

Lyudmila Anisimova

An Overview of Normative Documents on Taxation Issues for November-December 2012

In December 2012, a number of amendments and alterations were introduced into tax and budget legislation, as well as into legislation regulating the sphere of mandatory payments and government off-budget funds. An analysis of the possible scenarios for further development of the taxation system and the system of mandatory payments must be done with due regard for the Annual Presidential Address to the RF Federal Assembly delivered by President Vladimir Putin on 12 December 2012 and for the initiatives put forth by the RF Government and the RF Ministry of Finance.

The President Putin's Address to the RF Federal Assembly confirmed that the flat rate of personal income tax (PIT) would be preserved¹, while the RF Ministry of Finance was charged with the task to ensure that, in 2013, a tax on luxury should be introduced as a substitute for PIT's progressive scale. The RF President noted that it was intended to strengthen the financial base of Russia's regions and municipal formations. Thus, in particular, the bulk of taxes levied on small businesses (which are now operating subject to special tax regimes) will be transferred to the municipal level. Besides, many federal exemptions from taxes on property and land owned by legal entities have been abolished. These funds will also be allocated to regional and local budgets. The regions, in order to strengthen their own tax base, will be granted the right from the year 2014 onwards to switch over to immovable property taxation based on its cadastre value; it is planned that by that time the process of valuating immovable property units and verifying the information on their owners will have been completed.

Given the fact that the National Welfare Fund (NWF) has been created in an amount compatible with existing legislation, RF President suggested that the Fund's surplus receipts (Rb 100bn) should be invested in infrastructure projects through purchasing the liabilities issued by Russian investor organizations.

RF Government has recently become more active in its efforts to search for ways to overcome the currently increasing trend towards stagnation in the Russian economy. In particular, this was demonstrated by the agenda of the discussion concerning the need to fundamentally alter the RF tax system, with the abolition of VAT as an ultimate measure (the discussion was to take place on 26 December 2012). The scheme for government reserve placement has also been changed: the monies borrowed against RF debt obligations will no longer be invested in treasury bonds issued by the governments of the world's leading countries (as it was routinely done under former RF Minister of Finance Alexei Kudrin); instead, such monies will be invested in various instruments on world markets (including on the domestic market) in order to increase the yield on operations carried on within the framework of RF

¹ A flat rate ensures an automatic tax collection by deduction tax at source. Russia has already accumulated some experience of applying a progressive scale; if it is introduced once again, citizens will be obliged to submit tax declarations on an individual basis and to face the risk of sanctions being imposed on them for potential tax violations.

government debt management and create a source of 'long money' for businesses². At the same time, experts have warned the RF Government of the necessity to maintain proper macroeconomic balance, noting the current lack of coordination between the standpoints of different ministries and departments and the absence of any detailed plan for joint actions of the RF Ministry of Finance and the Bank of Russia on the financial and monetary markets³.

We share the experts community's opinion as to the necessity of a gradual abandonment of the spontaneous initiatives put forth by the RF Government in response to transient economic circumstances and, for our own part, we believe it to be necessary to more strictly correlate the current policy with the recommendations stipulated in the *Strategy 2020*.

By introducing the basic rule in the budgeting process, keeping the insurance contributions' margin at the level of 30% and abolishing some of the tax exemptions that expand the base on which insurance contributions are levied will, no doubt, serve as factors that will somewhat suppress any further growth of government expenditure. At the same time, the elimination of the mandatory funded component of the insurance contributions to the RF Pension Fund and the transfer of part of government reserves for placement on the domestic market may give rise to an illusory impression that cheap liquidity has become available, and that investments are on the rise. But the essence of the problem here is that excessive liquidity is created not by the monies owned by commercial structures and citizens, but by mandatory government reserves that have been poured onto the market. If the investments funded by this cheap liquidity are 'frozen', the government will be forced to urgently seek a way to cover the current shortage of funding, which may cause a reversal of the proclaimed tax policy course. Therefore, in view of the RF Government's goal – to speed up the development of infrastructure in this country – we think that the scale of involving government reserves in infrastructure development projects must be very limited. From the point of view of economics, it is better to consider the financing of infrastructure projects as part of budget expenditure while keeping government reserves in the form of risk-free assets – that is, to invest them in treasury securities issued by the governments of the world's economic leaders.

