



New rules for VAT taxation of e-commerce services in Russia

Tax Update

22 JUL 2016

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On 3 July 2016 Russian President Vladimir Putin signed Federal Law No. 244-FZ introducing rules for VAT taxation of e-commerce services in Russia (Law).

The Law enters into legal force on 1 January 2017.

In this information letter, along with providing an overview of the major issues to be taken into account when considering the new rules, we also provide a comparison of the current key provisions with the key provisions of the Law presented in its initial version of December 2015 which have since undergone substantial changes (Draft Law).

VAT on e-commerce services supplied to Russian customers – List of services

The Law introduces the internationally recognised 'destination principle' for VAT taxation of e-commerce services in Russia. According to this principle, VAT is charged in the country of the services recipient's location. Therefore, from 1 January 2017, e-commerce services (ie 'services rendered in an electronic form' – as defined by the Law) rendered to legal entities and individuals located in Russia (as defined by the Law) should generally be subject to 18% Russian VAT.

The list of 'services rendered in electronic form' set out in the new Article 174.2 of the Russian Tax Code (E-Commerce Services) has been modified to become more specific compared to the Draft Law and currently includes, inter alia:

- transferring software and database rights, including access to online games on the Internet, including through remote access
- installing (downloading) games on PCs and mobile phones, banner-ad blocking programmes, accounting and antivirus software, web filters
- enabling the placement of goods (works, services, property rights) offers on the Internet
- furnishing information via the Internet, including making available e-books and other e-publications, graphic images, pieces of music, both with and without text and audio-visual works through the Internet, including by providing remote access for viewing or listening to them through the Internet
- making search engines and other portals available
- providing web-hosting services
- providing cloud services and cloud-based e-platforms

- providing website visitor statistics
- broadcasting TV and radio channels using the Internet and other services.

There have been certain activities not listed in the Draft Law that only appeared in the final version of the Law.

These include:

- providing advertising services on the Internet, including by using computer software and databases functioning on the Internet as well as providing advertising space on the Internet
- providing online calculating capacity for placing information in information systems
- providing search services and/or providing information regarding potential buyers to service recipients.

Despite the above modification of the list introduced by the Law in its final version, one of the previously voiced critical comments remains, namely that the description of the E-Commerce Services is still very broadly defined. Undoubtedly, this will cause disputes related to its interpretation in practice.

However, as an advantage the Law in its final version clearly provides that the following transactions will not be considered to be E-Commerce Services:

- sale of goods (works, services) through the Internet if the supply of goods (works, services) ordered is performed beyond the Internet platform of supply
- sale of computer software (including computer games) and databases on physical sources
- consultancy services rendered via email
- Internet access services.

VAT registration in Russia and payment mechanism

The VAT registration and payment principles have not been changed compared to the Draft Law: a foreign supplier of E-Commerce Services is required to perform VAT registration in Russia and to pay Russian VAT unless another Russian or foreign entity-intermediary is interposed between the foreign supplier and the individual for the purposes of collecting payments. In the latter case, such entity-intermediary will perform the responsibilities of a VAT agent in respect to the E-Commerce Services rendered.

The Law provides specific rules for VAT registration/de-registration and the VAT payment mechanism. Therefore, foreign entities which are required to perform VAT registration in Russia must file the relevant application to the Russian tax authorities within 30 calendar days of the day since they started providing E-Commerce Services deemed supplied in Russia. Such foreign entities registered in Russia for VAT purposes will be subject to tax audits. The Russian tax authorities are entitled to request the following additional documents during such tax audits:

- documents (information) confirming that the E-Commerce Services are deemed supplied in Russia
- other information in relation to E-Commerce Services
- upon the agreement of the Head (Deputy Head) of the Federal Tax Service: information regarding the transfer of funds to the audited foreign entity from the payment intermediaries.

Importantly, the reclaim of input VAT arising from the purchase of goods (works, services) in Russia is not allowed for foreign suppliers required to pay Russian VAT on E-Commerce Services. Therefore, this remains one of the few most critical and controversial points in the application of the new Law, as the newly introduced VAT system for E-Commerce does not allow for the "flow-through" nature of VAT payments for foreign legal entities.

Determination of 'the location' of the E-Commerce Services recipient

Article 148 of the Russian Tax Code has been amended to include the 'destination principle' in the rules for determining the E-Commerce Services' place of supply. Specifically, according to Clause 1 Sub-Clause 4 of Article

148 of the Russian Tax Code, E-Commerce Services are deemed supplied in Russia if the recipient of these services is 'located' in Russia. The Russian location is defined on the basis of the state registration in respect to legal entities, whereas in respect to individuals this will be determined on the basis of where they reside (are domiciled).

