

Doing Business in Russia.

A Legal and Tax Update

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The better the question. The better the answer.
The better the world works.

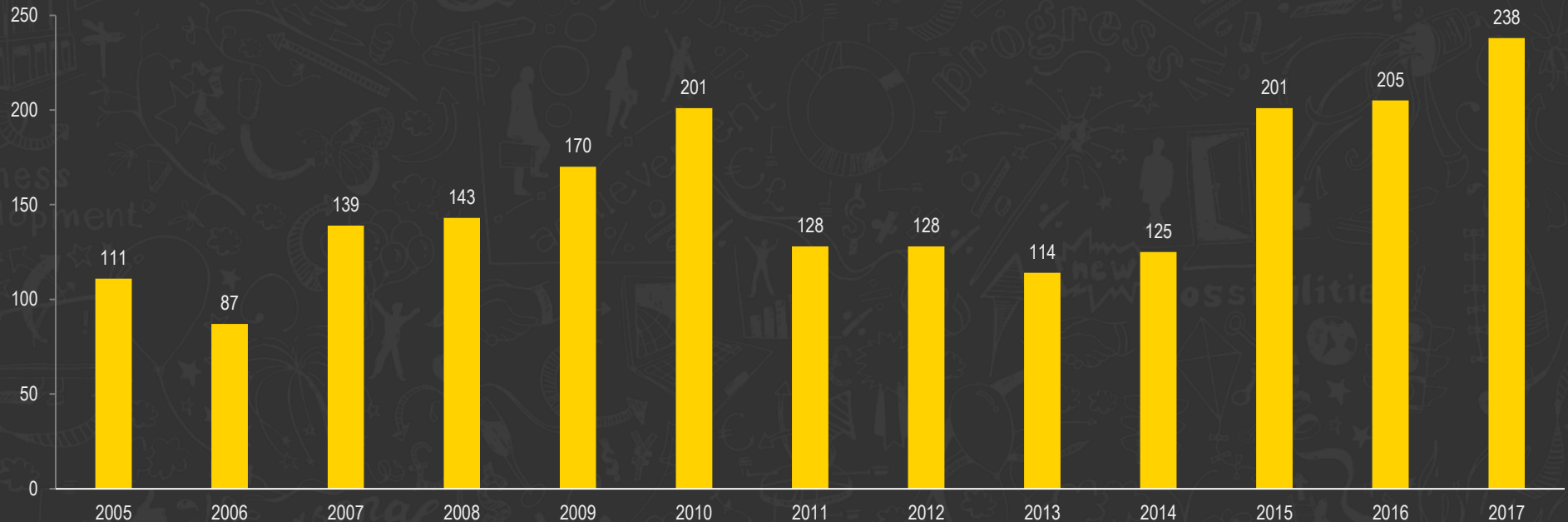


Building a better
working world

EY European Attractiveness Survey – Russia (1)

Record FDI Projects despite sanctions and geopolitical tensions













Fig. 2: Number of FDI Projects in Russia, 2005-2017



Source: EY European Attractiveness Survey 2018

EY European Attractiveness Survey – Russia (2)

Russia in European Perspective

	2016	2017	Change in rank vs. 2016	Share (2017)	% change	Jobs created	Jobs share
 UK	1,138	1,205	-	18%	6%	50,196	14%
 Germany	1,063	1,124	-	17%	6%	31,037	9%
 France	779	1,019	-	15%	31%	25,126	7%
 Netherlands	409	339	-	5%	-17%	8,541	2%
 Russia	205	238	+2	4%	16%	25,788	7%
 Spain	308	237	-1	4%	-23%	13,685	4%
 Turkey	138	229	+3	3%	66%	13,078	4%
 Belgium	200	215	-	3%	8%	5,838	2%
 Poland	256	197*	*	3%	*	24,000	7%
 Finland	133	191	+1	3%	44%	4,300	1%
 Ireland	141	135	-2	2%	-4%	8,961	3%
 Czech Republic	110	134	+1	2%	22%	14,490	4%
 Romania	132	126	-1	2%	-5%	16,490	5%
 Serbia	46	118	+8	2%	157%	20,103	6%
 Hungary	107	116	-1	2%	8%	17,017	5%
Others	876	1,030	-	15%	18%	74,819	21%
Total	6,041	6,653		100%	10%	353,469	100%

EY European Attractiveness Survey – Russia (3)

APEC Region on the rise

Fig. 4: Number of FDI projects by country of origin, 2010-2017

Country	2010	2011	2012	2013	2014	2015	2016	2017
China	3	3		4	7	12	9	32
Germany	26	13	28	12	11	36	43	28
US	24	24	29	24	14	29	38	19
Japan	11	6	9	14	8	10	12	17
Italy	6	6	5	2	4	12	7	17
South Korea	4	0	1	1	3	3	2	12
France	10	9	14	7	14	20	20	11
Switzerland	11	4	3	4	8	8	7	11
UK	14	4	2	3	6	5	2	8
Finland	8	6	5	5	6	9	7	7
Austria	7	1			2	6	9	
Netherlands	2	7	4	1	1	3	5	

