

## THE REVIEW OF REGULATORY DOCUMENTS ON TAXATION ISSUES IN AUGUST–SEPTEMBER 2015

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*The period under review is characterized by decisions aimed at preparation of the 2016 draft budget. It is expected to stop formation of the budget for the period of 3 years and limit it to one year only<sup>1</sup>; the deficit of the federal budget is determined by the President of the Russian Federation in the amount of maximum 3% of GDP, that is, the pattern of the current budget (2015) is virtually reproduced<sup>2</sup>. The President has confirmed that a tax burden on business is not going to be increased until 2018, though he expects the exchange rate differences received by primary sector companies from sale of primary products on international markets to be partially directed to the federal budget<sup>3</sup>.*

Within the frameworks of consideration of the 2016 draft budget, fierce debates took place over the prospect of freezing the funded pillar allocations to the Pension Fund of the Russian Federation and withdrawal of a portion of the exchange rate differences from hydrocarbons suppliers to the budget<sup>4</sup>.

The rates of mandatory allocations payable by entities to state social funds were raised by the government. A portion of those (mandatory) allocations was forwarded to commercial entities – non-government pension funds (NGPF) – for formation of savings meant to be used in future for payment of a certain portion of pensions to persons who were born after 1967 with a relevant reduction of the share of pensions paid by the government. The existing imbalances between the revenues and liabilities of the Pension Fund of the Russian Federation are covered as follows: a sum including the annual compensation of the funded pillar to NGPF<sup>5</sup> is transferred on an annual basis to the Pension Fund of the Russian Federation for payment of current pensions (the inflation pressure of the funded pillar will inevitably grow till 2022, that is, the date of retirement of the first group of pensioners in respect

of whom the funded pillar was introduced<sup>6</sup>). The disadvantage of the existing scheme consists in the fact that there is a mandatory redistribution of resources of some commercial entities in favor of others and that practice is not based on commercial principles. As a result, the size of the funded pillar fund placed with NGPF grows annually, while the own resources of the Pension Fund of the Russian Federation required for payment of existing pensions shrink and the outstanding deficit is getting higher. Such a situation entails a risk of further growth in a tax burden on business.

If freezing of the funded pillar permits to stop another injection of liquidity to the financial system (through the account of NGPF and payment of pensions out of the Pension Fund of the Russian Federation<sup>7</sup>), the expected introduction of a higher tax pressure on production of hydrocarbons (withdrawal of a portion of exchange rate differences) will mean direct withdrawal of income of commercial entities which expected to spend it on repayment of loans to creditors (including those in foreign currency) and a relevant reduction of the revenue base of regional budgets. In the latter case, the problem arose due to the fact that the government was too slow at switching over to excess-profits tax (EPT). At present, such a switchover will result in losses both to the federal budget and regional budgets<sup>8</sup>.

It is believed that for maintaining the financial stability before the progressive development of the economy begins it is necessary to “freeze” the funded pillar

1 The draft law on the 2016 one-year budget was approved in the first reading, the site: [kommersant.ru/doc/2814155](http://kommersant.ru/doc/2814155) as of 18.09.2015.

2 The deficit of the Russian budget has approached trillion rubles, the site: [lenta.ru/news/2015/09/15/budget](http://lenta.ru/news/2015/09/15/budget) as of 15.09.2015.

3 Putin: additional revenues of exporters from depreciation of the ruble should be directed to the budget, site: [ria.ru/economy/20150922/1273458511.html](http://ria.ru/economy/20150922/1273458511.html) as of 22.09.2015.

4 Yu. Barsukov. The government will discuss the prospect of raising the rate of the severance tax in an effort to find a compromise between the oil industry and the budget, the site: [kommersant.ru/doc/2820006](http://kommersant.ru/doc/2820006) as of 28.09.2015.

5 The Pension Fund will receive from the budget nearly Rb 3 trillion, the site: [lenta.ru/news/2015/09/18/pfr3trln](http://lenta.ru/news/2015/09/18/pfr3trln) as of 18.09.2015 (it is to be reminded that the rate of the funded pillar amounts to 6% with the aggregate rate of allocations to state extra-budgetary funds being equal to 30.5%).

