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# ACCOUNTING & TAXES IN RUSSIA



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## Introduction

*“We help international companies in Russia!”*

*The RUFIL CONSULTING vision*

Russia offers excellent opportunities to international companies.

RUFIL CONSULTING supports international companies in their business in Russia with service and competence in the fields of accounting & taxes, business set-up and expertise in Russia.

In this brochure, we give you an overview of the peculiarities of Russian accounting and tax. Please do not hesitate to contact us with any queries on this or any other related subject. You can find our contact details at the end of this brochure or online at [www.rufil-consulting.com](http://www.rufil-consulting.com).

Yours sincerely,

Philipp Rowe

General Director

RUFIL CONSULTING / Accounting & Management in Russia

## Accounting in Russia

### ***General Observations***

All enterprises registered in Russia, including representative offices of foreign entities, are required by law to maintain accounting records. This obligation must be met even if the enterprise in question is not engaged in commercial activities. However, companies that engage in tax accounting are exempt from the financial accounting requirement. Moreover, in all companies has to be both a general director and an individual legally responsible for the accounting. As a rule, this is the chief accountant; but it is possible, for instance, for the chief financial officer to take charge. If desired, the managing director can play a dual role where he or she is answerable for the accounting as well. However, given their legal liability, accountants in certain forms of enterprise (including OAOs, i.e. joint-stock companies) must fulfil the following criteria:

- Degree in accounting,
- 3-5 years of work experience and
- the absence of any relevant convictions.

However, the chief accountant in an ООО (“Общество с ограниченной ответственностью”, like the British PLC or American LLC) has not to fit any of these requirements. Therefore you have to be especially careful by filling this vacancy.

Russian accountancy tends to be very formal in practice. The types of document to be used are, for the most part, legally prescribed. Internally generated forms are only confirmed and validated for legal purposes by way of internal directives (“prikazy”). Likewise, the chart of accounts cannot be adapted to business requirements, but is instead fixed by regulations of the Ministry of Finance. However, companies are permitted to add sub-accounts.

Another peculiarity in Russia is that the financial year and the calendar year must be tally. Furthermore, enterprises are legally bound to define their accounting policies annually, according to both in terms of commercial and tax law. The depreciation policies for instance must be applied over the course of the new financial year and are not subject to retroactive modification.

The balance sheet, income statement, and corporate tax return must be submitted to the tax authorities quarterly. Additionally, further declarations are sent to the Social Security and Statistics offices. All in all, there are more than 15 different reports per quarter. If you are interested in an overview of these documents, we are happy to provide them at your request.

Funds from abroad are subject to currency controls. Prior to the receipt of sums exceeding \$50,000 (including sales tax), extensive applications (“pasport sdelki”) must be put in.

The underlying contracts and/or invoices must be included as well. In this context, delays and unexpected difficulties are common. Examples include a missing stamp or the bank demanding confirmation that the parent company really has no company seal and is indeed registered in country X. However, due to ambiguous regulation, bank policies vary widely in this regard.

Although Russian Accounting Standards (RAS, or PBU in Russian) have been in force since 1998, the reality is that financial accounting mirrors tax accounting to the greatest possible extent. Russian accountants are in constant contact with tax authorities in order to represent their employer’s interests.

Given the formalities and complications described above, Russian accounting typically features twice as many accountant records as it would be the case in the German jurisdiction, for instance. The number of documents that have to be generated gathered and archived is many times higher.

### ***Russian Accounting Documents***

Red tape in Russian accountancy gives rise to a multitude of documents, which are scarcely intelligible to outsiders. Below, we shed light on the most important ones.

In Russia, opposed to Germany, **invoices** are not enough for accounting and tax purposes. Invoices (Russian: “shcheta”) are merely seen as an invitation to pay. Frequently, these are sent by e-mail or telefax in advance as a postal delivery would take too long..

In contrast, **faktura invoices** (“shcheta-faktury”) and **handover certificates** for services or goods are much more important. The faktura invoice is a pre-defined accounting document whose format cannot be altered. The recipient of a service or

good can use it to recover input tax from VAT. In its absence, the recovery is impossible. As a rule, faktura invoices are only issued for non-cash transactions. Cash payments at restaurants or shops do not qualify for tax rebates.

Once an invoice is paid, a faktura invoice and a completion certificate are required so that it can be recorded as expenditure. Completion certificates are issued for provided services or delivered goods. Here, both parties to the contract confirm once again that a service has been rendered as agreed, or goods have been duly handed over. However, the certificate is not to be confused with a delivery note. For services it is called an "Akt", for goods "Tovarnaya Nakladnaya".

To recover input tax from VAT and to record the expense, the invoice, faktura invoice and handover certificate must be handed in. Incomplete records are penalized by fines. Consider the following example:

*You have concluded a contract that stipulates prepayment of a flat rate for Internet access at the beginning of each month. However, you cannot record this amount as an expense; as a result, the bank transfer is booked as a prepayment or a receivable. Only after the «Akt» and faktura invoice had been signed and stamped by the General Director of the Internet provider and had been sent to you, the accountants can rebook the Internet usage expense from the prepayment account to the expense account.*

To control the completeness of all documents, all purchases and sales are recorded in dedicated ledgers. As a rule, this initiates a time-consuming follow-up procedure, in which the missing documents must be followed-up and recovered; otherwise, existing payments cannot be recorded as expenses.

## **Cash Payments and Cash Management**

To pay in cash or keep money in the cash register, the company is required to keep an official cash register and cash ledger. To this end, a so-called cash limit and a ledger for cash withdrawals must be applied for at the company's bank in advance.

