THE REVIEW OF RUSSIAN REGULATORY DOCUMENTS ON TAXATION ISSUES IN SEPTEMBER–OCTOBER 2015

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In the period under review, development of the 2016 draft budget was the main line of activities in the sphere of the economy. The draft budget is yet to be considered by committees and commissions of the Federal Assembly of the Russian Federation, but it is already clear that the government is not going to change radically in the near future its economic policy and reduce and/or modify the pattern of the expenditures as compared to 2015; the planned deficit of the budget will remain within the range of 3% of GDP.

The analysis of documents approved in the period under review points both to a rather slow response of bureaucracy and the fact that the Government of the Russian Federation lacks schemes which permit to regulate promptly and legally correctly liabilities as regards expenditures in case state revenues fall.

1. For example, a decision was taken to abandon temporarily preparation of the budget for the term of 3 years and switch over to budget planning for one year. The decision was implemented within the frameworks of Federal Law No.273-FZ of 30 September 2015. The government has recognized that at present it cannot forecast revenues for the period of over a year (that is, there are no sources of funding liabilities). However, the government does not give up the liabilities it has already taken.

The above Law sets the specifics of preparation and approval of draft budgets of the budget system of the Russian Federation in 2015. Provisions of the Budget Code of the Russian Federation (BC RF) as regards the draft federal budget and draft budgets of state extra-budgetary funds for a planned period have been suspended till 1 January 2016. Under the same law, the term of budget loans out of the federal budget to budgets of constituent entities of the Russian Federation was extended from 3 years to 5 years and the existing limitations on the amount of the public debt of a constituent entity of the Russian Federation (a municipal debt) were suspended till 1 January 2018[1].

However, it is to be noted that in Article 5 (2) of the above law it is particularly specified that termination of agreements (contracts) under which the beneficiary of funds in accordance with the earlier established limits of budget commitments has taken liabilities which are due to payment in 2016 and 2017 and there is a possibility of entering into (in case of existence of the resolution of the Government of the RF) agreements (contracts) justifying origination of expenditure obligations of the Russian Federation in the period exceeding the effective term of the approved limits of budget commitments should not be initiated[2].

By Letter No. 06-04-11/01/56730 of 5 October 2015 of the Ministry of Finance of the Russian Federation, explanations were provided as regards approaches to forming of regional funds of financial support of municipal entities in the context of Law No. 272-FZ of 30 September 2015. The thing is that the above Law includes references to some norms of the BC RF. Other norms which are not mentioned in the law include other limitations on the amount of subsidies provided from budgets of constituent entities to budgets of municipal entities. It concerns, for example, Article 137 and Article 138 of the BC RF under which both reduction of the values of the criteria of adjustment of financial possibilities of urban settlements (including urban districts), rural settlements and city districts and that of the values of the criteria of adjustment of the calculated fiscal capacity of municipal districts (urban districts and urban districts with intra-city

1 The following limitations set by the Budget Code of the RF on the amount of the public debt have been suspended: 1) as per Article 107 the ultimate volume of the public debt of a constituent entity of the Russian Federation (a municipal entity) should not exceed the approved total annual volume of revenues of a respective budget without taking into account the approved uncompensated receipts; 2) as per Article 130 and Article 136 of the BC RF for constituent entities with the level of subsidies out of the federal budget amounting to over 40% of revenues and municipal entities with that of over 50% of the calculated volume of subsidies provided for adjustment of fiscal capacity, the ultimate volume of the debt should not exceed 50%.

