Doing Business in Russia

A Legal and Tax Update

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The Outlook for International Business in Russia
Foreign Investment Advisory Council (FIAC) survey

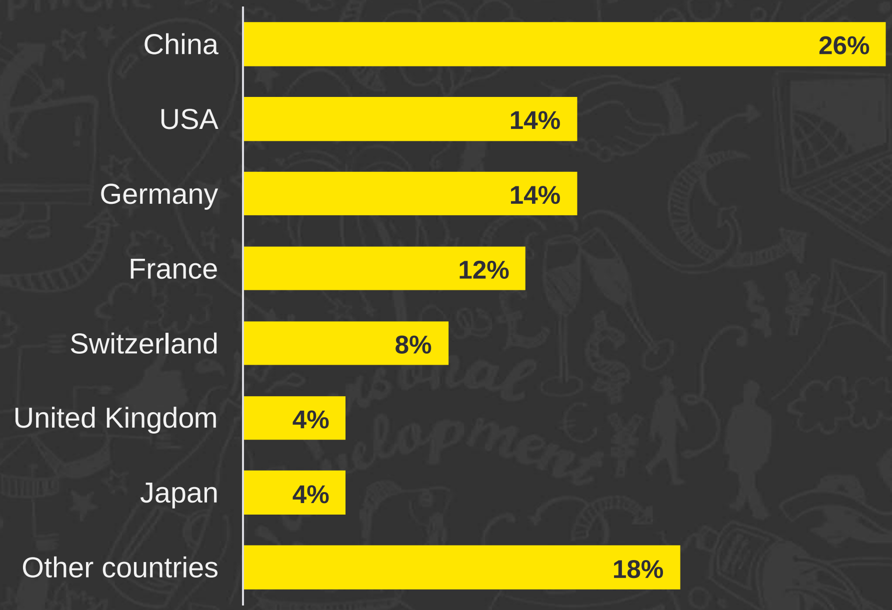
Background

- Survey conducted in July and August 2019
- Respondents from 95 foreign investors in Russia, 53 of which are FIAC members
- Survey done for the 25th anniversary of FIAC in Russia, established in 1994 as a result of the combined efforts of the Russian government and foreign businesses to improve the investment climate in Russia

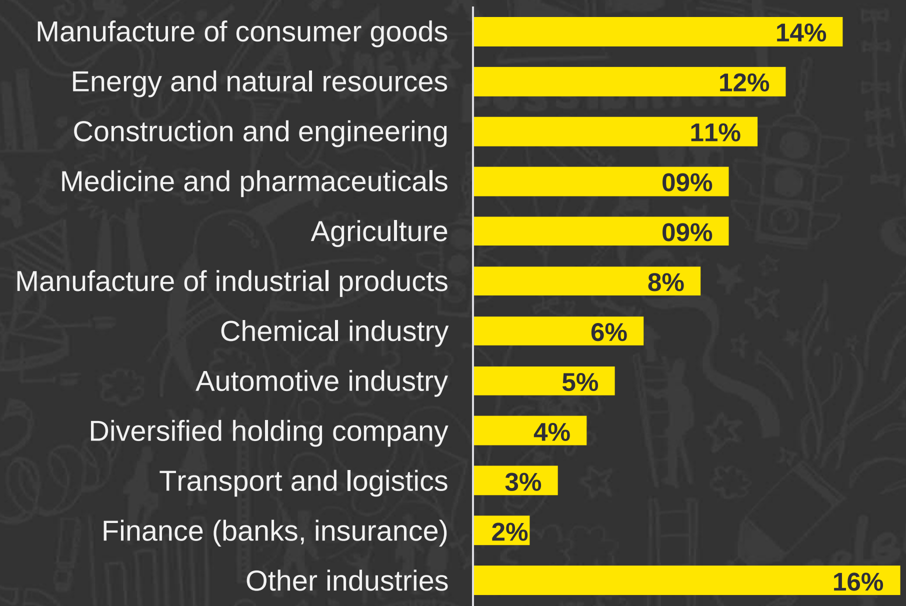
The Outlook for International Business in Russia
Demographics