In the course of cash management, further formal records of cash takings, cash disbursements and cash advances must be compiled. All transactions are then recorded again in the so-called "Avansovy Otshchet", which resembles an expense claim.

In the event of cash or credit card payments, care must be taken to ensure that the payees' tax ID is stated on the printout, and that the services are labelled and listed accurately. An additional "Tovarny Chek" is required where merchandise is purchased. This document once again lists all purchased items in detail. A faktura invoice is not issued for cash purchases; consequently, it is impossible to recover input tax.

To accept cash or credit cards, the company must register a till with the tax authorities. However, one must not offset the cash takings with the disbursements; the takings must be paid in separately at the bank.

The limit for cash payments between legal persons within one contract is 100,000 rubles.

### ***Personnel Administration and Payroll Accounting***

Russian labor law is highly complex and employee-friendly. This is especially true for the lengthy, bureaucratic regulations covering administration and personnel accounting. The most important points are listed below.

In Russia, a two-week notice period typically applies (one month for a general director). The probationary period generally lasts for three months, but six months for general directors, heads of representative offices, branch managers, chief accountants as well as the deputies of all of the above-mentioned positions. During probation, both parties can give three days' notice; the employer is obliged to justify his decision in writing.

In Russia, personnel administration is typically undertaken by the accounting department. One reason is the complex determination of monthly salaries which, according to Russian legislation, must be paid at least twice a month. If an employee takes a holiday, this determination is complicated further still. The salary drawn by an employee during his leave is computed based on his average salary over the last twelve months. Bonuses, salary increases, or a 13<sup>th</sup> monthly salary also influence the calculation. Salaries must be paid out prior to holidays.

All employees are entitled to a minimum of 28 calendar days per annum. Where expertly apportioned, these do not necessarily correspond to four weeks or 20 working days, but could easily end up to more. Unused days can be rolled over into the next holiday year.

Further, in the event of new hires, dismissals, or leaves, the contract of employment, written notice, or application for leave are not enough: internal directives (“Prikazy”) must also be drafted, as well as signed by the general director. For each month, spreadsheet documents whether a given employee was present, absent, or sick on a given day have to be established. Additionally, a so-called labor book must be maintained for each employee. Here, the employer records the job title, period of employment and reason for dismissal. A journal must be kept detailing all labor books in the company in their entirety.

Further information regarding this topic you can find on our website at the category [Payroll Accounting](#).

The table below takes stock of the documentation requirements in Russian payroll accounting and administration.

Legally required documents	Not legally required documents
<ul style="list-style-type: none"> <li>■ Employee roll</li> <li>■ Directive on initiation of employment when new staff is hired</li> <li>■ Contract of employment</li> <li>■ Code of practice</li> <li>■ Labour book</li> <li>■ Journal detailing labour books</li> <li>■ Overview of annual leave for all employees</li> <li>■ Rules and directives on bonus payments</li> <li>■ Remuneration guidelines</li> <li>■ Timekeeping table</li> <li>■ Employee data protection guidelines</li> <li>■ Employee job cards</li> <li>■ Application for mandatory health insurance</li> </ul>	<ul style="list-style-type: none"> <li>■ Organisation chart</li> <li>■ Employee files</li> <li>■ Journal detailing all employee files</li> </ul>



## ***Fines and Penalties***

Accounting and tax law in the Russian Federation stipulate fines for a variety of transgressions. Those must be remitted to the tax authorities, respectively to the tax inspectorate (“nalogovaya inspektsiya”) or labor inspectorate (“trudovaya inspektsiya”).

Below we adduce several examples:

- Where accounting rules are infringed upon, e.g. in the case of missing “Akt” or faktura invoices, violations over the course of one accounting period are punished by a 10,000 rouble (€ 145) fine; violations present over two or more periods incur a 30,000 rouble fine. Whether or not the error has led to a tax advantage is irrelevant; the fine is due in either case. That means that a fine has to be settled even though too many taxes were paid due to incorrect entries. In addition, the general director or chief accountant can be personally fined up to 3,000 roubles.
- Where personnel administration documents are not duly created or filed, fines from 30,000 to 50,000 roubles are levied.
- The fine for tax underpayment amounts to 20-40 percent of tax outstanding.
- Where the tax return has not been filed on time, the fine runs to the higher of 1,000 roubles and 5-30 percent of the monthly tax bill. If the tax return is delayed by 180 days, a 30 percent fine is incurred; from day 181, each extra month is penalized by an additional 10 percent.
- Companies that remit tax payments late are subject to moratory interest (1/300 of the Central Bank’s refinancing rate).
- If a tax return or tax payment deadline is missed by 10 or more working days, the tax authorities are entitled to freeze the delinquent taxpayer’s current accounts. They must unfreeze them within a day following submission/payment.

**Fines and penalties are not tax-deductible!**

## ***Internal transfer pricing in Russia***

A change in the treatment of internal transfer pricing in Russian tax law has also led to significant changes in accounting techniques.

The taxpayer must separately disclose all related party transactions. Parties are related if they are economically linked (for instance, parents and subsidiaries), even if they are unconnected from a legal perspective. In the event of a 25 percent stake or above, the law automatically assumes that the parties are related.

Mere suspicion of a related party transaction constitutes sufficient justification for a tax audit. The type of deal or any other criteria are inconsequential.

It is essential that the following transactions are disclosed:

- Dealings with foreign related parties, regardless of turnover
- Dealings between related parties on the Russian domestic market, provided their turnover exceeds one billion roubles.
- Dealings between related parties even if a third entity separates them in the supply chain; but only if the third party does not assume any risks or liabilities, does not employ any assets, and has no other function.