2 If counterparties refuse to fulfill the concluded agreements, they will be financially responsible for termination of such agreements. In such cases, as regards market counterparties it is not quite correct not to offer them such a way out of that situation as suits both the parties (compensation for termination of the contract, preferences in case of follow-up investments and other). If the Russian state fails to comply with the generally accepted schemes of termination of obligations by mutual consent, the Russian Federation will become a zone of higher risks for investments. If it happens, states of the place of the investor's residence may set a higher tax burden on investments in the Russian Federation which situation makes business ineffective for entrepreneurs in the Russian Federation.

division) as compared to the values of the criteria established by the law of a constituent entity of the Russian Federation on the budget of a constituent entity of the Russian Federation in the current fiscal year and planned period are inadmissible. Taking into account multiple questions from constituent entities of the Russian Federation, the Ministry of Finance of the Russian Federation had to specify in its letter that the volumes of the criteria and subsidies for 2016 and 2017 were not set below the values approved for the 2016 and 2017 planned periods in the law of a respective constituent entity of the Russian Federation on the regional budget in the 2015–2017 period.

Despite the fact that above Law No. 273-FZ of 30 September 2015 of the Russian Federation became effective, the Government of the Russian Federation carries on development of the mechanism of provision of subsidies (on a contractual basis) for some federal purpose programs and projects whose completion deadlines are beyond 2016. An example of that are Resolution No.1045 of 1 October 2015 of the Government of the Russian Federation on Setting of the Rules of Provision of Subsidies for Implementation of the State Program – *Development of the Pharmaceutical and Medical Industry* –- in the 2013–2020 Period As Regards Development and Clinical Trial of Important Domestic Pharmaceuticals (Anticancer Agents for Identification of a New Generation of Tumor Markets and Development of Products for Early Diagnostics and Treatment of Autoimmune and Neurodegenerative Diseases and Endocrine Diseases, Including Diabetes, Cardio-Vascular Diseases and Other) and Resolution No.1046 of 1 October 2015 of the Government of the Russian Federation on Organization and Clinical Trial of Domestic Implants.

According to Resolution No.1045 of the Government of the Russian Federation, subsidies are granted to Russian entities which have a license to manufacture pharmaceuticals within budget allocations provided for by the Federal Law on the Federal Budget for the respective fiscal year and planned period and the budget obligation limits approved in accordance with the adopted procedure for the Ministry of Industry and Trade of the Russian Federation.

Subsidies are allocated for compensation of incurred losses in case the start of release of pharmaceuticals took place within 3 years from the date of conclusion of the agreement on provision of subsidies, while the revenues from sale of the product within 3 years have exceeded three times over the amount of the subsidy. A medical institution has to secure a permit to carry out a clinical trial of the declared pharmaceuticals from the federal executive authorities in accordance with the adopted procedure and other. A subsidy is granted for compensation of maximum 50% of costs of the Russian entity. The maximum amount of the subsidy allocated to a Russian entity is not to exceed Rb 200m during the entire term of the agreement on provision of the subsidy.

As seen from the above, substantial amendment of the budget procedures for 2015 has required explanations as regards application of the existing rules and decisions and fulfilment of obligations taken on behalf of the government: whether they are cancelled and what procedure for implementation of them in new conditions is like. The documents discussed in this review actually point to the following position of the federal authorities: at present there is a shortage of budget funds, but the contracts which were concluded on the basis of the planned limits for 2016 and 2017 (within the frameworks of former laws on three-year budgets) should not be terminated on the initiative of government customers; subsidies are not going to be allocated from the federal budget to regional budgets in the planned period, but the criteria set by the BC RF in respect of fiscal capacity of budgets of municipal entities which is ensured at the expense of subsidies from regional budgets are to be complied with; subsidies from the federal budget on implementation of federal purpose programs in the field of import substitution of medical products and implants are envisaged by the terms of federal purpose programs and those subsidies are to be allocated later by way of compensation of costs incurred by contractors.

The scheme which is usually used by Russian officials in contracts with market entities is actually inadmissible in market conditions. Market participants are proposed to fulfil agreements concluded within state purchases frameworks at their own account. It is to be noted that officials do not even think about their responsibility for a delay in subsequent payment. Officials do not understand yet that in market conditions having entered into contracts with private companies the state like other market entities is fully responsible for a failure to fulfill those contracts and creditors may file claims to an international arbitration court with a subsequent charge imposed on the property of the Russian Federation abroad.

