NATIONAL COORDINATING CENTER FOR INTERNATIONAL BUSINESS COOPERATION

TAX COMPLIANCE

Taxation of foreign companies in Russia

No. 1

Monthly digest

Increase of charter capital with retained revenues of foreign shareholders from previous years

How Russia changes tax legislation in response to unfriendly actions of foreign states

Tax abatements in Russia: IT sector

Checklist: how to receive state accreditation for or IT company

Submission of CFC financial reports under sanctions

Language:

- Russian
- Chinese
- English
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Dear colleagues,

You are reading the first issue of a periodic review of taxation and anti-sanctions regulations for foreign businesses in Russia.

The idea of this review appeared largely due to the intense news agenda of recent years. In 2024, G7 members continued their course of unilateral sanctions against Russia.
The new reality led to a substantial transformation of Russian legislation. Although the West seeks to isolate Russia and limit its cooperation with the world, such cooperation continues and develops, therefore, it is more important than ever for businesses to monitor all legislative changes in order to avoid mistakes.

The issue sums up the initial results of 2024 in the field of Russian tax laws. Obviously, the main changes stem from the countering of unfriendly moves of foreign states.

The leading material of the issue addresses suspension of certain international treaties by Russia and nuances of exceptions, as well as amendments to transfer pricing laws and the introduction of the secondary TP adjustment concept.
In the Taxation Practice section, our team analyzed key court rulings on the charter capital enlargement with retained revenue of foreign shareholders from previous years. We have prepared statistics on such judicial practice of the past 20 years and mentioned international practices in this area.

Additionally, the review analyzes possible pending amendments to Russian legislation.
For instance, the latest initiatives aim to tighten the terms of IT preferences for foreign investors, which makes the issue relevant to Russian companies with foreign shareholders yet again. Read about the main terms of tax abatements and the upcoming legislative amendments in the IT sector in the Tax Abatements in Russia: IT Sector article.

In the final part of the review, we offer practical guidance on how to submit financial reports of controlled foreign companies and to receive IT accreditation for tax abatements.

We are hoping that our digest will serve as an information assistant to you and your business.

Yours sincerely,
Kirill Babayev,
NCC President

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Taxation Practice

One of the most interesting categories of tax disputes in 2023 was whether an increase in the charter capital with retained revenues of foreign shareholders from the previous years was their income subject to taxation. Three companies filed such claims and courts denied all of them. However, the Russian Supreme Court finally put an end to the dispute.

Cause of disputes

Federal Law No. 251-FZ dated July 29, 2018, On the Amendment to Law on the Organization of Insurance Business in the Russian Federation (hereinafter referred to as No. 251-FZ dated July 29, 2018) adjusted requirements to the minimal charter capital of insurance companies.

Some insurance companies with foreign participation enlarged their charter capital with retained revenues of foreign shareholders from the previous years.

Following desk audits, such companies were held liable for unlawful failure to withhold and remit the amount of corporate income tax on income paid to foreign entities. Some insurance companies (LLC Sovcombank Life Insurance, JSC ERV) disagreed with the back taxes and filed claims with the Moscow Court of Arbitration for invalidating the decision of the tax authority.

Case background

Foreign practices

While hearing the Eisner v. Macomber case in 1920, the U.S. Supreme Court decided whether a shareholder receives income when the charter capital is increased with retained revenues from the previous years.

The case stemmed from 1,100 additional shares with a par value of about $20,000 received by a shareholder, Mrs. Macomber, after an increase in the charter capital of Standard Oil. The increase in the charter capital occurred due to the retained revenues of the shareholder accumulated by the company in the previous periods.

The tax issue was controversial, since U.S. law explicitly defined stock dividends as income.

The justices were divided 5 to 4 in the case. The majority found that, according to the Sixteenth Amendment, the shareholder got no income because she did not actually receive cash or other assets and retained the same proportionate share in the company as she did before the dividends were paid.

Justice Brandeis voiced a dissenting opinion and pointed out that it was definitely income from the angle of the Sixteenth Amendment, which envisages the taxation of income from any source. In other words, the idea of the amendment authors was that everything that could reasonably be considered as income should be considered such.

Justice Brandeis's opinion was subsequently supported by U.S. Supreme Court justices in similar disputes that were no longer in favor of the taxpayer (United States v. Phellis, Rockefeller v. United States 257 U.S. 176 (1921) and Cullinan v. Walker 262 U.S. 134 (1923)).