The tax inspectorate also verifies whether the prices actually charged differ from market prices. It introduces the concept of a “market prices interval” and stipulates that for each firm, the permitted deviation from market prices have to be computed individually.

Controlled transaction disclosures must be submitted to the relevant regional tax authorities no later than the 20<sup>th</sup> May of the year following the reporting period. The disclosure can be handed in in hard copy or electronically. Indications of controlled transactions must contain the following information:

- The calendar year when the controlled transactions took place
- The subject of the transaction
- Details on the parties involved
- The counterparty’s full name and tax ID
- For individual entrepreneurs, their full name and tax ID

- Turnover and costs related to controlled transactions; internally determined prices must be highlighted

Since 2014, tax evasion associated with related party transactions is penalized separately; by 20 percent up to and including 2016, and by 40 percent from 2017. The sum charged must not be lower than 30,000 roubles.

## **The Bank Account in Russia**

Every company which is registered in Russia has to open a bank account in Russia. The reason is that tax payments have to be settled from a Russian bank account. This is required by a document of the ministry for finances of the Russian Federation, Department of taxes and custom policies, of April 13<sup>th</sup>, 2007 (number 03-02-07 \ 1-17). A lock of the account entails serious problems for the company. The most frequent reasons for an account lock are listed below:

- Tax reports were not punctually handed in to the Russian authorities.
- Amounts due to taxes were not settled.
- The accreditation was not extended up to the maturity day (representative office).
- Liquidity is not efficient enough to pay financial commitments.

When your account is locked, your company is no longer able to carry out payment transactions. Your suppliers, employees, landlord and other business partners cannot be paid. Professional, quick and direct actions are essential to make your company capable of acting again.

The following proceedings have to be initiated:

- Contact your bank and find out about the reason for the account lock
- Contact the responsible tax authority. Ask for detailed reasons for the account lock.
- Bring the situation under control. Convey the required documents as quick as possible and personally via your currier or accountant.
- Keep in close contact with the authorities and the bank until the account is unlocked.

What can you do to prevent an account lock? The following aspects should be taken into consideration in order to exclude a freezing of an account:

- Engage only professional accounting and reporting employees for the Russian accounting of your company.
- Transmit the required documents and information for the writing of reports to the responsible accountants on time.
- Let only trustworthy courier services transmit reports and documents for audits. Better not rely on the Russian postal service.
- Plan your liquidity long enough in advance. Always make sure that your availability of liquid funds is sufficient. To have a liquidity buffer of three months is recommended.
- Apply for the extension of the accreditation of your representative office long enough in advance so that you can prepare all required data and documents early enough. We recommend you to begin with the application for the new accreditation three months before the current accreditation expires.
- What else you have to keep in mind when opening a Russian bank account and how we could help you doing it, you can find out at [Russian Bank Accounts](#) at our website.

## Audit

Note: The term audit is here used as a synonym for annual financial statements.

According to the Russian tax law N 307-F3 of October 30<sup>th</sup> in 2008, the conducting of an audit is legally mandatory for all the companies listed below. But it has to be differentiated between an audit of consolidated financial statements and an audit of individual financial statements. The annual audit is carried out according to Russian accounting principles (Russian accounting standard – RAS):

- Public limited company
- Companies that have listed shares on the stock exchange
- Banks and other financial institutions, insurance companies, pensions funds and investment funds as well as their credit agencies, stock exchanges, clearing houses, registries, custodian banks, stock brokers and dealers.
- Companies that had an annual turnover of more than 400 million rubles in the previous business year.
- Companies with total assets of more than 60 million rubles of December 31<sup>st</sup> of the previous year.

An annual audit according to IFRS is mandatory for:

- Companies whose shares are listed on the stock exchange
- Banks and other financial institutions, insurance companies (except for companies whose business activities are restricted to the obligatory health insurance)
- Non-governmental pension funds
- Management companies of investment and pension funds and clearing houses
- Additionally, certain state-owned enterprises are obliged to make IFRS-consolidated financial statements.

Reasons for the legal obligation to carry out an audit are in the first place:

- Protection of public interests
- Contribution to the correctness of the reports
- Reduction of (tax) fraud risks

The results of the audits is not only interesting for the Russian general government or the tax authorities, but also for the general public, business partners, the management and shareholders.

An audit is meant to identify the following problems at the right time:

- Imprecise annual financial statements
- High tax risks
- Infringement of rights that could complicate business operations or lead to substantial fines
- Employee fraud
- Defects in internal control systems

The prescribed audits are to be carried out according to the following scheme:

The start of the auditing action is flexible. It can be decided that the audit is realized in several steps. In a first step, for instance, the first six or nine months of the business operations are checked and in a second step the remaining period of the business year is examined. What is favourable about this strategy is that the examinee is given the opportunity to implement recommendations from the first part of the examination until the end of the business year in order to avoid a potential audit certificate.

At the beginning of the audit, the examination team familiarizes with the company's business operations and sets an individual focus that corresponds to the corporate profile. Through a risk analysis, the audited aspects that call for an intensive treatment can be identified early enough and an audit program can be made out afterwards. The risk-oriented audit approach assures a purposeful and efficient audit of the financial statements.

As a rule, there is a system check which comprises basically a check of the internal control system (ICS). The ICS is responsible for the regulation and control of the processes in the company that are relevant for the financial statement. The ICS that is used in the company is basically responsible for the truth and fairness of the annual financial statement. Therefore, the auditors check the ICS, which is implemented in the company, for its suitability and effectiveness.