- Participants in the survey have been operating in Russia for an average of 28 years, including six companies which have been present in Russia since the early part of the 20th century
- Average Russia-related revenue of the participants in the survey: USD 745 million in 2018
- Average staff size: 3 thousand people

Country of headquarters

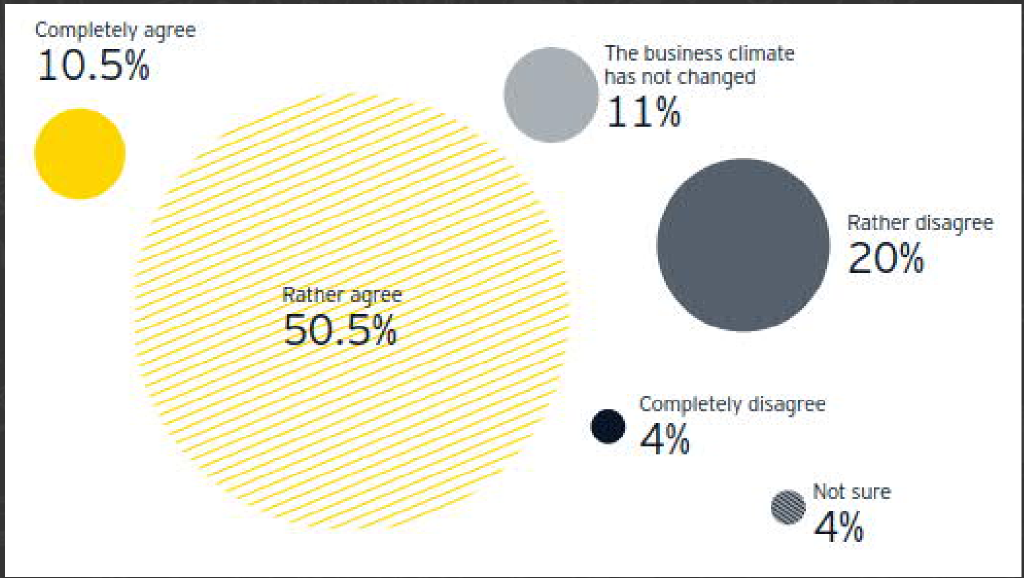


Main industry



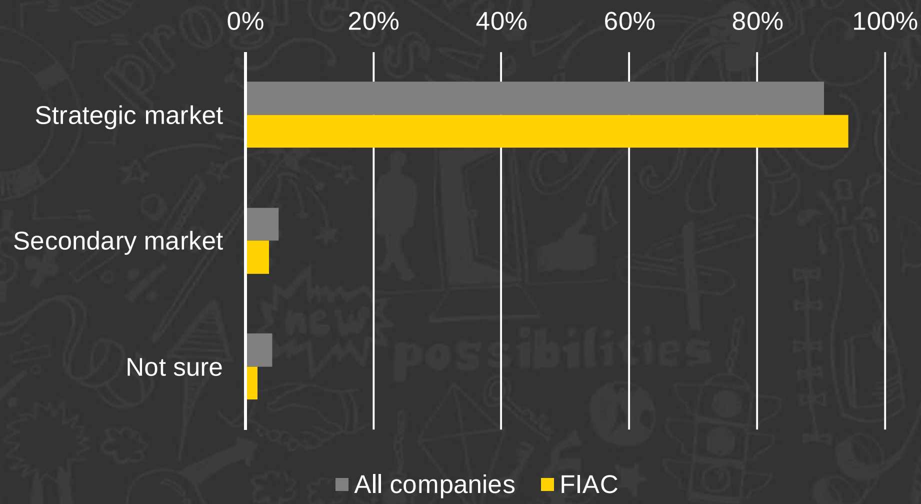
The Outlook for International Business in Russia
Main perceptions

Do you think the business climate has improved?