Currently, many foreign jurisdictions duly regulate the issue in national tax legislation. For instance, in France[1], Article 109 of the Tax Code expressly stipulates that revenues of a company are not recognized as distributed if kept as reserves and used to increase the charter capital.

This approach does not mean complete tax exemption. An increase in a member's share at the expense of retained earnings will qualify as a capital gain at the time of sale of the interest or company liquidation using the appropriate income tax procedure.

Some jurisdictions have a legislative ban on increasing the charter capital with retained revenue. For instance, in Uzbekistan[2], civil law stipulates an increase of the charter capital with “contributions from shareholders.” Therefore, before increasing the charter capital, retained revenues must become property of shareholders, i.e. be distributed. At the moment of distribution, a shareholder receives income in the form of dividends that are subject to taxation by national tax laws or international tax agreements.

[1] https://www.legifrance.gouv.fr/codes/article_lc/LEGIARTI000006302651/1979-07-01
[2] https://kadrovik.uz/uz/question/5130?ysclid=lvwjui59jk97737322

Russian practices

Russian tax laws define an increase of the charter capital with retained revenues of shareholders of Russian entities as income exempt from corporate income tax consistent with Paragraph 15 Part 1 Article 251 of the Russian Tax Code. Related disputes arise, for the most part, if shareholders are individuals or foreign entities.

Financial institutions and courts had a mixed reaction to such disputes:

01

Stance No. 1

Income from an increase in the nominal value of shares in the charter capital with retained revenues arises on the date of registration of the increase in the charter capital;

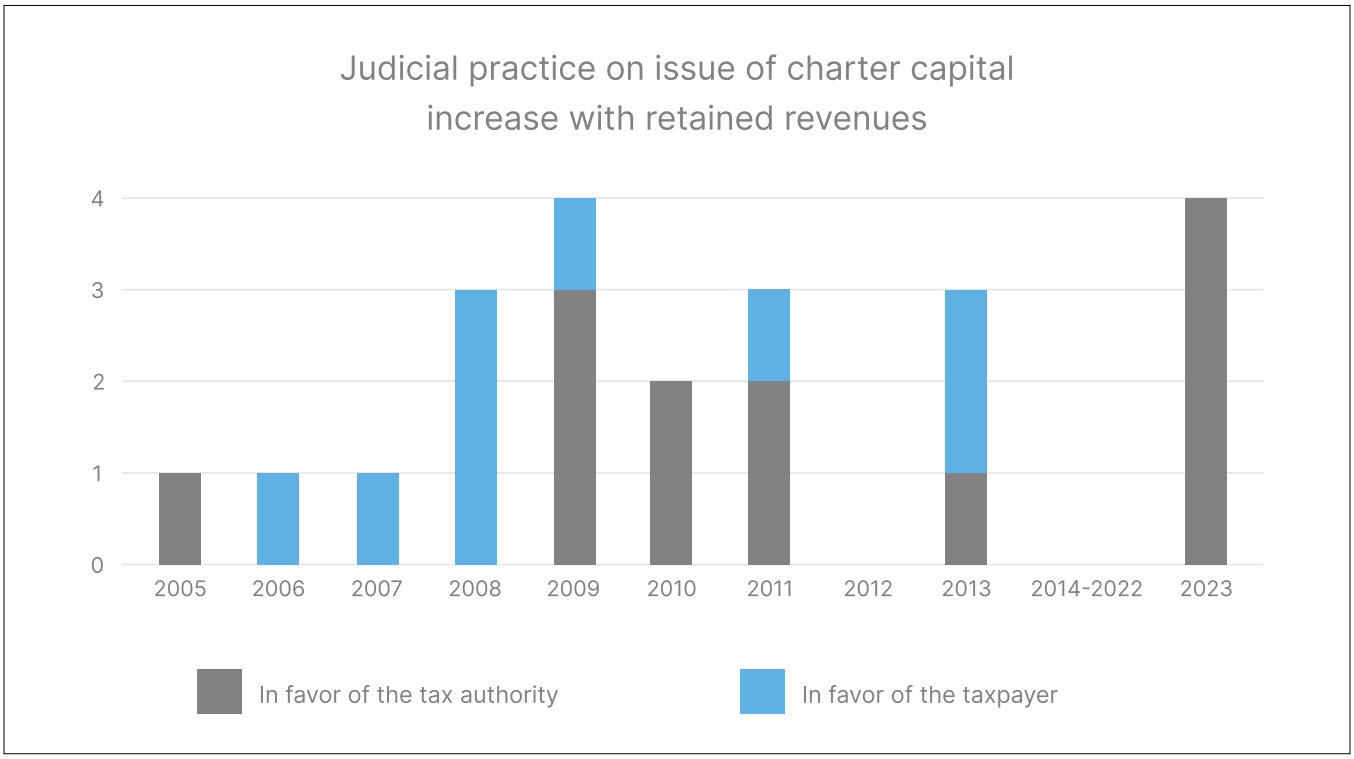
02

Stance No. 2

Income from an increase in the nominal value of shares in the charter capital with retained revenues arises on the date of actual receipt of money from their sale.