In a joint letter of 6 October 2015 of the Ministry of Finance of the Russian Federation (Ref. No. 02-04-04/56937) and the Ministry of Economic Development of the Russian Federation (Ref. No. 28329-ЕЕ/Д28i) specified in this review for the sake of comparison, quite a different approach to conclusion of agreements is set out. The above letter deals with the procedure for determination of a provider within the frameworks of making of capital investments at the expense of budget funds. The Ministry of Finance of the Russian Federation and

the Ministry of Economic Development of the Russian Federation explain that though the recipients of budget funds are in a position to start the procedure –- established by Federal Law No.44-FZ of 5 April 2013 on the Contractual System in the Field of Purchasing of Goods, Jobs and Services to Meet State and Municipal Needs – for determination of a provider (contractor, executing party) for entering into a contract, they should take into account the following: the norms of the above law do not provide for the right of a customer to cancel the purchasing – notification of which purchasing is placed on the official Web-site – from a sole provider (contractor, executing party). So, according to the explanations of the Ministry of Finance of the Russian Federation and the Ministry of Economic Development of the Russian Federation placement of such a notification is inadmissible prior to informing the recipient of funds from the budget of a constituent entity (local budget) of respective budget obligation limits. The Ministry of Finance of the Russian Federation and the Ministry of Economic Development of the Russian Federation advise recipients of budget funds to initiate the procedures for determination of the provider only if in the terms of purchasing it is specified that the contract may be concluded after the budget obligation limits have become known.

As can be seen from the above, officials are familiar with a situation where a ban is set on conclusion of contracts if recipients of budget funds have not been notified of budget obligation limits, while the situation where subsidies fail to be allocated in the period after conclusion of the contract due to a lack of budget revenues is not yet formalized in regulatory documents, though the consequences of untimely termination of contractual relations may happen to be more severe[1]. It is believed that the Ministry of Economic Development of the Russian Federation and financial agencies should develop a scheme of legally correct termination of mutual obligations between the state as the customer and the market counterparty as the performer, including foreign performers in case of a lack of sufficient funding for fulfillment of government contracts and/or purchases.

2. Another example of inefficient spending of public funds is preservation of cross-subsidies. By Order No.769 of 14 October 2015 of the Ministry of Economic Development of the Russian Federation, the Rules of Provision of Subsidies Out of the Federal Budget to Budgets of Constituent Entities of the Russian Federation for Liquidation of Cross-Subsidies in the Electric Power Industry Within the Frameworks of the RF State Program –- *Energy Efficiency and Development of the Power Industry* –- Approved by Resolution No.321 of 15 April 2014 of the Government of the Russian Federation were approved.

The surplus of generating entities established and connected for ensuring operation of the single national (all-Russian) network (hereinafter—recipients of funds) has resulted in the fact that tariffs on power supply turned out to be overestimated. In addition to the above, low tariffs for households are compensated by higher tariffs for legal entities (a cross-power supply scheme). Many entities – power consumers– found it cheaper to generate electricity independently for their own needs. They started to create their own power supply systems and switch off from centralized networks. As a result, the burden on budgets of constituent entities of the Russian Federation as regards both the leasing of power lines and, consequently, payment of costs included in the general system of generating entities increased, while revenues in the form of payment of tariffs set for consumer-entities fell. To ensure an uninterrupted power supply of the military-defense complex and other important facilities, including cities and settlements connected to centralized networks, a decision was taken not to close surplus capacity, but allocate subsidies from the federal budget to generating companies-recipients of funds for support of their operations.

3. The declared course to support small and mid-sized business entities as a driving force of development of the domestic market often actually results in additional costs which the above entities have to pay due to technical failures and faults made in development of regulatory documents.