In the second step, a detailed examination is carried out. It is the aim of the detailed examination to follow and question business transactions that are documented in the financial statement by plausibility checks. In this connection, it is important that the auditors check the adherence to the valid laws and that they, in order to do that, get access to the required licenses and permissions. If the company has a warehouse at its disposal that is relevant for the business activity, the auditor can carry out stocktaking. This check begins normally after the balance sheet date.

In the third step, the company receives a test report as well as an audit certificate. In a final meeting, all the results of the audit are presented to the client. The test report (also: Management Letter) contains a list with all the irregularities, their consequences as well as recommendations for solving these problems. The test report is only meant for internal use. The audit certificate is an official document which the auditor uses to check the accordance of the annual financial statement and the warehouse report with the help of the accounting principles that are valid for the company.

Companies which are obliged to have carried out such an audit have to hand in the audit report to the tax authorities as well as to the statistical authorities. The audit report should be handed in together with the financial statements, but 10 days after finishing the audit report at the latest. If there is an obligation to publish the figures of the financial statements, they have to be published together with the audit report.

Besides the audit which was explained above and is legally mandatory, there is another form of the audit, the internal audit. The company decides voluntarily for this kind of audit in order to get checked by professional auditors in terms of business activities, finances and control systems.

Regular clients and receiver of such audit reports in Russia are for instance foreign parent companies which want to check their Russian subsidiary with their local management systematically. The most important aims of such audits are mostly the determining and prevention of fraud and the assessment and evaluation of risks concerning taxes, finances and law.

Content, type and scope of those internal audits are not prescribed and are carried out according to the customer's demands. As a result, these audits are in most cases more understandable and more informative for international clients.

Only licensed companies which have to fulfill certain requirements are authorized to carry out these legally required audits in Russia. These requirements are only valid for the legally required and certified audit. In contrast, the carry out of an internal audit is not tied to those requirements. That is why the client should carefully check the qualifications of the auditors when carrying out an internal audit.

Further information about audit in Russia and about how to evaluate and analyze a recently bought company, you will find at [Internal Audit and Due Diligence](#) at our website.



# Taxes in Russia

## *Introduction*

The Russian tax system is based on the first and second part of the Russian Tax Code. Here, the taxation principles, procedures, and types of tax are standardized for the Russian Federation as a whole.

The Russian tax system has three levels: the first federal level, second federal level, and regional level. On the first federal level, a consistent tax rate is applied to the whole of Russia. One such instance is VAT. Second-level federal tax rates are also determined centrally by the federal fiscal code, but local municipalities are entitled to reduce this by a local part. An example is corporate income tax.

Regional or local-level taxes include wealth and property tax.

Here are the most important tax types in Russia with the respective rates:

- Corporate income tax: 20%
- Value-added tax: 18% (reduced rate 10%)
- Personal income tax: 13% (30% for non-residents)
- Wealth tax: up to 2.2%
- Dividend tax (withholding tax): 13% (15% for non-residents)  
(with double taxation agreements, potentially 5%)

We will now explore the tax types in more detail. After that, we will address the following issues: the simplified taxation system, tax issues related to company formation, tax inspection, and the double tax agreement.

## *Important Tax Types*

### **Corporate Income Tax**

Russian corporate income tax is a federal tax, payable by all domestic and foreign enterprises at a rate of 20 percent. 3 percent go into the federal budget, 17 percent into the relevant regional budget. Local authorities are allowed to reduce the tax rate from 17 percent down to 13.5 percent of the upper limit of assessment.

In special economic zones intended to develop selected industries, the regional portion of the corporate income tax rate applied to eligible companies may not exceed 13.5 percent.

The taxable profit equals total revenue minus deductible expenses. Expenses are deductible if they are economically justified, duly documented, and facilitate the generation of future income.

Essentially, the following expenses are recognized as deductible:

- Provisions for general maintenance costs
- Provisions for unclaimed holiday entitlements
- Reserve for warranties
- Provisions for bad debts, dependent on maturity (100 percent if over 90 days, 45 percent for more than 45 days and 0 percent for up to 45 days)
- Tax accrual
- R&D spend

The following expenses are partially taxable:

- Employer contributions to corporate life insurance or pension schemes (up to 12 percent of the total salary)
- Contributions to employee health insurance, paid by the employer (up to 6 percent of the total salary costs)
- Various marketing and promotional expenses
- Entertainment expenses (up to 4 percent of the total salary)

Losses in a given financial year offset profits in the current year. Tax loss carry forwards are possible for a ten-year period; they reduce taxable income in high-earning years by fully incorporating the earlier loss.

It must be noted that tax accounting can differ from financial accounting. The following examples demonstrate this:

- Interest on payables, import duties paid, and transport costs are included in current-period expenses under fiscal law, but in the purchase price under commercial law.

- Under Russian tax law, most types of fixed assets can be written down by 10 percent or 30 percent upon purchase. Write downs occur on a monthly basis and begin in the first month of operation.
- Travelling expenses are only eligible in part. For instance, in contrast to financial accounting rules, daily spend exceeding legal or employer limits is excluded for tax purposes. Within Russia, the law accepts subsistence costs of up to 700 roubles (c. €10) per day for employee who has business trips in Russian and up to 2500 roubles (c. €35) if he goes abroad. Travelling and hotel costs are approved based on receipts. Travel by taxi or local public transport within the city in which the company is based, is not tax-deductible.