- 61% of the surveyed companies think that the business climate in the country has improved
- The most positive assessment of changes in the business climate was made by Asian companies (78%), compared with 64% of North American and 49% of European businesses

Importance of the Russian market



- 91% of the survey participants regard Russia as their strategic market
- 85% of the surveyed companies expect to see growth in their business in Russia in the next three years, but majority expects a slow one
- Rapid growth is expected in medical and pharmaceutical sector (44%), construction and engineering (40%) and the energy industry (36%)

The Outlook for International Business in Russia

Impact of sanctions

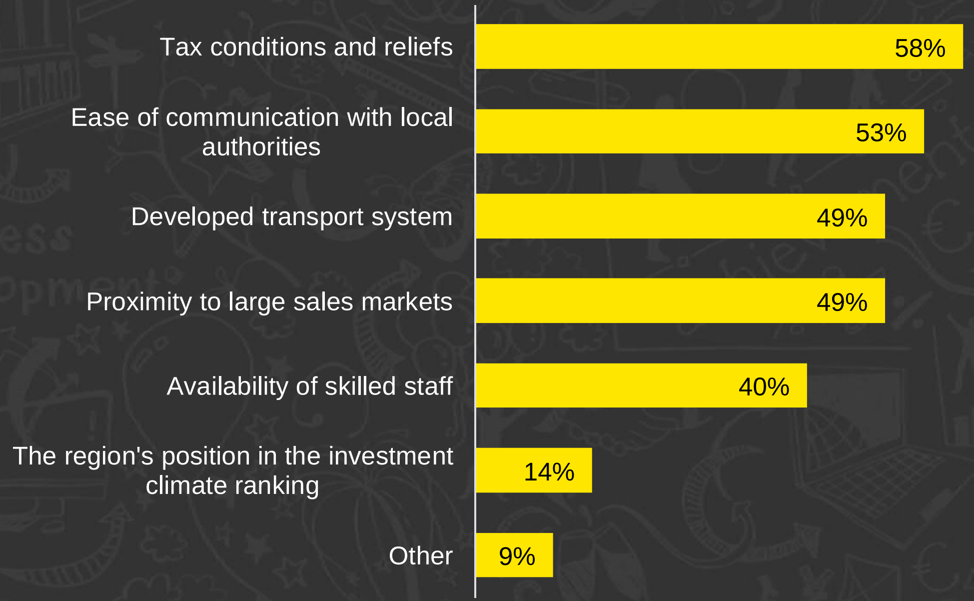
- Sanctions were confirmed to have had a negative impact on the business of 62% of the surveyed companies
- At the same time, 42% indicated that the restrictions imposed did not affect their revenue, while the remainder reported that the fall in income was insignificant

How is the negative impact of international sanctions actually manifested?

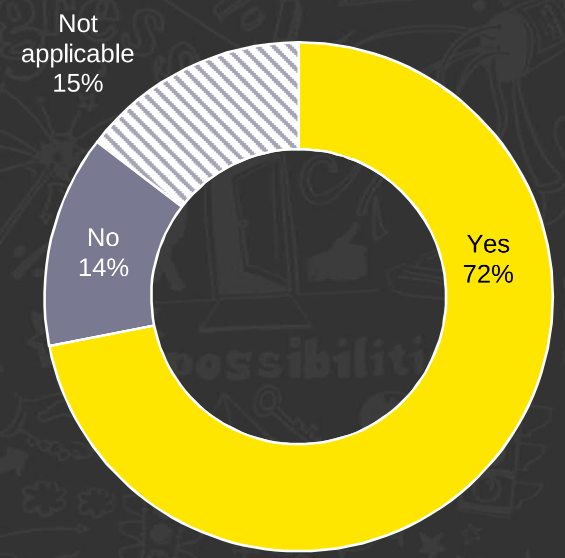
- The sanctions reduced the size of the Russian market for **44%** of companies
- **27%** have found it more difficult to finance Russian projects, with agricultural companies the most likely to encounter problems - **75%**
- Sanctions have caused disruptions in established supply chains for one in four companies. Manufacturers of consumer goods were the most likely to report having suffered in this regard - **64%**
- **38%** of large companies with annual revenues of USD 300 million and above indicate that sanctions caused serious reputational risks, while only **14%** of smaller companies report this