1 It is believed that formalization of contractual relations in accordance with a scheme provided for by Cl.12 (1) of Resolution No.1563 of 27 December 2014 of the Government of the Russian Federation on Measures to Implement the Federal Law on the 2015 Federal Budget and the 2016-2017 Planned Period (application is explained by Letter No. 02-01-09/56265 of 1 October 2015) cannot be regarded as compatible with market relations. In accordance with the above scheme, it is admissible to allocate budget funds reduced by 50% for a respective fiscal year under the concluded contracts provided that "provisions on the terms of fulfilment of the contract in the respective fiscal year" are included in those contracts. According to Russian officials, in case of disagreement with such a scheme the counterparty may take a legal action. The problem consists in the fact that the counterparty can do that only after it has fulfilled completely its obligations and complied with all the formal procedures required for confirmation of the fact of fulfillment of those obligations. It is to be noted that those procedures are rather expensive. Unfortunately, in the Russian Federation they do not pay proper attention to the fact that the practice of making providers under the threat of lawsuits accept new conditions actually results in subsequent growth in the cost of goods (jobs and services) for such customers due to the fact that potential providers hedge the risks of being involved in litigations by charging higher prices.

The timing of introduction of a fee for indemnification of the damage caused to motorways by transport vehicles with the permitted maximum weight of over 12 tons was quite an unfortunate one for businesses as it coincided with financial problems the Russian economy encountered in the 2014–2015 period. According to the estimates presented in one of the previous reviews, that pseudo tax may amount to Rb 800bn and result in price-rises and worsening of the competitive edge of Russian goods (jobs and services) and involuntary growth in production costs. In addition to the above, introduction of that fee may result in application of "mirror" measures to Russian carriers abroad.

In introduction of the fee for passage of heavy-weight carriers, an economically unjustified shift of the tax burden to small and mid-sized business entities was allowed. In Letter No. 03-11-11/57133 of 6 October 2015 of the Ministry of Finance of the Russian Federation, the issue of application of the VAT, the profit tax and the simple scheme of taxation (SST) by payers which are small and mid-sized business entities in making of such payments is explained.

The Ministry of Finance of the Russian Federation has explained that payments for indemnification of the damage caused to federal general purpose motorways by transport vehicles with the permitted weight of over 12 tons are not related to determination of the VAT tax base, so, they are to be paid by any carrier which transports a relevant cargo. By virtue of the general nature of the formula which determines the total base of the profit tax which base allows acceptance for deduction of all the expenses related to entrepreneurial activates, those costs can be accounted for as a part of other expenses for reduction of the tax base in taxation of the profit. However, taxpayers using SST with the tax base: "revenues reduced by the value of expenditures" may deduct from the tax base only the amounts of taxes and fees paid in accordance with the legislation on taxes and charges and specified directly in relevant articles of the Tax Code of the RF (TC RF). The fee of the owner of a transport vehicle for indemnification of the damage caused to federal, general purpose motorways is not included in that list as it was introduced by a non-tax law.

It is to be noted that serious technical work is being carried out to introduce in the Russian legislation regulatory schemes and mechanisms which contribute to development of market relations.

So, the reform of the judicial system starts to yield positive results. The issues of protection of property of legal entities and individuals are examined by courts on the basis of unified approaches.

4. In the period under review, the entire series of decisions and resolutions of the Supreme Court of the RF (SC RF) which form the legal base and universal approaches to solution of the issues related to assignment of proprietary rights in complicated situations was published. The issue of the period of origination of proprietary rights is a key one for application of the tax legislation.

4.1. By Resolution No.43 of 29 September 2015 of the Plenum of the Supreme Court of the Russian Federation, the issue of application of provisions on action limitation (Article 195 and Article 200 of the Civil Code of the Russian Federation (CC RF)) was explained. The SC RF explained that if an action limitation period (including that on claims for recovery of damages) was missed by a legitimate representative of the person who did not have full legal capacity (including tutorship and guardianship authorities), the missed period may be renewed either from the day when the infringement of the right became known to the bona fide representative of that person or the person himself and the latter was capable of defending single-handedly his/her rights in court, that is, from the day of origination or recovery of full civil or procedural legal capacity of that person.