The proposal that VAT should be replaced by sales tax is evidently a measure aiming to overcome stagnation. The discussion concerning the abolition of VAT is being perpetually revived for the following reasons. VAT is paid by entrepreneurs in advance and is refunded only at the moment of sale of goods (or work, or services), which means that approximately 20% of revenue is thus constantly immobilized in the budget. A sales tax, on the other hand, is paid only in the phase of retail trade – that is, after money has been paid by to the seller. In truth, if VAT is abolished, it will not mean that some additional resources will pour onto the market; soon, the macroeconomic balance between effective demand and supply will once again be reestablished – but at a new level of prices. However, the abolition of VAT may tip the balance between the volumes of commodity turnover and the available budget resources, thus having a harmful effect

² Yu. Barsukov, D. Butrin. *Fond tronulsia. Vladimir Putin reshil potratit' iz fonda natsional'nogo blagosostoianiia dlia nachala 100 mlrd rub.* [The ball has finally started to roll... Vladimir Putin has decided that, for starters, Rb 100bn should be spent from the National Welfare Fund. See Kommersant.ru, the *Kommersant* newspaper No 236 (5021), 13 December 2012.

³ Ye. Gavrilentov. *Neposledovatel'naia politika finansovikh vlastei razgoniaet inflatsiiu* [The inconsistent policy of the financial authorities speeds up inflation]. See Vedomosti.ru 10 December 2012.

on state finances. Besides, if VAT is abolished, an accelerated growth of the shadow market can be expected⁴.

After President Putin's Address to the RF Federal Assembly, in which the RF President specifically emphasized the necessity of maintaining a strong state in the Russian Federation⁵, the RF Ministry of Economic Development almost immediately – in any event, prior to the meeting with Chairman of the RF Government Dmitry Medvedev set for 26 December – adjusted its standpoint towards preserving VAT. (It should be reminded that previously we have repeatedly pointed out that VAT is one of the most important taxes levied on the federal level and generating federal budget revenue alongside mineral extraction tax and customs duties; after Russia's accession to the WTO its importance will only be increasing – in contrast to customs duties whose role is going to gradually dwindle)⁶. It is noteworthy that the issue of VAT abolition has recently been raised by foreign – rather than Russian – manufacturers and financiers⁷. Their attitude is quite understandable: the abolition of VAT in conditions of market globalization and the declining importance of customs duties essentially means the State's refusal to control imports, because the operation of that tax is based on the principle 'pay first, and then import and sell'. It is specifically VAT that prevents traders to import into RF territory and stockpile there those outdated commodities that have failed to find their buyers on other markets, because VAT paid on unsold commodities is not refunded. In view of Russia's accession to the WTO it is undesirable to weaken the role of VAT. Besides, as we have already noted, VAT really prevents the shadow market's growth. Commodity producers prefer to buy those products whose price incorporates a clearly stated VAT, because thus they can later on get a refund against the amount of incoming tax, which is part of a product's market price.

Over the period under consideration, the RF Ministry of Finance put forth some initiatives aimed at improving the taxation of personal income. These have to do with equalizing the terms of taxation of personal incomes derived in the form of interest on deposits and bonds, as well as incomes generated by sale of real estate and securities⁸.

While, generally speaking, we are not opposed to the idea of tax unification with regard to the interest derived by physical persons, the following point must, nevertheless, be emphasized. We do acknowledge the fact that the rate of refinancing increased by 5%, which is

⁴ The RF Central Bank has explained that the restrictions on cash turnover for individuals proposed by the RF Ministry of Finance as a measure of control over the shadow economy violate the rights and freedoms of citizens guaranteed by the Constitutions.

⁵ Which implies a fiscally sustainable budget.

⁶ V. Visloguzov, T. Edovina. *Fiskal'noe udvoenie: Minekonomiki protiv naloga s prodazh, no predlagaet ego vvesti* [A case of tax duplication: The RF Ministry of Economic Development is against the sales tax, but suggests that it should be introduced] See Kommersant.ru, *The Kommersant* newspaper No 241 (5026 of 20 December 2012)

⁷ In particular, this issue was raised during First Deputy Chairman of the RF Government Igor Shuvalov's visit to the New York Stock Exchange in December 2012 (see A. Bashkatova. *Svetloe nalogovoe budushchee ot Shuvalova. Deistvuiushchego prezidenta nazvali garantom fiskal'noi stabil'nosti* [The bright fiscal future according to Shuvalov. The current Russian president has been called a guarantor of fiscal sustainability]. See www.ng.ru of 5 December 2012).

