

A REVIEW OF TAXATION REGULATORY DOCUMENTS ADOPTED IN MARCH–APRIL 2015

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President Vladimir Putin's annual televised call-in show was held in the period under review. The Russian government economic and social blocs discussed whether to keep or revoke the compulsory funded component in the contribution to the Russian Pension Fund¹. Meanwhile, a decision was made to recover, effective 1.01.2016, the funded pension component. Presumably, Russia would apply to the World Bank for a due diligence of the Russian pension system. The Russian Finance Ministry has prepared a draft "The Main Guidelines of Tax Policy for 2016–2018", which provides for no tax increase until 2018.

The period under review was marked by Finance Ministry's evaluation of the current situation. In particular, Finance Minister, Anton Siluanov, noted that Russia in 2015 may spend no more than Rb 3 trillion or Rb 5 trillion from the Reserve Fund². The minister also said that the deficit had to be covered by cutting expenditure, as sources of budget deficit financing had been almost depleted. In other words, about 15% of all available gold and foreign exchange reserves will be spent in 2015 on budget deficit financing, while all, except social, expenditure for 2016–2017 will be revised. It is only a developing economy, according to the minister, that can be a source of budget revenues.

The Russian government intends to cope with crisis developments in the economy with the help of, first of all, large companies whose infrastructural and manufacture projects the government will finance using the resources of the National Wellbeing Fund (NWBf) as

soon as those of the Reserve Fund are depleted. Later, the resources (the funded component) of non-government pension funds (NGPFs) are planned for spending for the same purpose. Virtually, this is an attempt to restore a mobilization and centrally planned economy whereby all resources are mobilized in the federal budget and spent on a centralized basis. Indeed, an economy dominated by government involvement can rapidly concentrate and allocate substantial resources for specific purposes. However, market entities will not be willing to invest in infrastructure and manufacture if no returns are expected. This may result in another large-scale "necrosis" of government financing inside inefficient assets, while there will be no acceleration in economic development. Regrettably, the Chamber of Accounts' calculations data show that infrastructural and manufacture projects often turn into a tool that taps budget financing: budget allocations under government contracts are still transferred offshore. We already noted repeatedly that most efficient government strategy of economic development is subsidization of end consumers (individuals), although this scheme, like any subsidization, tends to lead to a certain distortion of the effective demand structure.

Following is an illustration of government inefficient (overspending) regulation of the economy. The Russian government's anti-crisis plan provides for government support of exports. Expectedly, the government began to implement this task with administrative preparation. A new entity (including personnel, budget, premises) under the auspices of Vnesheconombank (VEB) is expected to be established to spend budget appropriations for supporting exports. Yet, none of the currently existing VEB entities has been liquidated (i.e. personnel, allocated resources, developed channels of redistributing funds between units, etc. are still there). The new entity's "revenues" will be generated from payments for services (subsidized from the budget) rendered to exporters and shareholding in other "business" entities integrated into the VEB affili-

1 The Russian government economic bloc recommends to retain the compulsory funded (saved) component as compulsory source of domestic long-term investment resources of the society in the commercial area, whereas the government social bloc suggests to revoke the compulsory funded component on the ground of preventing the mounting deficit of the Russian Pension Fund (RPF).

(Author's comment: retirement dates of first retired persons entitled to funded component from NGPFs will fall on the period until 2022, and pay-as-you-go contributions to the RPF are anticipated to be further declining, because a majority of the labor force are persons born after 1967, i.e. persons whose contributions (accounting for more than 20% of compulsory contributions to the RPF) employers must pay to NGPFs. At the same time, a majority of retired persons will still receive retirement benefits directly from the RPF. The mounting (widening) gap (deficit) between pay-as-you-go contributions to and payments from the RPF within the given period will be compensated through higher budget social expenditure, i.e. it will be covered with other compulsory contributions (federal budget tax revenues), which in time of crisis may necessitate a heavier tax burden or trigger inflation processes and abnormal depreciation of the ruble, as it is being covered by simple money printing while the gold and foreign exchange reserves are depleted).