6 Unless the pension age is not increased in that period.

7 Resistance on the part of NGPF will be very high as at present there is high demand in the market on long-term funds, while all those funds which were injected by the government into NGPF in previous years were already handed out to borrowers.

8 The federal budget will fail to receive severance tax revenues – a tax which is paid on each ton of hydrocarbons produced, while regional budgets start to receive such revenues only after the accrued revenues have exceeded the accrued expenditures on a project in general.

in the Pension Fund of the Russian Federation to reduce the pressure on the budget. As regards withdrawal of a portion of the exchange rate differences, it is a controversial issue: non-payments to creditors – market entities – may trigger off a chain of bankruptcies; in addition to the above the revenue base of the regions may be reduced by the amount of the exchange rate differences to be withdrawn to the federal budget, which situation may result in a higher discontent with the financial policy of the federal authorities.

To optimize a tax burden, it is necessary to reduce fast state apparatus-related expenditures (including the number of officials). It is important to identify instances where the state machinery works inefficiently or “runs idle”. The above measure will permit to save timely resources and prevent preparation of documents whose relevance is not clear.

1. For example, by Resolution No.914 of 31 August 2014 of the Government of the Russian Federation, the Rules of Development and Approval of the Budget Forecast of the Russian Federation in the Long-Term Period were approved. The long-term budget forecast is provided for by Article 170.1 of the Budget Code of the Russian Federation. The budget forecast is developed for a 18-year period each six years. In 2015, the budget forecast will be developed for the period till 2030. The expected scheme of implementation of the above norm of the Budget Code of the Russian Federation is of some concern. The table developed probably by profile ministries and agencies and enclosed to the RF government resolution makes one suspect that the forecast is going to be based as usual on collection of the data in accordance with a standardized form from every recipient of budget funds of federal, regional and local governance, including offices of non-government social funds, public enterprises and other. Expediency of collection of the data in 2015 for the 2030 budget is quite a disputable issue: in case of optimization of the pattern of revenues and expenditures of budgets of all the levels (it is to be noted that such optimization has become long overdue), the effective value of such a “survey” for development of the forecast for 2030 is quite doubtful.

2. Formalization of the standard of development of competition in constituent entities of the Russian Federation (approved by Resolution No. 1738-r of 5 September 2015 of the Government of the Russian Federation) is not a good idea. The above standard was developed for the purpose of implementation of Section III (2) of the Plan of Measures (Road Map) – The Development of the Competition and Upgrading of the Antitrust Policy – approved by RF Government Resolution No. 2579-r of 28 December 2012. It seems that officials who prepared that standard were not

quite familiar with such issues as competition and a free market, but tried to formalize the issues of development of competition in regions. As a result, they made a regulatory document which application was rather complicated<sup>1</sup>.

Generally, only two types of entities interact on the market: the sellers and the buyers. The main objective of the state consists in protection of ownership rights of market participants, freedom of business deals and security of consumers and institutes which carry out operations on the market of goods (jobs and services). If the market expands and prices are free and formed as a result of equilibrium between the supply and demand, it means that the competition originated on its own.

The position which in our view is reasonably included in the standard is the objective to organize monitoring of situations on markets<sup>2</sup> “by means of surveying business entities, experts and consumers of goods, jobs and services by authorized bodies, national business associations and organizations which represent the interests of consumers and other”. On the basis of