The Outlook for International Business in Russia
Regional priorities and production and export in Russia

Most important factors in choosing a region for investment



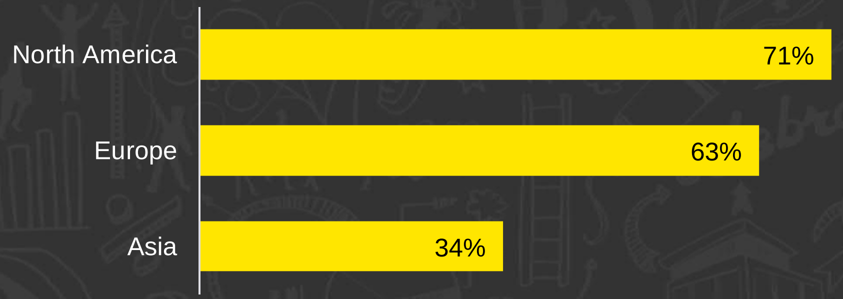
Production base in Russia



Differences in priorities

- Asian companies indicated tax reliefs as the most important factor (75%)
- European companies favored proximity to sales markets (70%)
- Americans saw ease of communication with local authorities (71%) and availability of staff (57%) as the main priorities

Export from Russia to other countries



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

Area	2012 May Decrees	2018 May Decrees
National Goals	► 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	► 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 average ► Inflation to be maintained below 4%
Demography	► increase birthrate to 1,753 ► increase life expectancy to 74 y ► increase women participation in labor market	► bring birthrate to 1,7% ► raise life expectancy to 78 y
Healthcare	► lower death rates from all kind of causes ► increase share of locally produced important drugs to 90%	► 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	► at least 5 Russian universities among top 100 ► Increase R&D spending to 1,77% of GDP	► 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	► mortgage rate to be reduced to inflation +2,2%	► mortgage interest rate to be reduced below 8%
Infrastructure	► create special mechanism to attract FDI	► 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	► increase by 50% from 2011 to 2018	► increase by 5% per year

Legal Update

New laws on Special Investment Contracts: SPIC 2.0

On 2 August 2019 the President of the Russian Federation signed a package of three laws aimed at updating the special investment contract mechanism – **“SPIC 2.0”**.
The laws entered into force starting **13 August 2019 (Tax Code amendments starting 2 September 2019, some other provisions starting 1 January 2020)**

1 **290-FZ “On Amendments to the Federal Law “On Industrial Policy in the Russian Federation” Relating to the Regulation of Special Investment Contracts**

2 **269-FZ “On Amendments to Parts One and Two of the Tax Code of the Russian Federation”**

3 **295-FZ “On an Amendment to Article 78 of the Budget Code of the Russian Federation”**

Legal Update

SPIC 2.0 – Changes compared to SPIC 1.0

Subject-matter of a SPIC

(i) implementation or
(ii) development and implementation
of modern technologies for the mass production of products that are competitive on the global market

Procedure for concluding a SPIC

Competitive process involving public or private tenders

(except where only one eligible bid is submitted or a relevant decision is made by the President)

Parties to a SPIC

Four parties necessary:

- Russian Federation
- Region in the RF
- Municipality in the RF
- SPIC investor

Required minimum investment

No requirements set

(as opposed to minimum investment of 750 million roubles for SPIC 1.0)

Term of a SPIC

Up to 15 years inclusively (investments ≤ 50 billion roubles)

Up to 20 years inclusively (investments > 50 billion roubles)

Separate record-keeping requirements

Separate management records relating to income and expenses (and in some cases assets and property rights) connected with SPIC activities and non-SPIC activities