Further examples of expenses that do not reduce taxable income (or claims that are difficult to assert) are:

- Rental cars expenses
- Private-vehicle parking expenses
- Private-vehicle fuel expenses
- Expenses for food, business lunches, cafés, restaurants
- Gifts to customers
- Corporate social events
- School and university fees
- Gym memberships and other social benefits
- Housing
- Other, comparable non-cash benefits that can be construed as constituting part of employee income

The items listed above are not only subject to personal income tax and social contributions, but also fail to reduce taxable income. In other words, in addition to the c. 43 percent of incidental wage costs, 20 percent corporate tax is due. Thus, the tax burden on the listed expenses rises to over 60 percent (!). Considering that no VAT returns are possible, we eventually get to 80 percent.

We recommend that international companies secure the services of a professional tax consultant.

Businesses must transfer funds to the fiscal authorities by the 28<sup>th</sup> calendar day of each month to go towards their quarterly tax liabilities. The quarterly tax return must be submitted by the 28<sup>th</sup> day after the end of the quarter, the annual tax return by the 28<sup>th</sup> of March of the following year. If quarterly turnover does not exceed 15 million roubles (about €215,000), it is sufficient to pay income tax each quarter.

Representative offices and branches of foreign companies are only required to engage in tax accounting and are exempt from financial accounting requirements.

### **Value-Added Tax**

In Russia, all revenue generated through the purchase or import of goods or services is subject to VAT. The destination principle applies; generally, the taxation principles used correspond to those of the EU. The current basic tax rate is 18 percent, the reduced tax rate for specific goods, for example staple foods, is 10 percent. For exported goods international transportation and freight-forwarding services no VAT has to be paid. Value-added tax has been calculated quarterly and paid monthly (one third of the quarterly amount) since 1<sup>st</sup> of January 2008. VAT must be paid before the 25<sup>th</sup> of each month.

Below are some peculiarities of Russian VAT:

- VAT can only be claimed as an input tax if the faktura invoice (see the chapter "Russian accounting documents") is presented to the fiscal authorities.
- Import tax can also be subtracted as input VAT, but only if the goods were received after clearing customs.
- Equally, VAT can be deducted as prepaid tax from purchased fixed assets or assets under construction. However, this is only possible once the asset has been commissioned.

### **Corporate Wealth Tax**

Corporate wealth tax is a regional tax payable by all Russian and foreign businesses that own assets in Russia. The tax rate depends on the type of business activity and does not exceed 2.2 percent. The net fixed assets are only taxed if they are being used. There is no offsetting of assets against liabilities, as it is common in other countries. Only depreciation is deducted from gross values. The tax return must be submitted quarterly to the tax authorities by the 30<sup>th</sup> of the following month and the

tax has to be paid five days after it is submitted. Where end-of-year accounts must be submitted, this period is ten days.

## Personal Wealth Tax

Personal wealth tax is a regional tax. Accordingly, the tax rate varies; it also depends on the location and intended use.

Consider the table below as a simplified example:

Cadastral value	Personal wealth tax rate
<ul style="list-style-type: none"><li>■ Up to 300,000 rubles</li><li>■ 300,000 to 500,000 rubles</li><li>■ Over 500,000 rubles</li></ul>	<ul style="list-style-type: none"><li>■ Up to and including 0.1%</li><li>■ 0.1 to 0.3%</li><li>■ 0.3 to 2.0%</li></ul>

Properties with a value up to 300,000 rubles are taxed at a rate up to and including 0.1 percent. For values between 300,000 and 500,000 rubles, the tax rate varies between 0.1 percent and 0.3 percent. Estates with a cadastral value over 500,000 rubles are taxed at a rate between 0.3 percent and 2.0 percent.

## Personal Income Tax

All natural persons that generate income in the Russian Federation are subject to personal income tax. A distinction is made between residents and non-residents. Natural persons that demonstrably spend at least 183 days per year inside the country qualify as tax residents. The basic personal income tax rate is 13 percent; however, non-residents are taxed at 30 percent.

Companies must calculate income tax for their employees and transfer it to the tax office on payday. Relevant information must be communicated to the authorities on a regular basis, and a standard form cataloguing all taxes deducted for all employees must be submitted annually.

Individuals who derive their income from abroad or work independently are themselves responsible for the calculation and payment of personal income tax.

## Social Insurance Contributions

All social contributions in Russia have to be paid by the employer. Those payments include contributions to the federal pension fund, the social security fund as well as to health care. Furthermore a mandatory accident insurance has to be paid. The rate for this accident insurance ranges from 0.2 to 8.5 percent and depends on the business field the company is settled in and on the task the particular employee has to fulfil.

Since 2015 several changes have been made in how to calculate those contributions. The following table provides an overview of how to calculate these contributions depending on the wage and on the resident status of the employee.

Table: Rates of the different contributions depending on the status of the employee's residence.

type of contribution status of the employee	pensions fund		social security		insurance for accidents	health care
	<=876.000	> 876.000	<= 755.000	>755.000	independent	independent
Temporarily working HQS* in Russia (with visa)	-	-	-	-	0,2%	-
Permanently working HQS* in Russia (with residence permit)	22%	10%	2,9%	-	0,2%	-
Temporarily working in Russia (with visa), no HQS*	22%	10%	1,8%	-	0,2%	-
Permanently working in Russia (with residence permit), no HQS*	22%	10%	2,9%	-	0,2%	5,1%
Russian citizen or permanently in Russia living foreigner, no HQS*	22%	10%	2,9%	-	0,2%	5,1%

\*HQS = Highly Qualified Specialist, explanation underneath

It is subject to the employer to calculate and pay the social contributions until the 15<sup>th</sup> of the following month as the latest. Reports to those funds have to be hand in quarterly.