Source: EY European Attractiveness Survey 2018

EY European Attractiveness Survey – Russia (4)

Localization deepening

Fig. 5: Number of FDI projects by industry

Sector	2010	2011	2012	2013	2014	2015	2016	2017
Manufacturing	89	55	48	55	61	105	109	127
Agriculture	18	13	9	10	12	38	41	38
Transport & Communication	54	28	39	29	26	32	30	31
Power Industry	18	6	6	2	11	15	15	26
Financial & Business Services	19	19	19	9	9	6	4	10
Retail & Hospitality	1	3	0	5	3	1	2	3
Other (culture, tourism, leisure)	1	4	2	1	2	0	1	2
Construction	1	0	3	3	1	4	3	1

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EY European Attractiveness Survey – Russia (5)

Industry and regional trends...

Fig. 6.1: Number of FDI projects by area of manufacturing

Area	2015	2016	2017
Pharmaceuticals	6	10	35
Machinery, equipment	28	27	21
Chemicals	27	33	19
Metals	5	10	13
Minerals	12	8	12
Digital, IT, Media	12	5	11
Electric equipment	10	15	7
Textile industry	6	1	3
Furniture			2
Other			3

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Fig. 6.2: Number of FDI projects by region

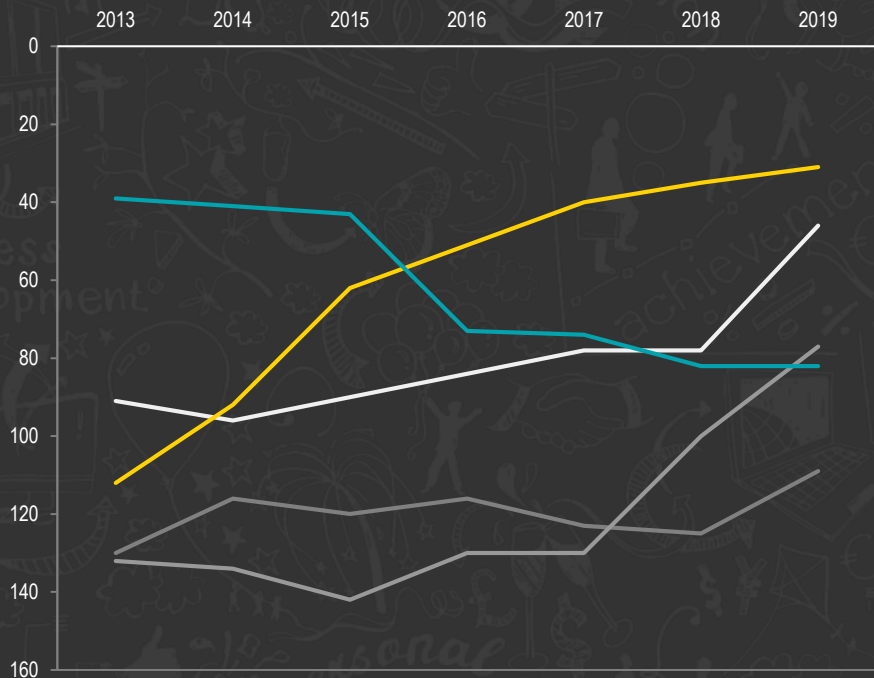
Region	2015	2016	2017
Moscow, Moscow Region	45	49	54
St. Petersburg, Leningrad Region	22	15	17
Tatarstan	15	7	14
Primorsky	1	7	12
Lipetsk	10	2	9
Kaluga	8	15	7
Rostov	1	3	6
Vladimir	3	6	5
Belgorod	1	2	5
Bashkortostan	0	0	5
Ulyanovsk	9	8	<5
Nizhny Novgorod	7	7	<5
Krasnodar	6	6	<5
Sverdlovsk	3	6	<5

EY European Attractiveness Survey 2018

Doing Business in Russia

Significant improvement since 2012, but...