⁸ *Minfin predlagaet uravniat' nalogooblozhenie po depozitam, aksiyam i obligatsiyam* [The RF Ministry of Finance suggests equal taxation to be levied on deposits, shares and bonds]. Finmarket Information Agency, 28 November 2012, www.vedomosti.ru;

Yu. Barsukov. *Minfin sulit naseleniiu nalogovye vychety. Grazhdane mogut poluchit' nalogovye l'goty pri investirovanii v tsennye bumagi* [The RF Ministry of Finance promises tax deductions to the population. Citizens may be granted tax exemptions when investing in securities]. See Kommersant-online, 28 November 2012.

taken into account when determining the size of deduction from the tax base for interest on deposits, is established by the Bank of Russia, and the banking licenses issued to banks confirm that they know the rules for applying that rate; but the other market participants issuing interest-generating liabilities (bonds) are not obliged to know how that rate should be applied. At the same time, we believe that the possibility of replacing the Bank of Russia's refinancing rate by an absolute deduction (in the amount of Rb 1m) (which is being considered by the RF Ministry of Finance) is not feasible. There can exist multiple interest-generating sources, and if an absolute deduction is applied in every case, then the greater the number of brokers and deposits, the greater the resulting accumulated amount of absolute deduction. As a result, the recipient of interest will be obliged to go to a tax inspectorate, to personally submit a tax declaration and a pile of documents confirming all the received amounts of interest, and then to pay the additional amount of tax. As a result, one of the most important advantages of personal income tax's flat rate of 13% is that tax is automatically deducted at source, thus freeing the taxpayer from the cumbersome necessity to go personally to a tax inspectorate and to wait in line to be received there, to collect the necessary documents, and to lower the risk of tax arrears and the resulting sanctions. It can be recommended that the RF Ministry of Finance, in order to unify the rules for levying tax on interest, should legislatively establish the rate of tax to be deducted from the received interest (similarly to the rate of refinancing established by the Bank of Russia) instead of establishing the amount of absolute deduction.

As for the proposal that unified rules should be established for the taxation of incomes from sale of real estate and securities, it is not quite clear what exactly it means. The taxation of individual investors' operations with securities and derivatives circulating on the organized financial market have been long ago brought in conformity with the taxation scheme established for individual entrepreneurs and investor organizations (Article 214.1 of the RF Tax Code). To those securities and derivatives that are not circulated on the organized market, the same procedure as established for the income from sale of real estate is actually applied (Article 217, Item 17.1). The tax-exempt incomes, alongside the income derived from sale of real estate that has been owned by a taxpayer over a period of 3 or more years, also includes the incomes from sale of other property owned over a period of 3 or more years (securities which are not circulating on an organized market are fully compatible with the definition of 'other property', in contrast to stakes which are not formalized as securities).

Within the framework of the elaboration of Federal Law No 216 of 3 December 2012 on the federal budget for 2013 and the planning period 2014 – 2015, a package of amendments to the RF Tax Code and the legislation regulating other mandatory payments was adopted.

1. By Federal Law of 3 December 2012, No 245-FZ an exemption from VAT is established for the import of cultural valuables purchased by state and municipal institutions irrespective of the source of funding for the purchase – budget funds, incomes from other commercial activities, or other incomes allowed by legislation.

2. By Federal Law of 29 November 2012, No 203-FZ the list of excisable goods is expanded (to include household furnace fuel), and the rates of excise duties on petrol, alcohol beverages and alcohol-containing products are raised.

3. By Federal Law of 29 November 2012, No 205-FZ, in order to protect the interests of low-income citizens, courts of justice are granted the right to exempt such persons from the payment of state duty on a case being considered by a given court of justice.

An exemption from personal income tax (PIT) is established for the sums of additional benefit received by families with children; for the sums of compensation paid to medical practitioners; and for state and municipal immovable property granted to taxpayers free-of-charge.

4. The most important clarifications introduced into the RF Tax Code by Federal Law of 29 November 2012, No 206-FZ we believe to be as follows.

