian Federation in relation to taxation of profits of controlled foreign companies and income of foreign organizations"

2.4. Disclosure of Information on Beneficiary Owners of a Company

On 21 December 2016 the amendments to the Federal Law "On countering money laundering and the financing of terrorism" came into force [1].

As of this date the Russian companies are obliged:

- to maintain information about their beneficiary owners;
- to provide such information at the request of the federal executive bodies, including the FTS.

Beneficiary owner is an individual who directly or indirectly (through third parties) owns (holds more than 25% of shares) a legal entity or is actually entitled to control its actions.

Moreover, legal entities shall update the information on their beneficiary owners regularly, at least once a year and keep it for at least 5 years from its receipt.

[1] Federal Law dated 23 June 2016 No. 215-FZ "On amending Federal Law "On countering money laundering and the financing of terrorism" and the Code of the Russian Federation on Administrative Offences"