Fig. 7.1: World Bank Ease of Doing Business Index, 2013-2019



Source: World Bank

— Brazil — China — India — Russia — South Africa

Fig. 7.2: Ease of Doing Business by subindicator

	DB 2017	DB 2018	DB 2019
Getting Electricity	30	10	12
Registering Property	9	12	12
Enforcing Contracts	12	18	18
Getting Credit	44	29	22
Starting a Business	26	28	32
Overall	40	35	31
Dealing with Construction Permits	115	115	48
Paying Taxes	45	52	53
Resolving Insolvency	51	54	55
Protecting Minority Investors	53	51	57
Trading across Borders	140	100	99

Source: World Bank

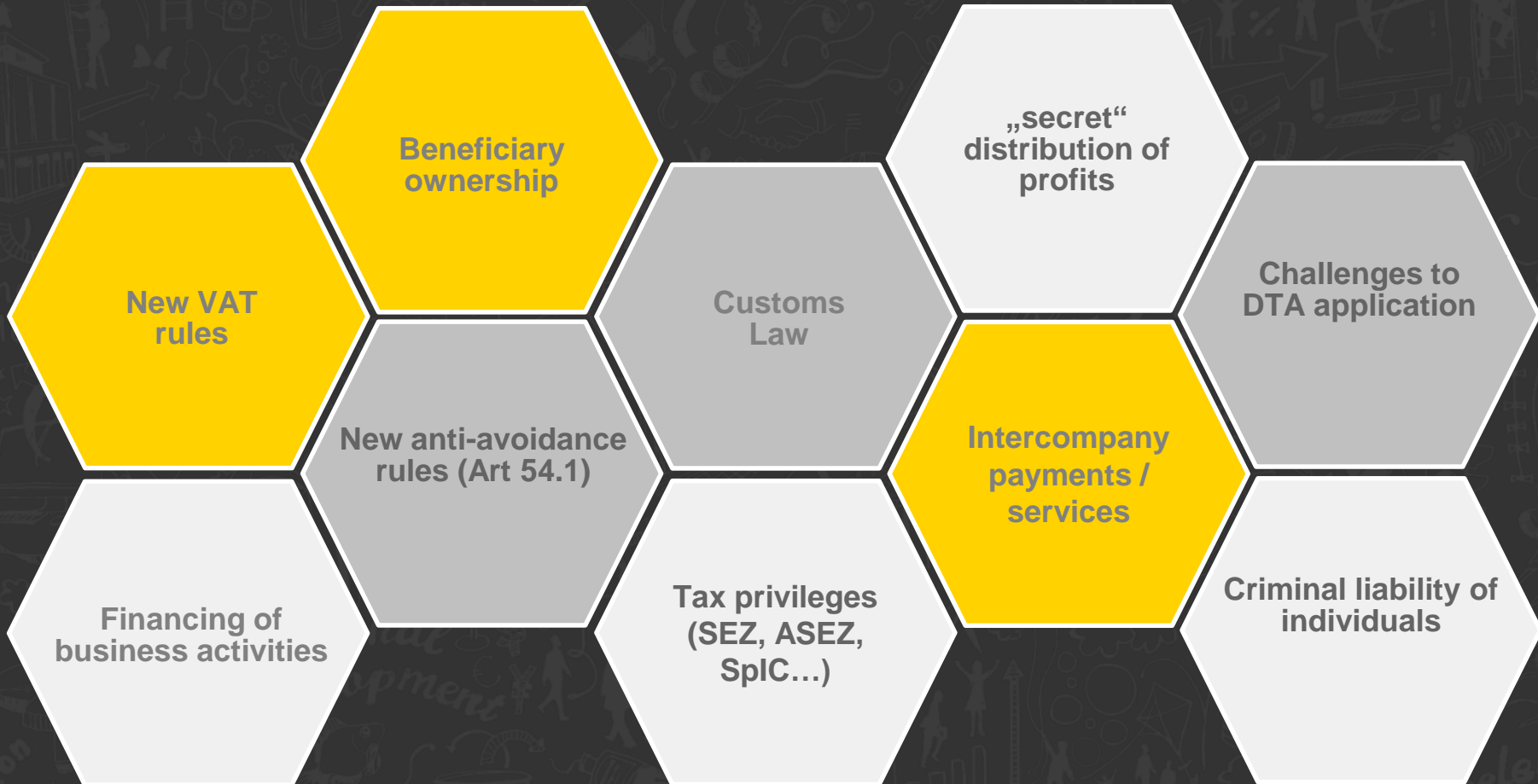
Primat der Politik

The policy agenda of V. Putin's 4th term

Area	2012 May Decrees	2018 May Decrees
National Goals	<ul style="list-style-type: none"> ▶ create 25 mn high productive jobs ▶ bring share of capital investment to 25% of GDP ▶ increase share of high-tech industries by 1,3 times ▶ move Russia from 120th to 20th position in WB Doing Business 	<ul style="list-style-type: none"> ▶ sustainable population growth ▶ sustainable growth of real income ▶ poverty brought to half of today's level ▶ accelerate digitalization ▶ Russia to become top-5 economy, growing above world avg ▶ Inflation to be maintained below 4%
Demography	<ul style="list-style-type: none"> ▶ increase birthrate to 1,753 ▶ increase life expectancy to 74 y ▶ increase women participation in labor market 	<ul style="list-style-type: none"> ▶ bring birthrate to 1,7% ▶ raise life expectancy to 78 y
Healthcare	<ul style="list-style-type: none"> ▶ lower death rates from all kind of causes ▶ increase share of locally produced important drugs to 90% 	<ul style="list-style-type: none"> ▶ lower death rates from all causes ▶ adequate access to healthcare for people from rural / remote areas ▶ access to annual preventive examinations ▶ medical services export to increase 4-fold from today's 1 bn USD
Education & Science	<ul style="list-style-type: none"> ▶ at least 5 Russian universities among top 100 ▶ Increase R&D spending to 1,77% of GDP 	<ul style="list-style-type: none"> ▶ Russia among top 10 countries for quality of education ▶ Russia among top 5 for scientific activity ▶ promotion of life-long learning offerings & practices ▶ R&D growth to exceed GDP growth
Housing	<ul style="list-style-type: none"> ▶ mortgage rate to be reduced to inflation +2,2% 	<ul style="list-style-type: none"> ▶ mortgage interest rate to be reduced below 8%
Infrastructure	<ul style="list-style-type: none"> ▶ create special mechanism to attract FDI 	<ul style="list-style-type: none"> ▶ more than 50% of regional roads to be in line with standards ▶ reduce overload of federal and regional roads by 10% ▶ transparent public spending control mechanism