Unlike the Draft Law that envisaged the responsibility of the Ministry of Finance to establish criteria in respect to individuals qualifying as recipients of E-Commerce Services in Russia in order to determine the place of the E-Commerce Services' supply, the Law establishes certain conditions for individuals in order to have them qualified as recipients of E-Commerce Services. In particular, E-Commerce Services are deemed supplied in Russia, if:

- the individual who is a recipient of E-Commerce Services resides in the Russian Federation
- the bank where the individual has his/her bank account used for paying for the E-Commerce Services (or the bank of the operator of electronic money used for payment) is located in Russia
- the IP address of the individual used when purchasing the E-Commerce Services is registered in Russia
- the individual used a Russian international telephone code when purchasing the E-Commerce Services.

'Tie-breaking' rules in case of potential double taxation of the E-Commerce Services

In addition, the Law provides for 'tie-breaking' rules in case of potential double taxation of the E-Commerce Services rendered to individuals in Russia and in another state. The rule operates on the following premise: if according to the laws of the other state which applies the 'destination principle' in respect to the E-Commerce Services, such services are deemed supplied both in Russia and in this another state, then the supplier of the E-Commerce Services has the right to opt to choose the specific place of supply for its particular services at its own decision. The Law does not provide any further guidance in this respect, however it may be assumed that in the described case the supplier may be asked by the Russian tax authorities to provide evidence confirming the correctness of the choice made (although it remains unclear how this may technically be done by the Russian tax authorities in practice).

VAT driven for "all taxes" or "VAT only" registration?

As mentioned in our Information Letter dated January 2016, one of the main concerns of the Draft Law was related to the potential creation of a permanent establishment ("PE") risk for foreign suppliers of E-Commerce Services in case of performing VAT registration in Russia. In this context, the Law now has a provision amending Article 306 of the Russian Tax Code with a new Clause 14 stating that provision of E-Commerce Services in Russia by foreign entity does not lead to the creation of a PE for such foreign entity in Russia.

While this is obviously a positive new feature, this provision does not, in our view, fully eliminate the Russian PE concern. It will still be necessary to monitor whether the services supplied into Russia include only E-Commerce Services or whether they also encompass other "related services" or auxiliary services ('as part of composite supply') that can lead to Russian profits tax consequences because of obtaining the full tax registration by the respective foreign company.

No revision of VAT exemption for software supplies

Another substantial difference of the Law compared to the Draft Law is that the VAT exemption in respect to the provision of software rights under a licence agreement (Article 149 Clause 2 Sub-Clause 26 of the Russian Tax Code) ("VAT Exemption") has not been eliminated from the Russian Tax Code unlike as proposed by the Draft Law. This initiative suggested in the Draft Law was widely criticised by experts and the business community as many Russian software developers use the VAT Exemption in structuring their transactions.

Formally, the VAT Exemption can still be applied by both Russian and foreign companies, if they qualify for this tax incentive under the generally applicable requirements.

However, in the context of the Law, as a practical matter, we expect that for VAT Exemption purposes the application of this incentive by foreign suppliers of the E-Commerce Services will likely cause various practical

difficulties associated with the legal construing of agreements which provide, inter alia, for the "provision of a right to software via the Internet". These difficulties may potentially have an impact on Russian suppliers of E-Commerce Services as well. We anticipate that clarifications will be issued soon or changes will be made to the Law to resolve this potential issue.

Since the Law did not exclude the VAT Exemption from the Russian Tax Code, there was therefore no need to retain in the Law the profits tax incentive and VAT concessions for Russian companies (described in our previous Information Letter dated January 2016) that were more of a compensatory nature.

Possible practical effect of the new VAT rules

The Law enters into legal force starting from 1 January 2017 and will definitely have an impact on both foreign and Russian businesses (including those structuring the provision of services via foreign entities) engaged in E-Commerce Services. There is therefore not much time left for the businesses to examine the existing transactions and discuss potential restructuring, if necessary. This may be associated with the need to discuss the issue and agree on an appropriate solution with all participants of the existing structure, including third party intermediaries.

Considering the expectation of the lawmakers to receive additional funds for the Russian budget (it was expected that the Law will generate over RUB 50 billion of additional VAT collections in 2017 alone), we anticipate additional scrutiny will be placed in respect to all Internet based transactions and, especially, SaaS arrangements in order to ensure the desired VAT collections. It is important to determine what changes are necessary for the underlying compensating agreements, both in the context of related party deals between foreign multinationals and their Russian subsidiaries and also into third party transactions between foreign suppliers and independent Russian resellers to avoid any VAT leakage due to the vague formulations used by the Law.

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