In the main body of the RF Tax Code, the issue of reinstating a depreciation premium as part of the income derived from the sale of fixed assets effectuated between two mutually dependent persons. It should be reminded that, for a long time, this has been one of the most painful issues because, in absence of any mechanism of control over transactions concluded between mutually dependent persons, the requirement of the RF Ministry of Finance concerning the reinstatement of a depreciation premium served as an artificial obstacle to tax-free withdrawal of incomes outside of the jurisdiction of the Russian Federation during a transfer of property from one mutually dependent person to another at an underestimated price, and so it was constantly disputed by taxpayers. In the new version of paragraph 4 of Item 9 of Article 258 of the RF Tax Code it is directly stipulated that in an event of sale of a fixed asset (to which a depreciation premium has been applied) to a mutually dependent person, the said depreciation premium is to be charged to overheads for a period of five years since the moment of putting that asset into operation. Accordingly, when a depreciation premium is reinstated, the balance sheet value of the sale of that fixed asset will be increased by the same amount. As a result, the sum of the tax will be the same – whenever that item is sold to a mutually dependent person or to another entity.

The list of commodities to be levied by VAT at the rate of 10% is extended, to include culinary and baking fats, milk fat and cocoa butter substitutes, spreads, and melted blends.

In order to determine the tax base for tax on profit levied on mobilization facilities put in reserve and not used in production, the general depreciation procedure is applied. All the current expenditures on mobilization training, including the cost of the upkeep of the assets and facilities needed for the fulfillment of the mobilization plan, are to be treated as the taxpayer's overheads. In this connection, the RF Tax Code does not mention budget allocations as a source of funding. It seems that budget subsidies allocated for these purposes are now treated as the payment for the services involved in the maintenance of mobilization facilities.

The notion of 'bad debt' (irrecoverable debt) has been defined more precisely. This is a very important clarification, because it specifies the conditions for recognizing debt as such for taxation purposes – the existence of an order issued by a court bailiff concerning the termination of proceedings, which confirms the futility of the effectuated measures due to the impossibility of locating the debtor, the debtor's property and deposited monies.

The trust management founder, for the purpose of calculating the amount of its taxable profit, is not allowed to recognize the losses incurred under those trust management agreements

where it is not recognized as a beneficiary. At the same time, a beneficiary is not allowed to recognize the losses incurred under such agreements for the purpose of profit taxation, either.

The date of realization of immovable property is specified more precisely: for the purpose of levying tax, this date is recognized to be the date of transfer of such property to the buyer under an act of immovable property transfer.

5. By Federal Law of 3 December 2012, No 243-FZ 'On Introducing Alterations into Some Legislative Acts of the Russian Federation on Mandatory Pension Insurance Issues', the rates of insurance contributions in state off-budget funds are prolonged through the years 2014 and 2015: the general rate – 30% (of which 22% goes to the RF Pension Fund, 2.9% - to the Social Welfare Fund, and 5.1% - to the Federal Fund for Compulsory Medical Insurance), the amount in excess of the established margin⁹ is 10% (this type of payment is to be transferred only to the RF Pension Fund). From 2014 onwards, the mandatory funded component of the pension insurance tariff for the persons born after 1967 will be decreased to 2%. An exception is made for those individuals who, as of 31 December 2013, will have concluded mandatory pension insurance agreements and submitted notification stating that their funds have been switched over a non-governmental pension fund, or submitted notifications informing of their choice of a government asset manager's investment portfolio. Such individuals, from 1 January 2014, will be granted the right to make a choice between different variants of pension provision: to transfer to the funded component of their labor provision either 2% or 6% of their insurance contribution tariff.

Some additional insurance contributions are introduced for the benefit of individuals engaged in underground work, or work with harmful and/or dangerous conditions of labor, or work in hot shops – in the amount of 4%, with the subsequent increase in the rate of the tariff to 9% by 2015; for those employed in the textile industry with increased labor intensity and some other categories of employees, the additional tariff size will amount to 2% in 2013, and then will be gradually increased to 6% in 2015. These additional tariffs are to be applied to the entire insurance base, without taking into account the margin established for each financial year.