Interestingly, the Russian Supreme Court of Arbitration adhered to both stances at different times.

The history of judicial practice on the issue of taxation of an increase in the charter capital with retained revenues, based on the two stances, is presented in the graph below.



Judging by the graph, practices fluctuated between the first and second stances before 2011. In 2011, the Russian Supreme Court of Arbitration ruled in favor of the tax authority[3], whereas its position changed in favor of taxpayers in 2013[4]. The Russian Supreme Court of Arbitration concluded that there is no income from an increase in the nominal value of shares until shareholders use any property right. The Russian Supreme Court of Arbitration resolution of 2013 put an end to such disputes for a long time, until 2023.

[3] Russian Supreme Court of Arbitration Ruling No. VAS-5515/11 dated 26.04.2011 on case No. A78-928/2010
[4] Russian Supreme Court of Arbitration Ruling No. VAS-13599/13 dated 11.10.2013 on case No. A41-34018/2012

New round of controversy in 2023

In 2023, courts ruled in favor of the tax authority in three such disputes.
Taxpayers and courts argue as follows:

Taxpayer's stance	Court's stance
The charter capital is increased to comply with Russian Law No. 4015-1 dated 27.11.1992 On the Organization of Insurance Business[5] (hereinafter referred to as the **Law on Insurance Business).**	1. The taxpayer's compliance with the Law on Insurance Business is the taxpayer's duty; 2. The purpose of the charter capital increase is insignificant for the evaluation of lawfulness of the tax authority's decision, considering that the liability results from the unlawful non-withholding and non-remittance of tax.
The charter capital is increased with the taxpayer's own funds (LLC property), as retained revenues are property of the company, instead of shareholders, until they are distributed.	1. The charter capital is increased with retained revenues from the previous years instead of own funds[6]; 2. As a general meeting of LLC (or the sole shareholder) decides to increase the charter capital **with retained revenues of LLC,** the duties of shareholders are fulfilled (rights

[5] The said argument was made by taxpayers in the cases of LLC Sovcombank Life Insurance (No. A40-272044/22-183-5166), and JSC ERV (No. A40-211798/22-154-2864)
[6] JSC ERV case (No. A40-211798/22-154-2864)

	are used) **at the expense of property of the legal entity,** - the payment is made at the expense of a third party (limited liability company) to increase the nominal value of a share of the shareholder (taxpayer), which is done to the benefit and in the interest of the taxpayer, an individual, and is defined by Article 211 of the Russian Criminal Code as an income received by a taxpayer, an individual, in kind[7].

[7] LLC Sovcombank Life Insurance case (No. A40-272044/22-183-5166)

There is no distribution of revenue (payment of dividends) to foreign shareholders in the case of an increase of the charter capital.	According to Paragraph 28 of the Commentary on Paragraph 3, Article 10 of the OECD Model Tax Convention on Income and on Capital, **payments considered as dividends** may include both distribution of revenues approved by annual meetings of shareholders and money or additional payments in the form of shares, bonuses, profits from the liquidation of a company, as well as **hidden distribution of revenues.** Such payments can be made from current revenues, as well as from **reserves, including revenues from previous years.**
Foreign shareholders get no income because an increase of the nominal value of shares in LLC does not bring economic gains to shareholders.	1. For foreign shareholders, retained revenues from the previous years constitute an income of foreign companies, which foreign companies used through increasing the nominal value of their shares in the company's charter capital; 2. Since a company shareholder decides to increase the charter capital with retained