Labor productivity	<ul style="list-style-type: none"> ▶ increase by 50% from 2011 to 2018 	<ul style="list-style-type: none"> ▶ increase by 5% per year

Regulatory Update

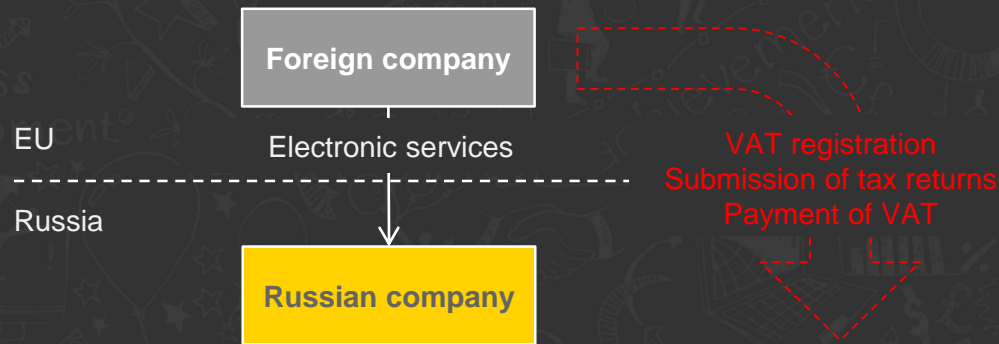
Current tax and law “hot” topics



Tax Update

New VAT regime on cross-border electronic services

Starting from 1 January 2019 Russian companies purchasing electronic services from foreign companies, which are registered for VAT purposes in Russia, should not apply “withholding VAT mechanism”. The foreign companies-suppliers will have to register for VAT purposes in Russia, submit regular tax returns and pay VAT due.



Starting from 1 January 2019:

The foreign suppliers of electronic services to Russian legal entities and individual entrepreneurs (B2B digital services) will be obliged to:

- ▶ apply for the VAT registration,
- ▶ report and pay VAT in Russia.

Russian companies purchasing electronic services will stop applying “withholding VAT mechanism”

Electronic services:

the provision of services via a data network, including the “Internet” data network on an automated basis with the use of information technologies:

- ▶ the provision of rights to use computer programs (including computer games) and databases via the Internet
- ▶ the storage and processing of information (including “cloud” storages)
- ▶ the provision of domain names and the rendering of hosting services
- ▶ the provision of services involving the administration of information systems and Internet sites

Tax Update

New VAT rate starting 01.01.2019



Starting 1 January 2019 the standard VAT rate (i.e. 18%) will increase to 20%. The tax-inclusive rate, which applies when VAT is calculated and paid by foreign suppliers of electronic services, would rise from 15.25% to 16.67% accordingly.

New rate will be applicable to goods, work, services and property rights **supplied** on or after 1 January 2019.

Practical issues



How the new VAT rate will apply to transactions for which the tax base is determined on cash basis (e-services, tax agent) or to shipments after 01.01.2019 for which an advance payments has been received



If goods purchased before 01.01.2019 are returned after that date, the question arises of how the seller should reclaim VAT based on an VAT invoice presented by the purchaser.



In the case of continuing contracts with a fixed VAT-inclusive price the increase in the VAT rate would reduce income actually received by the supplier of goods, work and services.