2 The Finance Ministry warns: expenses will see cuts. Available at: vz.ru/economy/2015/4/24/742022.html

ation network (in particular, the new entity is planned to hold an interest in EXIAR (Export Insurance Agency of Russia) and JSC Roseximbank).¹ As one can see, the objective of “supporting” exports has resulted in the emergence of a new, legally stand-alone consulting company whose services are virtually paid from the federal budget.

Information on a draft “The Main Guidelines of Tax Policy for 2016-2018” (at the moment, the document is not yet available in the official website of the Federal Tax Service (FTS Russia)) has emerged in the economic literature². The draft reportedly provides for an amnesty of capitals; the regions are authorized to lower tax rates using simplified and imputation tax systems; the profit tax rate will be lowered to 10% from 20% for newly established industrial enterprises; the value of depreciable assets will increase (this will allow costs on inexpensive equipment to be written off shortly after the equipment are put into operation); the right to declarative procedure for VAT rebate) for organizations having a guarantee of their parent company, etc. Tougher measures: the deducted VAT is to be recovered if no supplies received within a certain period of time; a ban imposed on formally legal schemes if they are used to avoid taxes or for illegal tax deductions.

Some of the proposed administrative measures are difficult to understand. For example, the proposal to adopt the foreign practice of preliminary tax control is challengeable. The idea behind the practice is that a company may receive in advance information from tax authorities on tax implications of a transaction (deal) to be undertaken. The introduction of this regulation in the Tax Code of Russia (TC Russia) would bind tax personnel with an obligation to audit, using budget funds, legal aspects of potential transactions, which is outside tax authorities’ terms of reference. Today one may ask tax authorities to explain their position in the event of disagreement between tax authorities and taxpayers on a certain completed transaction. Furthermore, tax authorities and the Russian Finance Ministry publish on regular basis the correspondence on most complicated issues whereby the law enforcement practice, can be unified. Tax authorities may not

authorize an audit of potential transactions unless tax authorities have been legally authorized to reclassify transactions. Neither does the Civil Code of Russia (CC Russia), nor the international treaties authorize tax authorities to do it.

Regarding the proposal to broaden the list of non-tax secret information which could be provided by the FTS Russia (on accounts, average manpower and average wages, the amount of taxes paid), such information constitutes a commercial secret. The data on the financial sustainability of a given counterparty are provided indirectly (in the form of indices) through special rating agencies, in particular, independent international rating agencies whose information can be accessed on the condition that a company provides such agencies with the data on itself and the business it is running.

Regretfully, public servants are not always ready to appreciate the rules of administrative interaction with foreign government agencies, international organizations, independent international organizations. Of most concern is contra-positioning the international law and the national law, because there are plenty of nuances here which can disrupt the developed economic environment. For instance, the Head of Investigative Committee of Russia (IC Russia), speaking of the need to introduce the prevalence of the national law over the international law³, might not realize that by taking such a decision⁴ Russia would be deemed to have disavowed its signature on the frame international treaties, i.e. Russia would simply find itself isolated from international economic relations. No wonder that the Russian President’s press secretary voiced doubts on that “someone is serious about strengthening Russia’s independence by revoking the international law prevalence recognized in the Russian Constitution⁵”. It is for the benefit of Russia to confirm its adherence to the prevalence of the international law. It is the recognition in the Russian Constitution of the international law prevalence over the national law that ensures freedom of economic activity, observance of the universal human rights and freedoms of Russian residents (organizations and nationals) staying and operating in foreign states.

1 Published in mass media: the VEB agrees on a Russian exports support scheme. Available at: msn.com/ru-ru/money/news/dated/3.04.2015. This article, in particular, mentions the establishment of JSC Russian Export Center (REC) which “will be registered as 100% VEB subsidiary before the end of April and begin its customer service on 1 June... the VEB will also purchase a secondary public offering by contributing the 100% stake in EXIAR to the REC’s chartered capital ... The agency in turn is to transfer within the year Roseximbank’s shares (EXIAR holds 99.9996%) to the REC”.

2 Visloguzov V. Taxes prescribed for “aging”. The Finance Ministry outlines fiscal plans for three years to come: kommersant.ru/doc/2707936 dated 13.04.2015.