	revenues from the previous years and the nominal value of a share grows, the foreign company's property rights are changed, which means the sole shareholder receives an income in kind (Part 1 Article 287, Paragraph 2 Part 1 Article 309 of the Russian Tax Code).
Paragraph 15 Part 1 Article 251 of the Russian Tax Code is applicable to foreign shareholders, as the exclusion of foreign shareholders of the company is discriminatory and without sufficient economic reason.	1. Whenever foreign companies receive income from sources in Russia, the taxation of such revenues is regulated by Articles 309 - 310 of the Russian Tax Code, which means Article 251 of the Russian Tax Code is not applicable to the case; 2. A comparison of laws applicable to the calculation of income through an increase of the charter capital with retained revenues from the previous years to a Russian or foreign company is not a discrimination but an implementation of an international agreement, which, by Part 4 Article 15 of the Russian Constitution, is an integral part of the Russian legal system.
An income tax may appear twice: (1) when the charter capital is increased (tax on dividends); (2) when a shareholder withdraws from the company (sells shares, divides property upon liquidation).	When determining the tax base for income received by a resident shareholder of a foreign state in the course of distribution of property of a liquidated organization, the difference between the property received and the cost of shares actually paid for by the shareholder, regardless of the form of payment, is taken into account.

Russian Supreme Court ruling on Mir Business Bank case – period or suspension?

The Russian Supreme Court pronounced its ruling on March 15, 2024. The Russian Supreme Court ruling[8] on the case of JSC Mir Business Bank did not reflect on the presence or absence of income and hidden distribution of dividends but said directly that it was a situation of "gains of a Russian entity, a shareholder, from an increase of the charter capital in the amount that corresponds to the increase of the charter capital with retained revenues." At the same time, the gains "are not viewed by the lawmaker as an income subject to taxation."

[8] Ruling of the Russian Supreme Court's Judicial Panel for Economic Disputes No. 305-ES23-22721 dated 15.03.2024 on case No. A40-243943/2022

The Russian Supreme Court emphasized the non-discrimination principle enshrined in international agreements on the avoidance of double taxation, noting that "the prohibition of discrimination implies the inadmissibility of situations where a taxpayer is subject to more onerous tax conditions in the Russian Federation only because of its foreign status (discrimination based on the residence of the income recipient)."

At the same time, the Judicial Panel did not see in this case any fundamental economic differences in the position of a Russian entity that is the sole shareholder of another Russian entity, as well as a foreign entity that is the sole shareholder of a Russian entity, when deciding on the use of retained revenues from previous years to increase the charter capital in the absence of payments. In this regard, according to the Russian Supreme Court, "there is no reason to subject a foreign shareholder that has retained capitalization of a Russian entity to more burdensome taxation in this part."

This stance of the Russian Supreme Court was long-awaited by all taxpayers with a foreign capital and served as a reminder for the tax authority and lower-tier courts about such an important principle of international taxation as non-discrimination. It has influenced the outcome of a cassation ruling on the JSC ERV case in favor of the taxpayer[9].

It is still unclear whether the stance will apply to the deals involving shareholders from unfriendly countries the treaties on the avoidance of double taxation with which have been suspended. Let us wait and see.

[9] Ruling of the Moscow District Court of Arbitration No. F05-24848/2023 dated 02.04.2024 on case No A40-211798/2022.

How Russia changes tax legislation

in response to unfriendly actions of foreign states

The article addresses key changes in the tax legislation of the Russian Federation made in response to unfriendly actions of foreign states. The first part concerns the suspension of international treaties by the Russian Federation and the nuances of exceptions. The second part analyzes amendments to the legislation on transfer pricing and the introduction of the concept of secondary TP adjustment. The third part is about the introduction of withholding tax on intra-group services and the potential risk of double taxation, coupled with the application of new transfer pricing rules.

Unfriendly states have been tightening sanctions against Russia for over two years. Foreign businesses are leaving the Russian market, foreign investments are frozen, and contracts are terminated. Under the circumstances, the trend towards Russia's "tax protectionism" has only been a matter of time. For instance, can tax treaties with unfriendly states remain valid under the international circumstances so unfavorable for Russia?

Russia took serious steps towards changing legal regulations for relations with unfriendly states in the second half of 2023. We will address these changes in our article.

Suspension of international agreements

Legal basis

Order of the President of the Russian Federation No. 585 dated August 8, 2023, "On the Suspension of Validity of Certain Provisions of International Tax Treaties of the Russian Federation" (hereinafter referred to as the Order) suspends the application of Articles 5-22 and 24 of the treaties on the avoidance of double taxation (hereinafter referred to as the Treaties) between the Russian Federation and a number of foreign states.

The treaties have been suspended with the following states: Australia, Austria, Albania, Belgium, Bulgaria, the UK, Hungary, Germany, Greece, Denmark, Ireland, Iceland, Spain, Italy, Canada, Cyprus, South Korea, Lithuania, Luxembourg, North Macedonia, Malta, New Zealand, Norway, Poland, Portugal, Romania, Singapore, Slovakia, Slovenia, the United States, Finland, France, Croatia, Montenegro, the Czech Republic, Switzerland, Sweden, and Japan.