The size of insurance contributions to the RF Pension Fund has also been increased for individual entrepreneurs, lawyers, notaries and self-employed persons. For them, the fixed size of contributions to the RF Pension Fund will be determined on the basis of a double size of minimum monthly salary established as of the beginning of a relevant financial year. In other words, the taxation base will now be calculated by multiplying the double minimum monthly wage amount by 12 (months). The fixed size of contributions to the Federal Fund for Compulsory Medical Insurance will be determined, as before, on the basis of a single minimum monthly wage amount.

6. By Federal Law of 29 November 2012, No 202-FZ a number of alterations is introduced into the RF Tax Code with regard to tax on property of organizations, and transport and land taxes. Tax on property will no longer be levied on newly acquired (or created) movable property belonging to the category of fixed assets. Besides, this tax is no longer to be levied on cultural heritage objects of federal importance, nuclear installations used for scientific purposes,

⁹ In 2012 – Rb 512K, in 2013 –Rb 568K, in accordance with the RF Government's Decree of 10 December 2012, No 1276.

nuclear waste repositories, nuclear-powered icebreakers, outer space systems, and vessels entered in the Russian International Register of Vessels. It should be reminded that these types of property are no longer to be placed in the category of objects of taxation – that is, they are not subject to regulation by the RF Tax Code in the part of tax of property of organizations.

Tax on property (at a lower rate) is from now on to be levied on railway tracks, trunk pipelines and electric power transmission lines.

Lower rates of land tax are established for those land plots that are granted for the purposes of state defense, security and customs service and are subject to restricted turnover in accordance with RF legislation.

7. One of the spheres regulated by tax legislation is usually the verification of compatibility of taxpayers' incomes and expenditures. In the Russian Federation, the system of control over incomes and expenditures is treated within the framework of anti-corruption legislation, which lies beyond the domain of the RF Tax Code. The normative base for control over the consistency of taxpayers' incomes with their expenditures is explained in Letter of the RF Ministry of Finance of 25 July 2012, No 03-02-07/2-107 and Letter of the Federal Tax Service of 31 August 2012, No ED-4-3/14509. In December 2012, several legislative acts were adopted in order to further specify the mechanism of control over the consistency of the incomes of civil servants, other high-rank officials, members of the RF Government, the staff of state and municipal administrations and their next of kin, including minors, with their expenditures.

In particular, in connection with the adoption of Federal Law of 3 December 2012, No 230-FZ 'On Control over the Consistency of the Expenditures Made by Persons Holding Government Offices, and by Other Persons, with Their Incomes', some alterations have been introduced by Federal Law No 231-FZ of 3 December 2012 in the federal laws whereby it is established that those citizens who apply for or occupy the posts that are subject to tax control will be obliged to submit, in the established procedure, information concerning their expenditures, as well as the expenditures of their spouses and children of minority age, incurred in the course of each transaction of purchase of a land plot, other immovable property object, means of transportation, securities, shares (or equity stakes or participating interests in the charter (or share) capital of an organization), if the amount of transaction exceeds the family's aggregate income received over three previous years, and information concerning the sources of monies covering the amount of the transaction. The corresponding alterations were introduced in the RF Federal Laws 'On Banks and Banking Activity', 'On the Tax Agencies of the Russian Federation', 'On the Prosecution Service of the Russian Federation', 'On the Status of Judges in the Russian Federation', 'On the Audit Chamber of the Russian Federation', 'On Service in the Customs Bodies of the Russian Federation', 'On Military Duty and Military Service', 'On the General Principles of the Organization of the Legislative (Representative) and Executive Bodies of State Authority of Subjects of the Russian Federation', etc.

Besides, the alterations introduced into Item 2 of Article 235 of the RF Civil Code establish the possibility of 'converting, by a court decision, into the revenue of Russian Federation, the property in respect of which no proof has been presented as to its acquisition with money received as a lawful income in accordance with the anti-corruption legislation of the Russian Federation'.

By the alterations introduced into the RF Labor Code (Item 7.1. Article 81) it is envisaged that failure, 'on the part of a worker, to implement measures designed to prevent or settle the conflict of interests that he or she is a party to, their failure to submit information on their incomes, expenditures, property and property liabilities, or their submission of incomplete or not authentic information thereon, or their failure to submit or their deliberate submission of incomplete or incorrect information on the incomes, expenditures, property and property liabilities of their spouses and children of minority age, or their deliberate submission of incomplete or not authentic information thereon in the cases envisaged by federal laws and normative legal acts issued by the RF President and the RF Government, if the said acts can provide grounds for a loss of trust in the worker by his or her employer', can constitute appropriate grounds for not giving this citizen the job he or she has claimed for, or for dismissing this citizen from such a job.