3 “Published in mass media: The Head of the Investigative Committee suggests to revoke the international law prevalence recognized in the Russian Constitution”. Available at: tass.ru/politika/1934292 dated 27.04.2015.

4 Actual failure to observe the globally accepted practices agreed between the participants in the global market and signed by the leaders of states including the Russian Federation.

5 “Published in mass media: The Head of the Investigative Committee suggests to revoke the international law prevalence recognized in the Russian Constitution”. Available at: tass.ru/politika/1934292 dated 27.04.2015.

To cope as soon as possible with the crisis situation and maintain the viability of Russian manufacturers, the Russian government, the Russian central bank, the supreme judicial authority have taken measures aimed at, on the one hand, cutting budget expenditure in 2015, and, on the other hand, easing temporarily the burden on enterprises operating within most important industries, settling complex and/or disputable situations.

1. The Federal Law of 06.04.2015 No. 68-FZ suspends certain legal acts with regard to indexation of salaries of public employees and civil servants, servicemen and equal-status persons, salaries of judges, payments, benefits and compensations.

Suspended until 1.01.2016 will be the provisions of the federal law with regard to payments and benefits annual indexation for the inflation rate established by the Federal Budget Law for the ensuing financial year. This measure also applies to payments under the law on social protection of citizens exposed to radiation as a result of the disaster at the Chernobyl Nuclear Plant, the Production Association Mayak, and the disposal of radioactive waste in the Techa River; cash payments to Heroes of the Soviet Union, Heroes of the Russian Federation and Full Cavaliers of the Order of Glory; payments to WWII disabled veterans and veterans, combat veterans, servicemen who served during WWII in military units other than regular troops; persons who worked at air defense facilities; persons who were engaged in the construction of defense facilities, military facilities; family members of killed (deceased) disabled war veterans; salaries of assistants to Federation Council members, State Duma members; maternity benefits, one-time childbirth benefit, monthly nursing benefits; sums of compensation to disabled persons for costs on guide-dog upkeep and veterinary attendance; на monthly cash payments to disabled persons; compensation for special funeral service in accordance with the list of guaranteed burial services, etc.

The difference between the actual consumer price growth index in 2015 and the established one in 2015 according to the specified in the Federal Law size of indexation of payments, benefits and compensations is planned to be indexed effective 1 February 2016.

Consequently, the suspended 2015 indexation of social benefits and compensations will be restored in 2016 for the 2015 inflation actual index.

2. The Federal Law of 06.04.2015 No. 83-FZ eases the tax burden on commuter rail and passenger air services. In particular, a zero VAT rate was introduced on Russian carriers rendering commuter rail passenger services¹. The VAT rate is reduced to 10% on passen-

ger and cargo domestic air services (except that a zero tax rate is applied to the services where the point of departure or the point of destination is situated on the territory of the Republic of Crimea or on the territory of Sevastopol, a city of federal importance).

The allowance is to be in effect until 31 December 2017.

3. The Federal Law of 06.04.2015, No. 84-FZ eases the tax burden on taxpayers subject to the unified agricultural tax (UAT) and eligible for simplified taxation system (STS). Before the amendments were introduced, the amount of VAT specified in the invoice issued by persons not subject to VAT was paid to the budget and automatically allocated to sales income subject to UAT and STS. After the amendments, the taxable base is calculated net of VAT.

Additionally, the ban on applying STS for organizations with representative offices was lifted.

4. Due to some technical difficulties with the enactment of standards regulating procedures for notifying tax authorities of shareholding in controlled foreign company(s) (CFC), the effective dates of the specified provisions were changed under the Federal Law of 06.04.2015 No. 85-FZ. Tax authorities must be notified not later than 15 June 2015 of transactions closed before 15 March 2015 (the old version reads "not later than 1 April). Additionally, the coming into force of a common provision on notifying tax authorities of shareholding in foreign organizations has been rescheduled for 15 June – not later than within a month from the date of occurrence (change) of shareholding in a foreign company.