Reflection in VAT return VAT invoices issued before 1 January 2019 and reflected an 18% rate when claiming input VAT for recovery and restoring VAT in periods after 1 January 2019

Practical steps required



Analysing existing contracts to identify tax and commercial risks (including the risk of additional costs being incurred as a result of the VAT rate increase) and considering appropriate amendments and risk mitigation actions



Devising measures to offset the temporary increase in cash outflow, for instance, by reviewing potential changes to VAT positions previously adopted by the Company



Preparing a request to the tax authorities or the Finance Ministry for guidance on issues arising in connection with the VAT rate increase



Modifying the Company's internal systems to ensure that the transactions under the new VAT rate will be properly reflected in the recording



Preparing internal guideline for the Company's departments how may affect VAT rate increase (logistic, sales, treasury etc.)

Tax Update

Updated Russian GAAR (Art. 54.1)

The Russian General Anti-Avoidance Rules (GAAR) have been adopted and take effect in August 2017. They are based on judicial practice and SAC Ruling No. 53 of 12 October 2006

Aggressive tax planning abuse

The GAAR prohibit any willful misconduct resulting in nonpayment or underpayment of taxes by means of:

- ▶ Misrepresenting of information on the business operation items (set of items), on the objects of taxation that are being accounted aimed at tax evasion

Mala fide taxpayers and sham transactions

Taxpayers may reduce the tax base and/or payable amount of tax if they can document that:

- ▶ Tax evasion is not the primary purpose of a transaction
- ▶ The contractual obligation is fulfilled directly by the party named in the contract or by a person to whom such obligation was transferred by contract or by law

How does it work?

- ▶ Absence of clear legal framework and multiple subjective criteria for evaluation of good faith behavior in vendors due diligence
- ▶ Extensive and contradictory case law

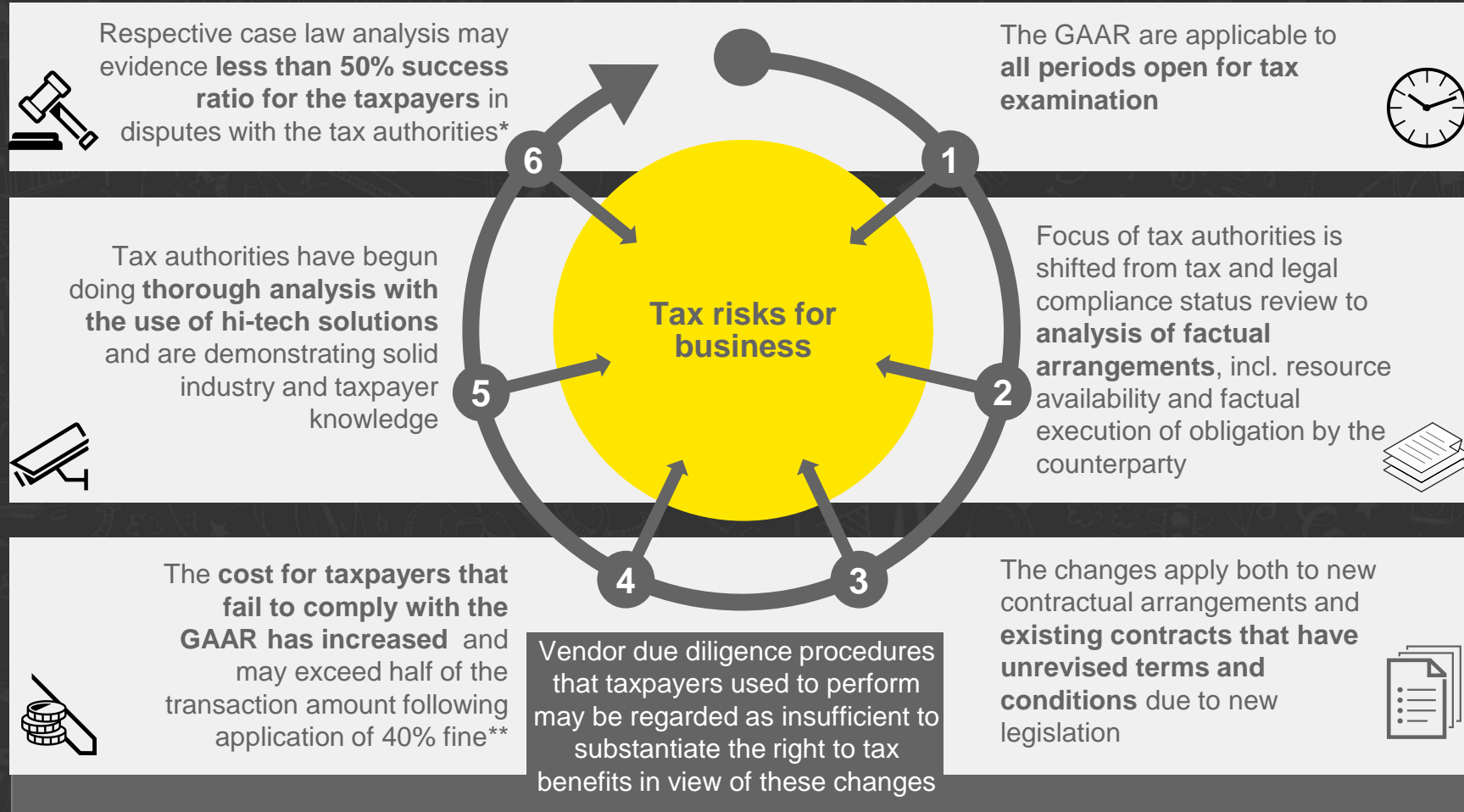
- ▶ Tax administration reform and implementation of IT solutions for taxpayer's big data analysis
- ▶ Business development towards digitalization and complex nature of services