## **Highly Qualified Specialists**

When it comes to the calculation of the income tax of an employee, there are several differences as soon as the employee has the title of a so called “highly qualified specialist” (HQS). For an employee who can be called a HQS only 13 percent income tax has to be paid, even though he lives less than 183 days per year in Russia. The regular income tax rate for non-residents is 30%.

According to paragraph 1 article 13.2 of the federal code 115-FZ an employee can be called a HQS as soon as he earns more than 167,000 rubles (app. €2,400) a month. Foreign teaching staff, as well as foreign employees in the industry, the tourism sector or the information technology can be called HQS when earning half of the wage (83,500 rubles app €1,200). Within selected, so called “Economy zones” in Russia employees with a wage of 58,500 rubles can be enforced as HQS.

According to paragraph 6 passage 1 article 65 and paragraph 1 passage 1 article 327.3 of the Russian Labour Code, the declaration of the wage is not enough if the task which has to be executed by the employee requires special skills and training. In this case the employer has to hand in certificates, evaluations or other reports, which confirm the training or the skills of this employee to the Russian authorities.

Special attention has to be paid to employees with two citizenships. An employee who stays less 183 days per year in Russia and has besides a foreign citizenship a Russian citizenship as well (dual citizenship), cannot be enforced as a HQS in any event and has to pay 30 percent income tax as well as social contributions.

## ***Simplified Taxation System***

The simplified taxation system for smaller enterprises was introduced in order to reduce their tax burden and simplify taxation. Smaller enterprises, under Russian tax law, are those that employ fewer than 100 employees, generate revenues of under 60 million roubles and own fixed and intangible assets with a net book value of under 100 million roubles (c. €1.45m). Further, no other firm which does not qualify as small under these criteria must have a stake in it of 25 percent or more. Instead of VAT, corporate income tax, wealth tax and social security contributions, only one single tax must be paid under this system. Two options are possible in this respect:

- Revenue-based taxation (cash method). The tax rate here is 6 percent.
- Profit-based taxation at a 15 percent rate.

However, some enterprises are ineligible for this procedure regardless of their size. The simplified taxation system is inapplicable to companies that are expected to earn particularly high returns, i.e. banks, insurances, investment and pension funds. Foreign companies are also excluded.

From 2017 on new criteria apply referring the annual revenue and the fixed assets. Companies who want to apply the simplified tax system may not:

- Reach a higher revenue than 150 million rubles,
- Hold fixed assets worth more than 150 million rubles.

### ***Tax Issues Related to Company Formation***

In Russia, operating expenses are only recognized as tax-deductible once the business activity has begun. The Russian tax authorities maintain that such activity commences only when revenues are first generated. Hence, it is difficult to claim deductibility for earlier expenses.

In the initial phase of business activity, more VAT is usually paid on invoices received than on invoices sent. Thus, an input tax surplus is accumulated.

The tax surplus is typically reimbursed only after three appeals and a comprehensive tax inspection. It is thus recommended not to disclose small start-up costs in the tax return immediately, but to record them in the future. At the same time, the first cash receipts should be generated as soon as possible, and all commercial activities should be documented in great detail from the very beginning.

A newly formed company can be funded through equity capital, shareholders' loans and/or invoices to the parent company. The advantages and disadvantages of these forms of financing are discussed below.

In Russia, the amount of capital stock required for the foundation of a corporate equity is many times lower than in Germany. For a limited-liability company (Russian: OOO), the amount is at least 10,000 roubles (c. €145); for an open joint-stock company (Russian: OAO) at least 100,000 roubles (c. €1,450). A high level of equity capital can fund early business activity. Moreover, a greater amount of capital stock makes a more stable impression when dealing with third parties, and can be easily reduced later. Given a 10 percent+ stake that exceeds €82,000, dividend tax of 5 percent is payable. In other cases, the rate is 15 percent.



Disadvantages of high equity capital include the required changes to the charter and possible currency fluctuations, given that the amount is denominated in roubles. Furthermore, all customers must be informed when the capital stock is reduced; in that event, they enjoy special cancellation rights.

Equity capital from the parent can be injected relatively quickly and unbureaucratically and is not subject to corporate income tax in the event of a controlling stake. However, capital can only be transferred back in the form of a dividend; the 5 percent or 15 percent tax rate must be applied, as the case may be.

Another form of financing is the shareholder's loan. As elsewhere, the thin capitalization rule must be observed. For interest to be fully deductible for the Russian subsidiary, the loan must not exceed the equity capital by a factor greater than three. Also, the interest rate paid must be economically justified. The foreign parent can grant an interest-free loan if the tax laws in its home country allow it. If a Russian company grants an interest-free loan, it must add an amount corresponding to the market interest rate to its taxable income. In case of undercapitalization, the payment of interest is considered a dividend and taxed accordingly.

The Russian subsidiary can invoice the parent company for "services provided" and thus, generate operating cash flow at the outset. The advantage is that the initial operating expenses turn tax-effective immediately. In addition, the tax rate paid by the Russian subsidiary is often lower than that paid by a Western parent domestically. Please note that the "services provided" may be subject to VAT in Russia but are often not tax-deductible at home.

Losses recognized for tax purposes can be carried forward for up to 10 years and fully used to offset profit in later years.