5. The Constitutional Court of Russia Ruling of 31 March 2015 No. 6-P explains the jurisdiction of the Supreme Court of Russia (SC Russia) regarding challenging regulatory acts federal executive power bodies, if such acts affect the claimant's rights or legitimate interests in business and economic activity of any other type. Such disputes previously used to come within the jurisdiction the Supreme Commercial Court of Russia (SCC Russia) as court of first appearance. However, due to the recent judicial reform, administrative cases challenging legal regulatory acts of federal executive power bodies, including economic disputes settlement, fall within the jurisdiction of the Supreme Court of the Russian Federation as court of first appearance.

The claimant, JSC Gazprom Neft, applied to the Constitutional Court of Russia (CC Russia) with the problem of having been denied by both the SC Russia and the SCC Russia with regard to challenging the FTS Russia's explanation on how to apply Paragraph 3,

incoming VAT, which in turn will allow for cuts of budget subsidies to incoming expenses of railway companies.

¹ Taxation at a zero rate instead of total exemption from VAT will allow railway companies to claim deduction of the amounts of

Subclause 1, Clause 1, Article 342 the TC Russia (according to the SC Russia's viewpoint, the FTS Russia's explanation lacks the regulatory act's characteristic features specified in Clause 1, Part 4, Article 2 of the Federal Constitutional Law of the SC Russia, while according to the SCC Russia's viewpoint, the FTS Russia's explanation establishes no legal regulations (rules of conduct) mandatory for public at large).

The CC Russia explained that challenging a document in court is deemed to be individual way of seeking judicial remedies to protect rights and freedoms and must be subject to administrative proceedings. The CC Russia ordered to make amendments to the legal and regulatory framework in force with regard to establishing specific features of court hearing of cases challenging acts of federal executive power bodies, including acts of the FTS Russia, clarifying the tax legislation, which technically are not regulatory legal acts, but actually have regulatory features, as they are binding on subordinate tax offices with regard to the public at large.

Cases challenging non-regulatory acts of federal executive power bodies including the FTS Russia, must be considered in the manner specified by the procedural law for challenging of laws and regulations, until proper amendments are made to the legal regulation in force.

6. The central bank letter of 2 April 2015 No. 10-MP contains methodological recommendations on paying greater attention to certain customers' operations with a view to detecting and preventing illicit schemes converting money into cash. This refers to the use of corporate customers' bank accounts for accumulating funds to be subsequently credited to the accounts at the Russian Post (a federal state unitary enterprise (RSUE)) branches and withdrawn in cash by individuals using the infrastructure of the Russian Post RSUE.

7. The Federal Service for Financial Monitoring (FSRM) in an attempt to prevent suspicious transfers of funds outside the Russian Federation issued a Information Letter of 11.04.2015 No. 43, containing recommendations on verification of customers' place of registration (residence) (counterparty, its representative or founder) while examining transactions (deals) matching the unusual transaction criteria. In particular, it is recommended to check whether the international sanctions approved by the Russian Federation in accordance with the United Nations Security Council Resolutions (UNSCRs) are in effect at the place of residence of persons in question; whether the country (territory) is listed among the countries (territories) failing to observe the recommendations of the Financial Action Task Force on Money Laundering (FATF); whether the country (territory) is listed among

the countries (territories) financing or supporting terrorism (according to the lists published on the international organizations' websites in the Internet); whether the country (territory) is listed among the countries (territories) with above-normal corruption and/or other criminal activity (according to the lists published on the international organizations' websites in the Internet); whether the country (territory) is listed among the countries (territories) known to be involved in illicit production or transit (through them) of narcotic drugs, as well as the countries or territories permitting uncontrolled distribution of narcotic drugs (except countries or territories using narcotic drugs exclusively for medical purposes).

8. The joint Letter of the Russian Finance Ministry and the Federal Treasury of 1 April 2015 No. 07-04-05/09-202 contains for information and work purposes detailed answers to the questions on implementing by the Federal Treasury Administration (FTA) decisions of tax authorities (including those concerning the procedure for deducting funds from the accounts opened with the FTA by government, autonomous and publicly-funded institutions), as well as updated forms of books for logging and recording decisions made by tax authorities.