The Federal Tax Service is expected to be actively involved in developing uniform law enforcement practice

Prerequisites for changes

Tax Update

New business risks related to Art. 54.1

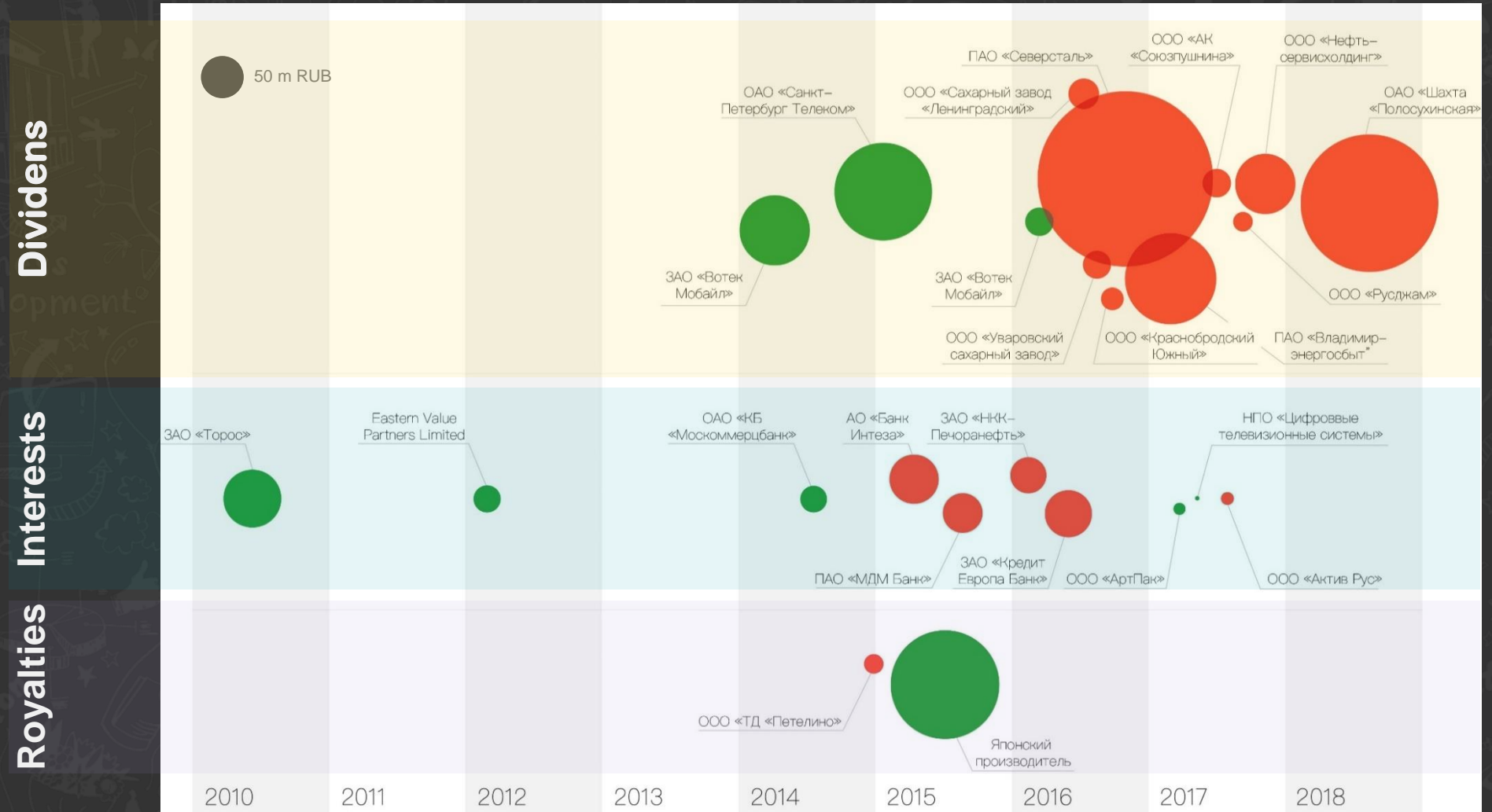


* According to the analysis of existing court practice

** Letter of Federal Tax Service # ED-4-2/13650@ dated 13 July 2017

Tax Update

Beneficiary ownership rules: recent court practice



Tax Update

Beneficiary ownership rules

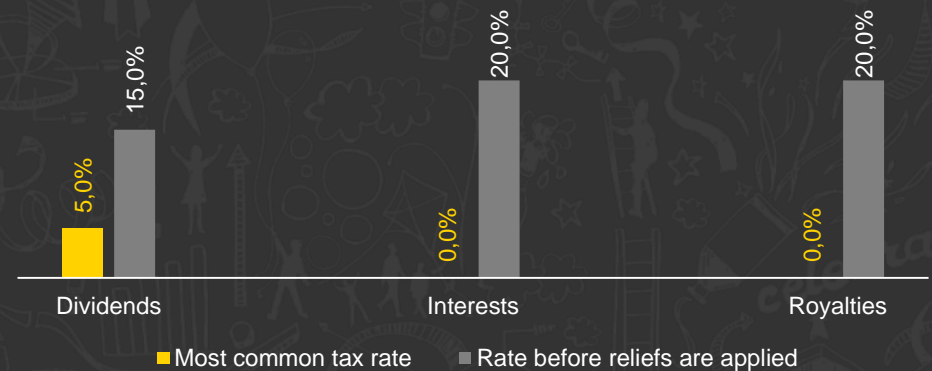
Overview

- ▶ The beneficial ownership rules have been enshrined in Russian law since 1 January 2015.
- ▶ The purpose of the rules is to prevent the improper use of lower rates of withholding tax. However, the rules are not always clearly formulated, and many companies face the risk of legal challenges against tax reliefs claimed on “passive” income (dividends, interest and various other payments) paid from Russia to recipients abroad.
- ▶ Furthermore, as from 1 January 2017 it became compulsory to obtain confirmation of beneficial ownership from a foreign company before tax treaty reliefs could be applied.



Risk analysis:

- ▶ companies with back-to-back contract arrangements and “transit” money flows;
- ▶ payments to foreign companies which have limited functions and presence abroad;
- ▶ multinational groups with head offices in countries whose tax treaties with Russia grant less favourable conditions (such as Japan, Canada, the UK, Italy, Australia, et al.), and those which invest in Russian assets via other countries (the Netherlands, Cyprus, et al.).



Remedies

- ▶ change structure
- ▶ defend existing structure
- ▶ use positive precedents

Customs Update

New Customs Regulations

New Eurasian Customs Code

- ▶ New Customs Code entered into force on 1 January 2018
- ▶ Respective national legislation is on the way or already adopted
- ▶ Several international treaties were integrated into the Customs Code and were terminated therefore.
- ▶ New Customs Code creates a legal basis for further modernization of customs administration.

Risk Analysis

- ▶ Ambiguities in the absence of respective national legislation.
- ▶ Terms of the Codes enactment are unclear.
- ▶ Most of the facilities for automatic solutions still in test regime (errors!).