Similarly, at the request of a legal entity the beginning of the action limitation period is linked to the day when the person who had the right to act on behalf of the legal entity became aware of or was to learn about the infringement of the rights of that legal entity. It is to be noted that the liquidator cannot be that person. In other words, the court paid attention to the fact that the action limitation period starts from the day when the infringement of the rights of the legal entity became known to the holder of that right and not to the liquidation commission (the liquidator).

As per Article 106 (2) of the CC RF, the action limitation period is not to exceed 10 years from the day of infringement of the rights, except for cases provided for by Federal Law No.35-FZ of 6 March 2006 on Prevention of Terrorism.

By implication of the norm of Article 205 and Article 23 (3) of the CC RF, the action limitation period missed by a legal entity, as well as an individual entrepreneur as regards claims related to their business activities is not subject to recovery irrespective of the reasons for which it was missed. The imperative character of the above norm is aimed at establishment of clear deadlines for filing of claims by all the market participants.

4.2. By Decision No.18-KG15-128 of 8 September 2015 of the SC RF, the issue related to the procedure for recognition of assignment of the proprietary rights from one of the owners to the third party is explained. The SC RF explained that reasons for refusal to recog-

nize as invalid a transaction on assignment of the title to a portion of the joint property from the owner to the third party may be a failure by the plaintiff to claim within 3 months that the rights and obligations of the buyer in respect of the disputed property should be assigned in his/her favor.

4.3. By Decision No. 307-ES15-6545 of 25 September 2015 of the SC RF, the issue of offsetting of counterclaims between the debtor and the original creditor in case of assignment of claims under the agreement is explained. Referring to the principle of equality of participants in civil-law relations, the SC RF believes that a change of the creditor should not worsen the position of debtor. According to the explanations of the SC RF, the proposal of the debtor to offset its counterclaim to the original creditor against the claim of a new creditor is legally justified. To do that, a request is to be submitted by one of the parties.

4.4. By Decision No. 306-ES15-5083 of 25 September 2015 of the SC RF, explanations are provided in respect of quite a complicated situation where funds transferred by the buyer in accordance with the banking details specified in the contract with the provider were not credited to the provider's settlement account, but remained in the correspondent account of the bank as unclarified sums. According to the SC RF, the debtor (payer) should not be responsible for the risk related to selection by the creditor of the bank which it maintains an account with. Due to that, from the day of credit of funds to the correspondent account of the bank which the creditor has an account with it is considered that the debtor (payer) has fulfilled its obligations. The SC RF proceeded from the principle that civil-law participants acted in good faith. It was the creditor that had contractual relations with the bank and not the debtor.

4.5. By Resolution No. 45 of 13 October 2015 of the SC RF, some issues related to procedures applied in cases on insolvency (bankruptcy) of individuals were explained. Legislative regulation of recognition of individuals as bankrupt is a required condition in determination of the limits of the property liability of the individual when commercial deals are concluded.

In particular, the SC RF explains that if the debtor has the status of an individual entrepreneur, only one lawsuit on its bankruptcy can be initiated and considered. It is inadmissible to initiate and consider simultaneously two legal proceedings on bankruptcy of that person both as an individual and an individual entrepreneur.

5. In the period under review, other regulatory documents which have an effect on development of market relations and clarify technical issues of taxation were approved.

5.1. By Federal Law No.275-FZ of 5 October 2015, amendments were introduced in the Federal Law on Protection of Competition and individual statutory acts of the Russian Federation.