Consistent with Clause 4 of the Order and the Russian Foreign Ministry notes sent to respective foreign states, provisions of the treaties will be suspended from August 8, 2023 until the foreign states stop violating the legitimate economic and other interests of the Russian Federation and the rights of its citizens and legal entities, or until the termination of the treaties in regard to the Russian Federation.

The following articles have been suspended:

- Permanent office;
- Revenue from commercial operations;
- International transportation;
- Dividends;
- Interest;
- Revenues from real estate;
- Revenues from selling real estate and movable property;
- Revenues from copyright and licenses;
- Income from employment;
- Independent personal services;
- Director remuneration;
- Public service;
- Pensions;
- Artists and athletes;
- Teachers, scientists, students and trainees;
- Other revenues;
- Property;
- Non-discrimination.

The following articles remain valid:

- Avoidance of double taxation;
- Information exchange;
- Mutual agreement procedure;
- Embassy and consular employees.

Since August 8, 2023, income of residents of the said foreign states from sources in the Russian Federation has been taxed consistent with the Russian Tax Code (that is by the general rules laid down by Articles 246, 247, 309 and 310 of the Russian Tax Code[10]).

[10] Russian Finance Ministry Letters No. 03-08-13/76470 dated 14.08.2023, Russian Federal Tax Service letter No. TsPO-4-13/10502@ dated 16.08.2023.

Exceptions

Three days after the Order was published, the Russian Finance Ministry website published information, according to which in case of the payment of income in the form of interest to export credit agencies located in unfriendly countries, as well as banking institutions conducting operations in accordance with personal law, which were previously exempt from withholding tax (or qualified for a reduced withholding tax rate) in accordance with international tax treaties of Russia, suspended by the order, tax agents have the right to continue not to calculate and not withhold, or withhold at a reduced rate, tax at source on such interest income, provided that such foreign entities (institutions) have the actual right to the income received.

Federal Law No. 539-FZ On the Amendment of the First and Second Parts of the Tax Code of the Russian Federation and Certain Legislative Acts of the Russian Federation and the Invalidation of Certain Provisions of Legislative Acts of the Russian Federation (hereinafter referred to as No. 539-FZ) was adopted on November 27, 2023. The exceptions envisaged by the new law are presented in the following simplified algorithm:

IF:

- The tax exemption (or a reduced rate) applied to the treaty concluded before the Order, and
- The income was paid between August 8, 2023, and December 31, 2025, and
- A foreign company is not interdependent with a Russian company, and
- A foreign company is a beneficial owner and proves its actual right to the income in the procedure envisaged by Article 312 of the Russian Tax Code,

THEN:

The suspended articles of DTT treaties continue to apply to the following types of revenue:

- The interest to export credit agencies and banking institutions;
- Income from the provision/use of intellectual property on television, as well as copyright, patent, know-how, industrial designs, etc.;
- Income from plane leasing;
- Income from selling or leasing sea vessels;
- Income from international transportation.

Selected features

Please note that in certain cases the formal existence of DTT treaties has an effect on Russian taxpayers. For instance, Part 7 Article 25.13-1 of the Russian Tax Code says that a controlled foreign company is exempt from taxation if it is located in a state with which Russia has a tax treaty. The suspended DTT treaties are not terminated, so the article applies.

Certain nuances of international transportation and forwarding services deserve a special mention.

According to Paragraph 8 Part 1 Article 309 of the Russian Tax Code, the income of a foreign entity subject to revenue tax withheld at the source of payment in the Russian Federation includes revenues from international transportation. International transportation means any transportation by sea, river or aircraft, motor vehicle or rail, with the exception of cases when transportation is carried out exclusively between destinations outside the Russian Federation.

At the same time, revenue from the provision of forwarding services (services for organizing the delivery of goods) is not included in revenue from international transportation.

The Russian Finance Ministry points out that whenever revenue from international transportation is received through forwarding companies, which are not designated as carriers, such revenue may include remuneration of an intermediary or cost of other forwarding services. In that case, the actual amount of each type of revenue in the overall payment needs to be specified to determine respective tax consequences[11].

[11] Russian Finance Ministry Letter No. 03-08-05/16315 dated 26.02.2024.

The clarification indicates that for the purpose of taxing revenue of a foreign entity from international transportation, the possible separation of an intermediary's remuneration and the cost of other forwarding services must be considered.