- ▶ **Automated customs declaration acceptance and release of goods:** The EAEU's Customs Code allows to accept and release of goods automatically, without human involvement. Russian Customs completed testing and plans to increase the percentage ratio of automatic acceptance declarations and automatic released goods for import. For reliable importers and exporters only!



- ▶ **Binding rulings on customs valuation:** It is allowed for Member States to introduce binding ruling on customs valuation which should decline risks related to customs value adjustment.



- ▶ **Authorized Economic Operator:** Three types of AEO depending on the simplifications that may be used and requirements.



- ▶ **Submission of customs declaration without supporting documents:** New Customs Code allows to submit customs declaration without enclosed invoices and other documentation. But customs authorities may request documents which were basis for filling submitted customs declaration.

Customs Update

New Customs Regulations

Federal Law N 289-FZ

- ▶ The Law entered into force on September 4, 2018
- ▶ Some provisions of the Law will enter into force gradually



- ▶ **Customs control:** The law limits the timeline for customs expertise (4 months) and cameral audits (90 days). These were not limited before at all.



- ▶ **Customs taxes:** Shortened period for return of overpaid customs taxes or amounts deposited as a pre-payment.



- ▶ **Binding Tariff Information:** Shortened period for issuing BTIs – 60 days vs 90 days previously. Period of validity is extended from 3 to 5 years.



- ▶ **Customs procedures:** Free warehouse customs procedure is introduced in Russia. It allows for duty-free manufacturing of goods designated for export in special free warehouses.



- ▶ **E-customs:** Introduces an electronic complaint to superior customs authorities against actions of local customs offices.

Customs Update

Recommendations by EaEC re: License Fees & Customs Value

Recommendation No. 15 of the Board of the EaEC of August 28, 2018

The board of the Eurasian Economic Commission (EaEC) has made amendments to the Statute Concerning the Addition of Licence Fees and Other Similar Payments for the Use of Intellectual Property Assets to the Price Paid or Payable for Imported Goods.