Legal Update

SPIC 2.0 – Tax relief in comparison to SPIC 1.0

Criteria	SPIC 1.0	SPIC 2.0
Reduced profit tax rates	► Federal budget – 0%; ► Regional budget – up to 0% (according to regional law)	► Federal budget – 0%; ► Regional budget – up to 0% (according to regional law)
Timeframe for application of profit tax relief	► Until 31.12.2025	► The reduced tax rate generally applies until the reporting period in which an organization loses SPIC participant status
Condition of application of profit tax relief	Applicable to the entire tax base ► provided that revenue from sales of goods produced within the framework of the SPIC accounts for 90% of all taxable income and ► provided that separate records are kept of income/expenses related to and not related to the SPIC	One of two scenarios: ► Scenario 1. Applicable to the entire tax base if income from the SPIC accounts for at least 90% of all taxable income; or ► Scenario 2. Applicable to the taxable base arising from SPIC activities provided that separate records are kept of income/ expenses related to and not related to the SPIC
Transitional provisions	► Not applicable	► Scenario 2 for profits tax relief in the context of a SPIC applies to participants which concluded SPICs from 1 January 2017 onwards; ► Taxpayers which concluded a SPIC before the effective date of the law regarding SPIC 2.0 may apply Scenario 2 starting from the profits tax period following the tax period in which the relevant method of determining the tax base was established in their accounting policies.

Tax Update
Key Amendments to the Tax Code – a Brief Summary

Federal Law No. 325-FZ “On Amendments to Parts One and Two of the Tax Code of the Russian Federation” was published on 29 September 2019. The major changes are summarized below:

Profit tax	▸ Limit on the **carry-forward of losses** (50% only) is extended by a year until 31 December 2021
	▸ Limitation on the **recognition of losses in the event of re-organization**: losses may not be recognized if a tax inspection finds that the main purpose of the re-organization was to reduce the successor company’s tax base by amounts of losses made by the re-organized entities in the past
	▸ **Depreciation/amortization**:
	  ▸ The useful life of fixed assets temporarily removed from service would no longer be extended by the period for which they were out of service
	  ▸ Fixed assets considered as depreciable also if the historical cost is below RUB 100,000
	  ▸ Switch from linear to non-linear method of depreciation allowed no more than once every five years

Transfer Pricing (esp. regarding use of intangible assets)	▸ Changes made include clarifications and additions resulting in the Russian tax law on transfer pricing developing in line with global trends:
	  ▸ Definition of **functions and risks** to be taken into account in a functional analysis of parties to controlled transactions involving intangible assets (known in global practice as DEMPE functions and related risks)
	  ▸ Establishing of **characteristics of intangible assets** that must be taken into account in assessing the comparability of transactions involving such assets (exclusivity, conditions of legal protection, useful life, etc.)
	  ▸ Extension of scope for applying the profit split method: the method can be used not only when the parties to a tested transaction possess rights in an intangible asset, but also when one of the parties controls the use of that intangible asset (broadly in line with the OECD approach)

Tax Update

Looking forward to changes: tax policy guidelines for 2020-22

The **Draft Law** "On the Federal Budget for 2020 and the Planning Period of 2021 and 2022" was submitted to the State Duma on 30 September 2019

International tax	► Changes suggested in the approach to taxing companies in the digital sector, resulting in profit taxation in the location of the users (consistent with current international initiatives)
Excise	► Suggested 4% increase in excise rates in 2022 to compensate for inflation
Special tax regimes	► A number of amendments have been suggested to make special tax regimes even more attractive for taxpayers, such as ► Requirement to submit tax declarations is to be eliminated for individual entrepreneurs who pay tax on income under the Simplified tax system (STS), which includes usage of cash register equipment which automatically transmits fiscal data to the tax authorities ► Several more constituent entities of the Russian Federation may be included in the experiment to introduce a special tax regime for the self-employed
Other	► Any legislative amendments that worsen the position of taxpayers and are published after 1 September should enter into force no earlier than a year later ► A unified information space is to be created to enable taxes to be collected from the shadow economy. Special attention in this initiative will be given to personal income tax and insurance payments.