WHAT SHALL BUSINESS DO?

Analyze company payments for changes in their taxation. It is possible that the negative consequences of double taxation will be completely offset by applying a tax credit or deduction;

Determine whether the actual recipient of revenue is correctly identified. Consider the option of transferring payments to another recipient located in a friendly country;

Be very careful with exceptions specified by Federal Law No. 539, as their incorrect application may cause the taxpayer's liability;

Any change in the structure of deals, specifics of calculations, pricing and other aspects of a deal will be scrutinized. The tax authority may analyze them for possible unjustified tax benefit;

Assess financial risks of the potential demand of foreign counterparties to execute gross-up closes of contracts.

Changes in transfer pricing

There have been changes in transfer pricing as well. We will analyze the most significant of them.

Expanding interdependence criteria

The list of grounds for recognizing parties as interdependent is expanding. In particular, it is also proposed to recognize the following as interdependent entities:

- The controlling party and the controlled foreign company;
- Controlled foreign companies of the same controlled parties;
- Entities in one of which an individual has a share of over 25% (or has the authority to appoint a single executive body or at least 50% of the collegial executive body or board of directors), and another entity in which an individual has the above share or authority.

Median value of the market price interval

The mechanism for adjusting the cost to the maximum/minimum range of market prices is abolished. However, the tax base is adjusted after checking the transfer pricing according to the median value.

At the same time, taxpayers are given the right not to apply the median value when making independent price adjustments using any transfer pricing method within the market price range.

Substantial expansion of disclosure requirements

With regard to transfer pricing documentation: its content in relation to controlled transactions is clarified. The following information needs to be provided:

- Functions of the parties to the transaction, the assets they use, the commercial risks they take, etc.
- Extended information about the foreign counterparty (information on income/expenses, number of employees, cost of fixed assets and intangible assets;
- Registration documents of a foreign entity, information about representatives;
- Analysis of the commercial and financial terms of the controlled transaction, carried out in accordance with Article 105.5 of the Russian Tax Code;
- Description of adjustments to ensure the required degree of comparability of the financial and/or commercial terms of the controlled transaction and the comparable transactions (entities).

Whenever it is impossible to submit financial statements simultaneously with transfer pricing documentation, financial statements must be submitted no later than 12 months from the end of the fiscal year in which the controlled transaction was completed.

Regarding **the notification of controlled transactions:** the list of mandatory disclosures in the notification of controlled transactions is expanding. Now, information about commodity transactions must include the terms of transactions (including the basis for the supply of goods, the date of transfer of ownership, the date of revenue/expense recognition), the methods used and the sources of information on comparable transactions.

In addition, for goods that are part of one or more groups defined by Part 5 Article 105.14 of the Russian Tax Code, the notification must include information about subsequent sale and previous purchase of goods and their terms. In this case, the taxpayer cannot refer to the related party's refusal to disclose information about the value chain.

With regard to **the financial statements of foreign members of an international group:** an obligation is introduced for international companies to submit financial statements of their members who are not tax residents of the Russian Federation, if at least one of the group companies carries out controlled transactions with goods included in one or more groups specified in Part 5 Article 105.14 of the Russian Tax Code.

In addition, the tax authority has been granted the right to request documents outside the scope of the transfer pricing audit on transactions of international group members who are not tax residents of the Russian Federation.

New liabilities for transfer pricing violations and larger fines

The bill significantly increases penalties for transfer pricing violations. Please note that the changes only apply to cross-border controlled transactions.

Penalties have been increased for non-payment or incomplete payment of taxes as a result of the application for tax purposes in controlled transactions of commercial and/or financial terms that are not comparable with the commercial and/or financial terms of transactions between parties that are not interdependent.

Fines for the non-submission of all kinds of transfer pricing statements (notifications of controlled transactions, documentation and cross-country reporting) or the provision of incorrect information have been raised.

Fines for certain violations have been increased ten- or even 20-fold. For instance, a fine for the non-submission of an international group notification has grown from 50,000 to 500,000 rubles, a fine for the non-submission of a country report has been increased from 100,000 rubles to 1 million rubles, and a fine for the non-submission of a controlled transaction notification has risen from 5,000 rubles to 100,000 rubles.

Secondary TP adjustment concept

A new clause qualifies additional transfer pricing charges as hidden dividends subject to withholding tax at a rate of 15%.