1

Trade marks

2

Reproduction

3

Know-how

The amendments may affect your Company in the following situations:

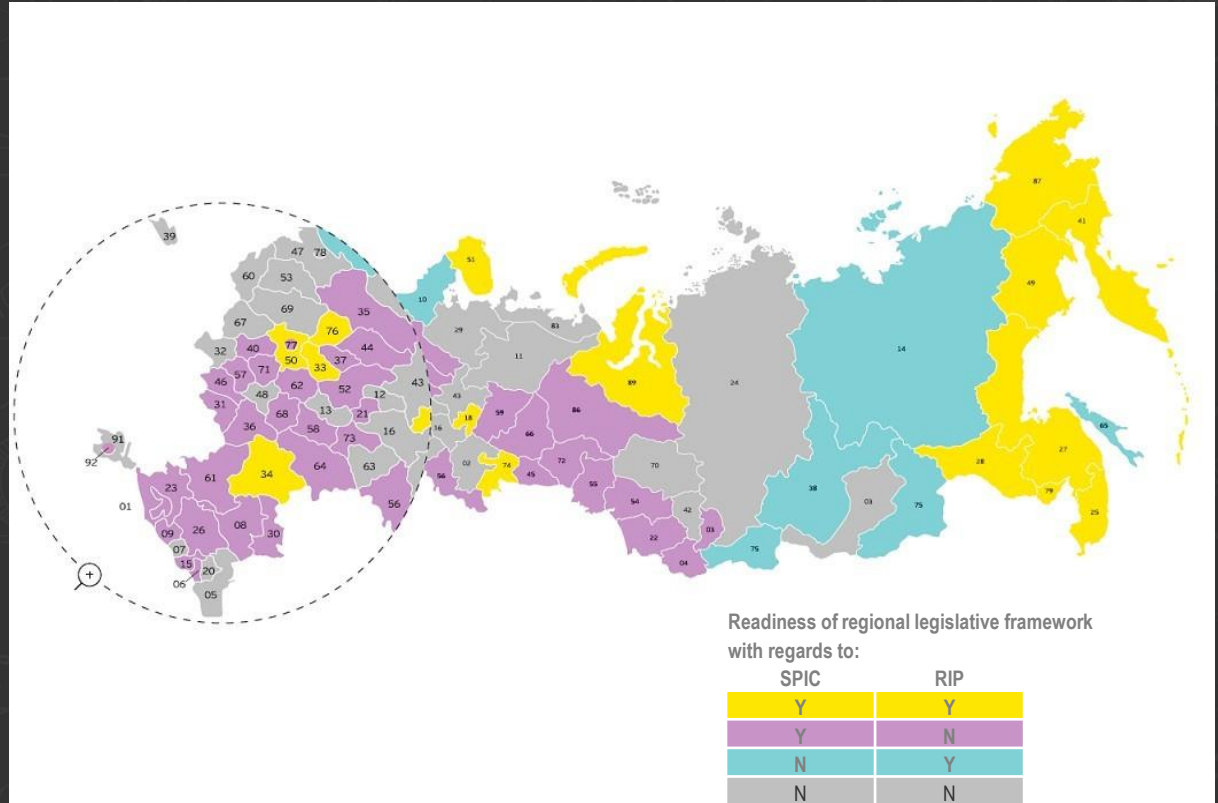
1. The importation of a product marked with a trademark and the payment of licensing fees for the use of the trademark.
2. The importation of a product for reproduction in the Russian Federation and the payment of licensing fees for the reproduction right.
3. The importation of raw materials and other materials for the manufacture of licensed finished products in the territory of Russia. The finished products must be marked with trademarks for the use of which the Company pays licensing fees to the rights holder.
4. The importation of special equipment and other goods for the manufacture of products using a licensed manufacturing process (know-how). The Company pays the Seller a licensing fee for the right to use the manufacturing process (know-how).

Law Update

Preferential tax regimes for foreign investors

Overview

- ▶ **Territorial Development Zones**
 - ▶ gov. lists eligible regions
 - ▶ grants tax credits to foreign investors
- ▶ **Special Economic Zones**
 - ▶ creation by government decree
 - ▶ moratorium on new SEZs since 2016
- ▶ **Advanced Special Economic Zones**
 - ▶ min. investment sum RUB 500 k
 - ▶ various ASEZs depending on regions
- ▶ **Special Investment Contract**
 - ▶ min. investment sum RUB 750 m, RUB 3 bn if single supplier status for government procurement purposes
 - ▶ depends on sector / region (s. right)
- ▶ **Regional Investment Contract**
 - ▶ min. investments of RUB 50 m over 3 y, RUB 500 m over 5 y



Do you have questions?



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