1 According to the wording of the standard, “the principles of introduction of the standard are as follows: a) orientation at the consumer, that is, a top executive (a manager of the supreme state executive authorities) of the constituent entity of the Russian Federation ... and executive authorities of constituent entities of the Russian Federation and local government officials carry out measures aimed at facilitating development of competition on the basis of the existing and expected needs of consumers of goods, jobs and services, participants in economic relations and the public in general; b) interest of a top executive, that is, a top executive ensures identity of purposes and lines of activities by executive authorities of the constituent entity of the Russian Federation for effective implementation of the standard c) a system approach, that is, upgrading of performance of state executive authorities of constituent entities of the Russian Federation as regards the analysis of markets of goods, jobs and services, behavior of economic entities on the above market, identification of expectations of consumers of goods, jobs and services, planning, as well as formation of processes and systems of monitoring, evaluation, control and analysis of activities of state executive authorities of constituent entities of the Russian Federation; d) permanent upgrading of performance, that is, upgrading of satisfaction of consumers and other participants in economic activities with the quality of goods, jobs and services, ensuring of information interaction with consumers of goods, jobs and services and other interested parties, carrying out of audit and analysis of efficiency of measures aimed at facilitating the development of competition; e) transparency of activities, that is, facilitation by state executive authorities of the Russian Federation in ensuring of transparency and accessibility for consumers of goods, jobs and services and other participants in economic activities of the information on measures aimed at development of competition, procedures for rendering of services, as well as decisions which have an effect on economic competition”.

The present review does not pursue the objective to provide a detailed analysis of the above multipage document. It is given here only as an example of an administrative and bureaucratic casus.

2 Cl. 43 of the Standard.

the results of the monitoring, measures should be taken on the local level or (in case of need) information is to be sent to legislators and supervising authorities for approval of the relevant decisions which ensure the revival of the freedom of competition on the market of the Russian Federation.

3. Efforts to form new separate economic structures at the expense of state funds and with legislatively secured own sources of income and no competitors on the market (on the basis of the principle of establishment of state social extra-budgetary funds, the Deposit Insurance Agency (DIA) and other) are manifestation of the bureaucratic apparatus's inefficient work. An example of that is the information disseminated by high-ranking officials of the Ministry of Finance of the Russian Federation via the press media on approval by the Government and the Central Bank of Russia of the decision on establishment of the state reinsuring agency. It is expected that the agency will assume the risks of entities which are under sanctions and rejected by Western reinsuring institutions.

It is clear that insurers are concerned that financing of the new institution is going to be carried out by means of their mandatory deductions<sup>1</sup>. As in case with contributions to state social extra-budgetary funds or the DIA, such payments to the state reinsuring agency are a pseudo tax. Actually, the government will organize indirect financing (not through the budget) of loss-making enterprises by means of withdrawal of funds from individual groups of market participants.

4. Another bureaucratic initiative – the proposal to support the VEB and its structures by means of market participants' funds – is no less unpopular. In that case, a mandatory subscription of large exporters and banks to VEB's bonds can play the role of a pseudo tax<sup>2</sup>.

As seen from the above, instead of reduction of ineffective state expenditures the Government of the Russian Federation carries out inexplicitly the policy which obligates market entities to make higher mandatory payments, which situation is equal to an additional burden on the revenues of the business.

Out of the list of technical documents on taxation issues published in the period under review, it is important to pay attention to the following.

5. By Letter No. 03-03-10/42213 of 22 July 2015 of the Ministry of Finance of the Russian Federation and Letter No. GD-4-3/15620 of 4 September 2015

1 T. Grishina. Decision on Sanction-Related Risks Approved. The State Will Engage in Reinsuring, The site: [kommersant.ru/doc/2815828](http://kommersant.ru/doc/2815828) as of 22.09.2015.

2 E. Kiseleva, D. Ladygin, S. Demetieva and Yu. Barsukov. The VEB Will be Underpinned by the Entire Export. State-Run Companies May be Offered Bonds Issued by the VEB. The site: [kommersant.ru/doc/2816066](http://kommersant.ru/doc/2816066) as of 23.09.2015.

of the Federal Tax Service, explanations were sent as regards the issue of determination of the value of the share – received as a result of conversion of equities in restructuring of a joint-stock company into a limited liability company – in the entity's charter capital.

According to the above explanations, in conversion of equities (interests and equity units) of the restructured entity one should proceed from the value of its net assets as of the date of completion of restructuring – that evaluation of the capital of a restructured entity is a justified one. Shareholders (founders, participants) receive equities (interests and equity units) of the entity established as a result of restructuring in the amount which is equal to the size of the capital of the entity which was subjected to restructuring. In case of restructuring of several entities or as a result of restructuring several entities were established, the principle remains the same: aggregation (division) of capitals is carried out on the basis of the value of net assets of entities subjected to restructuring. According to the Ministry of Finance of the Russian Federation and the Federal Tax Service of the Russian Federation, restructuring of a joint-stock company into a limited liability company is a form of restructuring and has no specific aspects in determination of the value of the capital.