9. The Russian Finance Ministry Letter of 25 March 2015 No. 02-02-04/16546 clarifies the procedure for discharging obligations under concluded public contracts, agreements, accords which are due in 2016 and 2017, as well as the procedure for assuming new obligations for a period beyond the effective period of budget limits. Such cases shall be subject to Clause 4–6 Article 3 of the Federal Law of 8.03.2015 No. 25-FZ "Concerning the Suspension of Certain Provisions of the Budget Code of the Russian Federation". Obligations assumed under government contracts concluded prior to 1.01.2015 and due in 2016 and 2017 shall be discharged on the condition that the said public contracts, agreements, accords have sub-agreements on the terms of execution thereof beyond 2015. The supplier (contractor), effective 2016, shall not discharge its obligations until the supplier (contractor) has received a notice from the customer of that the scope of rights to assume and/or perform obligations has been communicated (established for) to the customer, allowing the contract to be paid in a respective year, without altering the terms and conditions thereof.

In 2015, in cases of reduced limits of fiscal commitments, the customer must enter into a sub-agreement to agree on new terms of the contacts due in 2015, including prices and/or terms of contract and/or the number of goods, scope of works or services stipulated in the contract in accordance with the Method

of Reducing the Number of Goods, Scope of Works or Services approved by the Russian Government Executive Order of 28.11.2013 No. 1090.

10. The Federal Tourism Agency (Rostourism) points out that tour operators are obliged to annually (until 15 April) transfer to the indemnification fund a contribution accounting for 0.1% of the revenues (but not less than 100,000) from selling tourism products according to the data contained in year-end accounting reports. Should the contribution fails to be paid in due time and amount, the Association of Tour Operators (outbound tourism) shall expel a tour operator from the Association and notify Rostourism which shall delist the tour operator from the Unified Federal Register of Tour Operators. Normally, when it comes to non-performance or improper performance of obligations under an agreement on purchase/sale of tourism products, liability insurance contracts normally contain termination provisions if the tour operator (insurer) is delisted from the Register or expelled from the Association of Tour Operators. All of the foregoing measures are aimed at ensuring that tour operators function uninterruptedly in the market and fulfill in good faith their obligations to customers.

11. Above mentioned is the CC Russia stand with regard to federal executive power bodies' non-regulatory letters being subject to the procedure for challenging, similar to that established for regulatory documents. This is a very important stand, because non-regulatory letters contain, none the less, legally elaborated conclusions which taxpayers must know for making decisions on the performance of their tax obligations in complex situations. Failure to observe tax obligations may result in penalties and termination

of taxpayer's activities, while any subsequent challenging an explanation not accepted by the taxpayer (provided that the taxpayer has no tax arrears to the budget) will result in reimbursement and interest payment from the budget for utilizing another person's (i.e. taxpayer's) assets, provided that court finds in favor of the taxpayer.

Risks arising from disputable interpretation of the Law may be very high. The Russian Finance Ministry Letter of 31.03.2015 No. 03-08-05/17640 explains that despite Clause 1.1 Article 309 of the TC Russia¹ contains no explicit reference to the revenues specified in Subclause 5, Clause 1, Article 309 thereof, these are revenues from the sale of shares (shareholding) in all legal entities (including foreign legal entities) whose assets include more than 50% of immovable assets located on the territory of the Russian Federation, – it doesn't mean though that a Russian organization (the source of payment) must not withhold the tax from the revenues specified in Subclause 5, Clause 1, Article 309 thereof. It is expressly stated in Clause 2, Article 309 of the TC Russia that "foreign organization revenues from the sale of goods, other properties, *other than (emphasis added)* specified in Subclauses 5 and 6 Subclause 1 ..., are not subject to the withdrawal tax", i.e., conversely, the source must withhold the tax from the revenues, specified in Subclause 5, paid to the foreign seller of securities. Failure to withhold the tax may end up with the tax agent having to pay at its own expense. ●

¹ Subclause 1.1, Clause 1, Article 309: "The revenues specified in subclauses 1-4 and 6-10, Clause 1 herein shall be subject to the withholding tax".