Perhaps this innovation is the most controversial in terms of practical application. Let's consider a situation where, based on the results of a transfer pricing audit, the cost of intragroup services is adjusted (15% is charged on the amount of the adjustment as hidden dividends). However, the adjusted cost is also essentially a payment for services, and under the newly introduced withholding tax on intra-group services (more on that below), will the adjustment also be subject to 15% tax? Theoretically, this is a case of double taxation.

What shall business do?

01 Analyze transfer pricing risks in controlled transactions to avoid higher fines.

02 Clarify the list of information that must be submitted to the tax authority within transfer pricing documentation.

03 Assess the need for adjustment of interest rates in intragroup transactions.

04 Assess other risks, including those in intragroup transfer pricing transactions and transactions at risk of double taxation.

Intragroup services tax

From January 1, 2024, revenue from sources in the Russian Federation includes revenue received by a foreign entity from work and services provided to a related party in Russia. Such revenue is subject to revenue tax at a rate of 15%. The new withholding tax will apply to intergroup services provided in current year and paid for next year.

This includes revenue in the form of payments for work (services) provided on the territory of the Russian Federation and received by an interdependent party. The place of performance of work (provision of services) will be determined by the location of the client, i.e. the Russian entity that makes the payment.

Please note that the provisions of the law introducing withholding tax on intragroup services do not make any exceptions for certain types of work (services). Thus, the new provisions apply to any services: those to which you are already accustomed (consulting, legal, accounting, etc.), and to various other services (brokerage, banking, etc.).

This means that disputes over the reclassification of intragroup services as hidden dividends may gradually become a thing of the past. All the issues that the tax authorities were so interested in (duplication of services, association with joint stock activities, etc.) when applying Part 2 Article 309 of the Russian Tax Code are no longer important - all services are taxed at a rate of 15%.

Moreover, in cases where payments for services are made in favor of related parties from friendly states, the tax rate of 15% can be reduced based on the applicable tax treaty.

Tax abatements in Russia: IT sector

The main conditions for the application of tax benefits and upcoming legislative changes in the field of IT

Russia introduced a series of tax abatements for IT companies in 2021. The measures were called "the tax maneuver in the IT industry" and aimed to support software developers above all.

The "tax maneuver" was initially viewed as an experiment to be completed by **the end of 2024.** Yet tax abatements for IT companies were so popular with IT businesses that the Russian Finance Ministry and Digital Transformation, Communications and Mass Media Ministry are actively discussing their possible extension.

Not just domestic developers but also foreign investors wishing to open software development centers in Russia seek the tax abatements. It is worth noting that recent legislative initiatives are aimed at tightening the conditions for the application of IT benefits to foreign investors, which makes this relevant for Russian companies with foreign participation.

Read about key terms of tax abatements and upcoming legislative amendments in the IT sector in our article.

Types and terms of tax abatements

There are the following tax abatements for IT companies:

- Zero rate of revenue tax (Part 1.15 Article 284 of the Russian Tax Code);
- Unified 7.6% discounted rate of insurance contributions (Paragraph 3 Part 1, Part 5, 2.2 Article 427 of the Russian Tax Code[12]);
- VAT exemption for: (1) distribution of exclusive rights to computer programs and databases included in the Russian software register on the territory of the Russian Federation; (2) provision of the right to use such programs and databases, including updates and additional functionalities, including by remote access on the Internet;
- Limitation of on-site tax audits through 03.03.2025;
- Accelerated depreciation of certain fixed assets and intangible assets.

[12] The abatement is available in 2022-2024

Tax abatements apply in case of simultaneous fulfillment of the following conditions:

- A company needs state accreditation from the designated agency, the Russian Digital Transportation, Communications and Mass Media Ministry;
- The share of revenue from IT operations in the overall revenue of a company in the reporting period must be at least 70%.

IT benefits for Russian companies with foreign participation

Many foreign investors have state accreditation and enjoy the abatements. For instance, the register of accredited IT companies includes subsidiaries of Huawei (Huawei Technologies LLC) Samsung (LLC Samsung Research Center), SAP SE (LLC SAP CIS) and others.

The opportunity may be significantly limited soon. This cannot be called unexpected, since the planned legislative changes have been talked about for quite a long time. Both market actors and the Russian government have been discussing the issue.

The legislative restriction is due to take effect on August 1, 2025, through an additional criterion of state accreditation of IT companies – the share of foreign parties must not exceed 50%. Importantly, the criterion may lead to the exclusion of companies with the predominant foreign participation (over 50%) from the register.