By Federal Law of 3 December 2012, No 4-FKZ amendments were introduced to Article 10 of the Federal Constitutional Law 'On the Government of the Russian Federation'. In accordance with these amendments, the members of the RF Government will also have to declare not only their incomes, but also their large-scale expenditures, including the expenditures of their spouses and children of minor age.

The expenditures incurred by a member of the RF Government, his or her spouse and children of minor age, the information of which must be submitted by the member of the RF Government, are defined as transactions involving the purchase of a land plot, other immovable property objects, means of transportation, securities, shares (or equity stakes or interests in the charter (or share) capital of an organization), if the amount of the transaction in question exceeds the aggregate income received by the member of the RF Government and his or her spouse over three years prior to the transaction. It will also be necessary to specify the source of monies covering the amount of the transaction.

8. By Regulation of the RF Government of 3 December 2012, No 2250-p the plan of measures designed to improve normative legal regulation for the purpose of preventing tax evasion is approved. First of all, these measures are aimed at ensuring the freedom of access for tax agencies to the information on monies kept on the bank accounts (or as deposits) by organizations and individuals; access to the information on the activity of third parties who act as participants (or intermediaries) in especially large transactions concluded by a taxpayer; the list of grounds for a denial of State registration to a legal entity is specified; the proposals aimed at preventing tax evasion via offshore jurisdictions are prepared, including the introduction in legislation of the notions 'tax resident – organization' and 'actual recipient of income', the definition of the procedure for levying taxes on non-distributed profit of controlled foreign companies; the publication in the Internet of the list of payers, tax agents, and banks that delay for 2 months or longer the payments in regard of the claims filed by tax agencies, etc.

9. One of the key events in the sphere of taxation that occurred over the period under consideration was the publication of Resolution of the RF Supreme Arbitration Court of 29 November 2012, No VAS-13840/12. The essence of the Resolution is by no means the subject of the dispute, which was as follows: OJSC *Sibirskaja energeticheskaja kompania* [Siberian Energy Company], having read Explanatory Letter of the RF Ministry of Finance of 4 April 2012, No 03-03-10/34, arrived at the conclusion that the explanation concerning a zero rate being not applicable to dividends paid from previous years' profits imposed on taxpayers an additional

burden of paying profit tax. To put this matter straight, the company submitted to the RF Supreme Arbitration Court a petition that the said letter should be recognized as null and void. The RF Supreme Arbitration Court decided that the Ministry's letter referred to an unspecified range of taxpayers, and therefore it was an act adopted (or issued) by a federal body of executive authority empowered to perform the function of elaborating government policy and exercising normative legal regulation in the sphere of taxes and levies, and so it contained explanations that were to be applied on a multiple basis and was to be considered from the point of view of its essence (thus the Court confirmed that the issuance of such explanations was within the sphere of competence of the RF Ministry of Finance). Having considered the issue from the point of view of its essence, the RF Supreme Arbitration Court disagreed with the standpoint of the RF Ministry of Finance, recognized it to be incompatible with existing legislation, and ruled that the letter should be recognized as null and void and demanded that the legal costs should be paid by the RF Ministry of Finance for the benefit of OJSC *Sibirskaja energeticheskaia kompania* in the amount of Rb 2,000.

Thus, what in reality took place was a judicial expert's estimation of the status of the explanatory letters issued by the RF Ministry of Finance. The recognition to be null and void of an act adopted by a federal ministry with regard to issues placed within the sphere of that ministry's competence entailed no payment of any penalties from the budget, and the taxpayer did not suffer, either, because the court required the RF Ministry of Finance to pay court costs. Thus, the RF Supreme Arbitration Court has explicitly shown that it is possible, in the framework of existing Russian tax legislation, to implement in practice the form of operative control, by judicial instances, over the compliance of acts issued by ministries and departments with the existing laws in absence of any actual property dispute, and the abolition of such acts in the event of their incompatibility with the norms stipulated in the laws – in full correspondence with international legal practice.