### ***Tax Inspection***

Russian tax law envisages two types of fiscal audit: single-entry audits and external audits. Single-entry audits take place on the tax office premises and may only be carried out within three months following the submission of the relevant tax return. The scrutinized entity is not informed about the audit. However, the authorities are required to issue a written report and send it to the taxpayer once the audit is concluded. The company can file an objection within 15 days.

External audits may be carried out at the inspected company up to three years after the event and may take up to two months. Only in exceptional cases can the period be extended to 4-6 months.

### ***Double Taxation Agreements:***

The Russo-British agreement to avoid double taxation in terms of income and wealth tax has been in force since 18<sup>th</sup> of April 1997 and has been effective in Russia since 1<sup>st</sup> of January 1998. Fundamentally, it contains rules concerning the taxation of individual and company income whereby the income of banks and insurance agencies gets treated separately.

The double taxation agreement between Russia and the United States of America had been signed 17<sup>th</sup> of June 1992 and came into force 1<sup>st</sup> of January 1994. This agreement contains amongst others rules to the taxation of income of companies and individuals, insurance activities, dividends and substantial similar taxes. It states a maximum dividend tax of 5 percent if the beneficial owner is a company which holds at least 10 percent of the voting stock and a maximum dividend tax of 10 percent in all other cases.

Currently the Russian Federation is involved in bilateral treaties to avoid double taxation with 82 countries and Hong Kong.

## **Foreign Exchange Controls**

In Russia, all payments between residents and non-residents are subject to foreign exchange controls. All legal persons founded under Russian law and all natural persons whose annual stay in Russia exceeds 183 days are considered residents. Conversely, legal persons formed elsewhere and natural persons that remain in Russia for less than 183 days per year are considered non-residents.

The recipient of a controlled payment in excess of USD 50,000 is required to apply for a transaction certificate (“passport sdelki”) at his bank. To this end, all documents associated with the payment (contracts, invoices, etc.) must be submitted to the bank.

Russia’s official currency is the rouble. While Euro- or dollar-denominated contracts can freely be entered into, the actual cash or non-cash payments must be made in the local currency. Often, differences in FX rates between the day of entry and the

day of fulfilment arise as a consequence, leading to a duplication of records and VAT calculation issues.

To learn more about the Russian tax system and how to reach highest tax efficiency, just visit the category [Tax Accountancy in Russia](#) at our website.

## **Business Premises in Russia**

The foundation of business premises by foreign companies has increased relatively in Russia. This has something to do with the sanctions and the efforts of Russia towards the import substitution. In order to replace foreign imports by Russian products, production facilities have to be built or, if already existing, to be modernized. In doing so, especially the foreign engineering technology is in high demand. The assembly of such industrial plants is often realized over several months. How this is connected with the foundation of the foreign business premises and what has to be taken into consideration in doing so will be explained in the following:

At first, two examples will help to answer the following questions:

- What are the preconditions for a foundation of constant business premises in Russia?
- Do I have to be registered at the Russian tax authorities?
- Do I need work permits and working visa for my foreign staff?
- What rules exist concerning income tax and national insurance contributions?

Afterwards, a detailed explanation of central terms and topics that are crucial for the field of constant business premises will be given.

### **Example 1**

A Russian company hires a German firm for the performance of a service. This service is fulfilled by a German employee of the German company. The duration of this task is two weeks.

As the duration of the task in Russia does not exceed 30 days:

- A foundation of business premises in Russia will not be realized
- and as a consequence of this, a registration at the Russian tax authorities is not necessary.

The task takes less than 30 days and can therefore be treated as a single business event. The German employee does not need a work permit or working visa. The German employee is allowed to be in the country as a business traveller with a normal business visa. The income does not underlie the Russian taxation. The employee is still a person who is registered and taxable in Germany. All conditions for the double taxation agreement are fulfilled:

- A) The employee stays less than 183 days in Russia per year.
- B) The payment is made by an employer who is not registered in Russia.
- C) Business premises in Russia do not bear these payments.

Furthermore, no contributions for industrial injuries insurance or social insurance arise for the German employee.

## **Example 2**

A German company signs three different contracts with three different companies from three different administrative districts. The services that are indicated in the contracts are performed by three German employees of the German company. The total duration, in which the services are to be rendered, is six months.

As the activity in Russia takes more than 30 days,

- There is the obligation to register at the Russian tax authorities. The German company has to register in every administrative district where it provides services. In this example, in all three districts.
- The activity justifies the foundation of constant business premises. Calculation and payment of the profit tax are to be made in the place of registration of the respective administrative district.

In this case, the German employee needs a work permit and a working visa. The conditions of the German-Russian double taxation agreement, that are indicated

above, are therefore not fulfilled and the payment of the German employee who does not stay longer than 183 days in Russia per year (no-tax-resident) has to be taxed by the Russian income tax of 30 percent (point 3 article 224 of the Russian Tax Code). The earnings that are taxed in Russia are exempted from the German taxation system. National insurance contributions and industrial injuries insurance do not arise for non-Russian employees.

End of examples

Basically, foreign companies are obliged to register at the tax authorities in Russia within 30 calendar days after beginning of the activities if the services are provided by a representative office or a branch. The foundation of business premises are justified if the following conditions are fulfilled (Art. 306 SteuerGB und Art. 5 DBA):

- existence of a fixed place of business in Russia,
- the business activity must be performed by this fixed place of business
- frequent and actual performance of the above-mentioned activity (30-day-rule)

Crucial is mostly the 30-day-rule. If the company is in Russia for more than 30 days of the calendar year or it is planned that the company will be in Russia for more than 30 days, the foundation of business premises are necessary.