Customs Update
Tracking Goods. Marking and Documentary Tracing

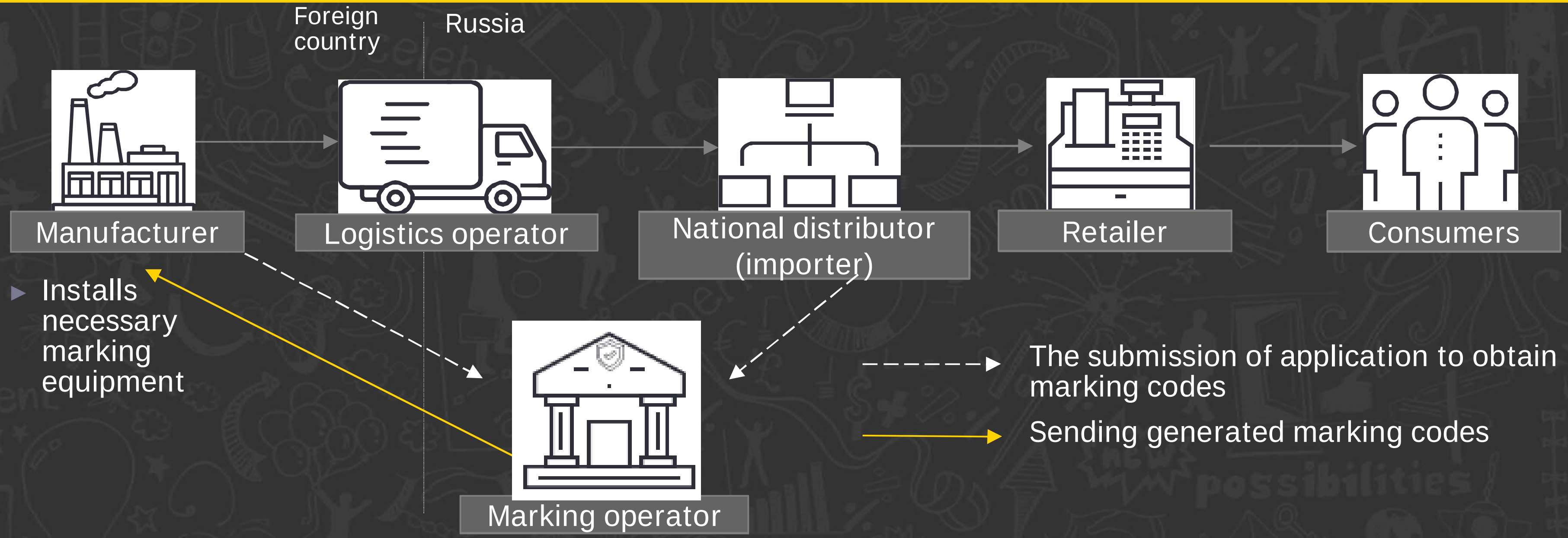
Concept of goods tracking & tracing

Physical tracking (marking of goods)

Documentary tracing

Customs Update

Marking of certain goods sent to Russia



Currently marking is mandatory for some groups of goods, for others, a voluntary marking experiment is in progress. It is planned that by 2024 the marking system will cover a considerably greater range of consumer products.

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Customs Update
Documentary tracing

Customs $\xrightarrow{ID\#}$ Electronic document flow $\xrightarrow{ID\#}$ Reporting $\xrightarrow{ID\#}$ Tax authorities

ID# = Number of custom declaration + serial number of declared good

The list of goods to be traced will be subject to the approval of the Government. It is expected that the list will include the following goods. The list of controlled items may be extended in future

- Refrigerators and refrigeration equipment
- Forklifts and bulldozers
- Monitors and projectors
- Prams and child seats
- Integrated circuits
- Washing machines

Do you have questions?

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The better the world works.

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