The notion – "*unfair competition*" – was introduced; it includes: discrediting (Article 14.1); false representation (Article 14.2); incorrect comparison (Article 14.3); mixing of the information (Article 14.6); divulging of the illegally received information which constitutes a commercial or other secret protected by the law (Article 14.7) and other. It is legislatively forbidden now to use unfair competition technics.

Also, the above law provides for establishment of collegial authorities at the Federal Antitrust Agency. Those authorities are entrusted with such duties as: consideration of disputes, taking of decisions on compliance of deals with the antitrust legislation, solution of issues whether it is admissible to carry out restructuring of commercial entities, consideration of a possibility to conclude agreements between competitor-economic entities on cooperation in the territory of the Russian Federation if according to the latest balance sheets the aggregate amount of their assets or the total revenues from sale of goods within a calendar year preceding the year of conclusion of the agreement exceeds Rb 7bn and Rb 10bn, respectively and other. The composition of collegial authorities is approved by the head of the federal antitrust authority. The procedure for operation of collegial authorities is determined by the federal antitrust authority.

The above law specifies the criteria of determination of a natural monopoly. It is established that a natural monopoly entity is recognized a person whose share of income from a natural monopoly in the total volume of income amounts to over 1%. At present, jurisdiction of deals of natural monopolies to the state supervising authorities is determined on the basis of the following two factors: the amount of the deal (spending of funds in the amount of over 10% of the own capital of the natural monopoly) and a natural monopoly entity which transacts a deal (the share of income of the natural monopoly entity from activities in the field of natural monopolies exceeds 1%).

A new article (Article 7.32.4) was introduced in the Administrative Offences Code of the Russian Federation. In the above Article, penalties are set for different violations of the procedure for mandatory auctions, sale of state and municipal property, conclusion of agreements on the basis of the results of such auctions and sales or in case such auctions were recognized as void. The minimum amount of a penalty for an official and legal entity is up to Rb 50,000 and Rb 100,000, respectively. An exception is modification by the organizers of the auction of the terms of the

agreement on sale of state and municipal property if a ban is set by the federal law on such activities. Such a violation entails a penalty of up to Rb 300,000 for a legal entity.

5.2. By Letter No. SD-4-3/17948@ of 14 October 2015 of the Federal Tax Service of the Russian Federation (FTS of Russia), explanations are provided as regards completion (in accordance with the TC-1 Form) and submission of a notification to the tax authorities on payment of the sales tax.

5.3. Examples of calculation of the sales tax and the rules of showing the sum of the tax in a tax return on the profit tax for foreign business entities are given in Letter No. GD-4-3/16910@ of 28 September 2015 of the FTS of the Russian Federation.

5.4. By Letter No. SA-4-7/16633 of 22 September 2015, referring to decisions of a number of judicial authorities the Ministry of Finance of the Russian Federation and the Federal Tax Service of the Russian Federation explained that excessive reimbursement by tax authorities of the earlier paid VAT should be qualified as arrears from the day of actual receipt by the taxpayer of funds (in case of a tax refund) or from the day of decision on the offset of the tax amount declared for reimbursement (in case of the offset of the tax amount).

It is to be noted that in determination of the arrears the Ministry of Finance of the Russian Federation and the Federal Tax Service of the Russian Federation pay attention to the need to take into account explanations of the Plenum of the Supreme Arbitration Court of the Russian Federation (SAC RF), that is, Resolution No.57 of 30 July 2013 on Some Issues Arising in Application by Arbitration Courts of Part One of the Tax Code of the Russian Federation. In Cl 20 of the Resolution of the Plenum of the SAC RF it is specified that one may be held accountable for a tax violation if actions (inaction) of the person resulted in non-payment (incomplete payment) of the tax, that is, generation of the debt on that tax. The debt is determined as of the day of expiry of the term of payment of the tax in the fiscal period for which arrears were calculated (if the taxpayer has made an excess payment of that tax and in the amount equal to the understated tax, in such a situation there is no debt).