The foundation of business premises requires paying profit taxes and other taxes in Russia. Correspondingly, it is necessary to draw up and to hand in a tax declaration to the Russian tax authorities.

### *Exceptional position of building sites and assemblies as business premises*

Construction sites and assemblies have an exceptional status that has to be considered. With Assembly operations it is important to check if a construction site is justified in terms of taxes. A construction site or an assembly by a German, Austrian or Swiss company are only then considered as business premises if the duration of such an activity exceeds the period of 12 months (art. 5 para. 3 of the Austrian-Russian double taxation agreement of the 13<sup>th</sup> of April 2000 or of the German-

Russian double taxation agreement of the 26<sup>th</sup> of May 1996, or of the Swiss-Russian double taxation agreement of the 15<sup>th</sup> of November 1995). Within this period of time, the business activities of a company from these countries will not lead to a foundation of business premises which means that no Russian profit taxes have to be paid for the period of time mentioned above.

The term construction site or assembly was not defined any further in the double taxation agreement of the three above-mentioned countries with Russia. Therefore the definition of the Russian tax law is used (art. 308 para. 1<sup>st</sup> Tax Code). According to this, a building site of a foreign company in Russia is defined by one of the following points:

- a place of construction of new buildings as well as the place where buildings are redeveloped, expanded, renovated in terms of technical aspects and/or repaired.
- a place of construction and/or assembly, repair, redevelopment, expansion and/or renovations in terms of technical aspects of plants, including floating plants and drilling rigs, machines and installations, which need to be firmly anchored in the fundament or in construction elements of the building, plants or floating plants, in order to work normally.

The following activities do not count as a construction site or assembly:

- construction supervision and control only, without building or assembling operations.
- Constant repairs, laying of telephone cables.
- Assembly of plants that do not need to be firmly on the ground in order to work normally.

When founding business premises in Russia, it is crucial that the building will take 12 months. When calculating the time required for construction, it has to be taken into consideration that the duration of activities of subcontractors at site will be added to the total duration of the prime contractor.

The beginning of a construction site is defined as follows: date of the handover certificate of the construction site or the actual start of the building operations. The

end of a construction site is defined as follows: Date of the signature of the inspection report by the building owner or general contractor of subcontractors as well as possibly the actual finish of all tasks if no inspection report is made out or with tasks after the inspection report.

The time required for construction includes the following tasks:

- all preparation, construction or assembling activities including the construction of approach roads, basic infrastructure, electric wires and water evacuation
- tasks of subcontractors
- resumption and continuation of activities
- construction of streets, cables, channels and the laying of infrastructural pipes are seen as activities of a building site

### *Taxation of business premises and the opening of a bank account*

The opening of a bank account for business premises in Russia is not regulated by law and in most cases not necessary at the beginning of the business activities in Russia. But at the latest from the time when business activities begin and the first taxable profits are made, the opening of a business account in roubles at a Russia-based bank should be considered. In the following the taxation process will be exemplified:

#### **Option 1 – without business premises**

The Russian customer pays the German provider, which is not registered in Russia as a tax payer, for the tasks performed. As the German provider is not registered at the tax authorities in Russia, the Russian customer has to act as a tax agent for the German provider and pays the VAT to the Russian tax authorities.

#### **Option 2 – with business premises**

When founding business premises in Russia, the registration at the tax authorities must be made. From that time on, the business premises are registered tax payers in Russia. The invoice which includes all the provided services contains also the VAT that has to be paid to the tax authorities by the business premises. Even though the Russian customer pays directly to Germany, it is recommended that the business premises, instead of the tax agent, transmit the VAT to the Russian tax authorities.

At the end of every quarter, the foreign parent enterprise has to calculate the receipts and expenditures in connection with the VAT that incurred in the connection with the business premises and must hand over the results to the accounting department of the business premises. On this basis, the business premises calculates the payable taxes (VAT and profit tax) and hands in the corresponding tax declaration.

The payable taxes are to be paid to the Russian tax authorities only in roubles and only by the tax payer (business premises). It is strongly advised to avoid direct transfers from German bank accounts to the Russian tax authorities in order to avoid false transfers or misunderstandings between sender and receiver of the tax payments and to assure an unambiguous assignment of the payment at the authorities as well as to achieve a smooth communication with the authorities. Furthermore, it is strongly recommended to 1) have a bank account in roubles with a Russia-based bank and 2) to hire a local accountant or a qualified expert who a) prepares the transfers with online-banking accurately and b) reacts to questions of the tax authorities quickly and properly. The very formalistic money transfer forms in the Russian banking business, the keyword exchange controls and the frequent mistakes made by the Russian tax authorities when assigning payments are here just mentioned as examples.

To transfer the taxes from a German bank account directly to the Russian tax authorities is only than advisable when there are only one or very few tax payments. But also in this case it has to be made sure that a) the reason for transfer meets the requirements of the tax authorities and is indicated correctly and b) it is checked if the payment is accepted by the right department. When preparing, executing and checking of the transfer from a German bank account to the Russian tax authorities, the support by a Russian accountant or tax expert is strongly advised.



## Final Word

If you have any further question about Russia, we will be delighted to give you advice in your businesses. You can contact our office in Moscow at any time. Just call us or send us an e-mail. We are looking forward to hearing from you! Your German contact in Moscow is:

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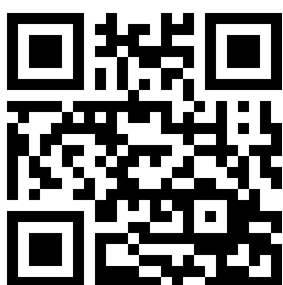
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