It is to be added that in our view in case of restructuring the expenses related to purchasing of equities (interests and equity units) of the entity subjected to restructuring can be taken into account as expenses in sale of equities (interests and equity units) of the entity which was established as a result of restructuring, but only to the extent which salable equities (interests and equity units) account for.

6. By Letter No.03-11-09/49191 of 26 August 2015 of the Ministry of Finance of the Russian Federation and Letter No. GD-4-3/15508 of 3 September 2015 of the Federal Tax Service of the Russian Federation, explanations are provided as regards the issue of determination of the depreciable value of capital assets received by the entity (concessionary) from the owner (concessor) on the basis of the concession agreement for carrying out statutory activities. As per Article 346.12 (3) (16) of the Tax Code of the Russian Federation, entities whose depreciable value of capital assets determined in accordance with the legislation of the Russian Federation on accounting exceeds Rb 100m are not entitled to apply the simplified taxation scheme. It is to be noted that the Ministry of Finance of the Russian Federation interprets broadly the definition "capital assets" by including in it other depreciable assets as well, in particular, the outputs of intellectual activities and other items of intellectual property used for generation of income.

According to explanations of the Ministry of Finance of the Russian Federation and the Federal Tax Service of the Russian Federation, in determination of the depreciable value of capital assets one should be guided by the provisions of Federal Law No. 115-FZ of 21 July 2005 on Concession Agreements under which the property of the owner is assigned for the term of the agreement to the concessionary. The property and other items assigned by the concessor to the concessionary under the concession agreement are shown on the balance of the concessionary separately from its property. In respect of such property and items, due to its obligations under the concession agreement the concessionary keeps a separate accounting of that property and items with depreciation accrued.

Consequently, limitations set for the simplified taxation scheme should be applied to the property received by the concessionary from the concessor under the concession agreement and accounted for separately from the concessionary's other property.

7. In September 2015, the information letter of the Federal Tax Service of the Russian Federation was published. In the above letter, it is reminded that according to Federal Law No. 140-FZ of 08 June 2015 (the so-called Law on Amnesty of Capital), voluntary declaration by individuals of assets (including real property abroad and securities issued by foreign companies and controlled foreign companies) and accounts (deposits) with banks is in effect till 31 December 2015. The law provides for a tax secret guarantee to declarants, non-use of the data declared as evidence of infringements of law and committed

before 1 January 2015, relief from tax, administrative and criminal responsibility for unlawful actions related to purchasing (formation) of capitals and committed before 1 January 2015 and a feasibility to assign property from the nominal to the actual owner without tax consequences.

8. The Central Bank of the Russian Federation has prepared and submitted to the Ministry of Justice of the Russian Federation a number of sectorial accounting standards (hereinafter SAS) for non-credit financial institutions, including: Standard No. 490-P of 4 September 2015 (SAS on deferred tax liabilities and deferred tax assets), Standard No.487-P of 2 September 2015 (SAS on revenues, expenditures and other aggregate income of non-credit financial institutions) and Standard No.488-P of 2 September 2015 (SAS on derived financial instruments). The above documents have an effect on the accounting of tax liabilities and formation of the taxation base.

9. By Order No.133-n of 26 August 2015 of the Ministry of Finance of the Russian Federation, two international financial reporting standards (IFRS) were introduced in the Russian Federation: IFRS 9 "Financial Instruments" and IFRS 9 "Financial Instruments" (Hedge Accounting and Amendments to International Financial Reporting Standard (IFRS) 9, International Financial Reporting Standard (IFRS) 7 and International Financial Reporting Standard (IAS) 39). A switchover to IFRS is important in terms of application in the Russian Federation of generally accepted rules of evaluation of the financial situation of Russian entities for attraction of investments on international markets. ●