At the same time, restrictions on foreign participation were previously imposed on software copyright holders that planned to include their software products in the register of Russian software for the purpose of tax abatements. In particular, in order to include software in the register, it was required that the exclusive right to the software belongs to a Russian entity without predominant foreign participation (no more than 50%).

When considering possible limitations, several important points cannot fail to be noted:

- At the moment, this initiative is only being considered at the legislative level and can subsequently be revised in terms of reducing the percentage of foreign participation.
- If this initiative is approved, the possibility of an IT company with foreign participation obtaining accreditation is still not completely excluded. The main thing is to comply with the criterion - foreign direct or indirect participation (ownership, control) should not be predominant (less than 50%).

Check list: how to receive state accreditation for IT company

We have prepared a short check lit to help you understand whether your IT company meets the mandatory criteria of state accreditation in the IT sector.

START

Does the company meet the following criteria?

Respective OKVED code:

An extract from the Unified State Register of Legal Entities indicates the core economic activity from the following list: 26.20.4; 26.30.16; 46.51.2; 47.91.2; 58.11; 58.13; 58.14; 58.19; 58.21; 58.29; 59.14; 60.10; 60.20; 62; 63.1; 63.91; 71.20.9; 72.11; 72.19; 73.11; 73.12; 73.20.1; 74.90.9; 85.30; 85.41; 85.42; 95.11[13];

Level of salaries[14]:

Salaries of company employees in the last three months of the reporting (settlement) period must be higher than average in the Russian Federation or a constituent territory of the Russian Federation;

Share of revenue from IT operations[15]:

Revenue share from IT operations must exceed 30% (in order to receive state accreditation) / 70% (in order to qualify for IT tax abatements);

Information on the Internet:

The company's official website must contain information about its IT operations (in Russian);

Consent to disclosure of tax secret:

The company gives its consent to the tax authority to disclose the tax secret to the Russian Digital Development, Communications and Mass Media Ministry;

The company is not listed as a specialized entity:

It is not 1) a company with over 50% state participation; 2) a public or municipal establishment; 3) a bank, a non-banking credit institution, a non-banking financial institution, an operator with a significant position in the public communications network; 4) an insurance company;

Absence of arrears

On taxes, dues, insurance contributions, penalties and fines exceeding 3,000 rubles;

Absence of an non-expunged or outstanding criminal record

Of the sole executive body;

The company does not have predominant foreign participation[16]:

Russian legal entities and/or individuals own, manage or control either directly or indirectly over 50% of voting shares in the company's charter capital.

[10] If a company chooses for its core economic activity one of the following OKVED codes - 26.20.4, 26.30.16, 46.51.2, 47.91.2, 58.11, 58.13, 58.14, 58.19, 58.21, 58.29, 59.14, 60.10, 60.20, 63.91, 71.20.9, 73.11, 73.12, 73.20.1, 74.90.9, 85.30, 85.41, 85.42, 95.11, state accreditation can be provided only in case of additional activity compliant with OKVED codes of class 62 and/or 63.1 group.

[11] The salary condition does not apply if the company exists for less than three months or the company is the holder of rights to software from the Russian software register.

[12] By the general rule, this is the revenue for the year preceding the date of submission of the application. Revenue of the current year is taken into account if the company is established (1) in the current year and its revenue is > 1 million rubles; (2) last year with zero revenue from the previous year and > 1 million ruble revenue in the current year.

[13] From August 1, 2025.

One or several criteria are not met? → **Accreditation impossible**

All of the criteria are met? → **Accreditation possible**

Submission of CFC financial reports under sanctions

Guideline

Controlling parties are often wondering how to comply with Russian tax legislation in case the CFC jurisdiction does not provide financial statements because of sanctions against Russia

Information

- A Russian entity, the controlling party, confirms revenue (loss) of the controlled foreign company in particular through the submission of the CFC financial reports drawn up consistent with personal law of such a company for a fiscal year (Part 5 Article 25.15 of the Russian Tax Code).
- The failure to timely submit documents confirming revenue (loss) of a CFC to the tax authority is punishable with a fine of 500,000 rubles on the controlling party (Part 1.1 Article 126 of the Russian Tax Code).

Russian Federal Tax Service Letter No ShYu-4-13/15999@ dated 21.12.2023 indicates as follows:

• If it is not possible to submit documents in relation to a CFC, the controlling party has the right, taking into account the restrictions and obstacles in force in relation to it and its CFC, **to submit to the tax authority written explanations** signed by itself and providing significant information about the effect of factors that prevent the taxpayer from obtaining confirmation documents, as well as pledging to submit such documents immediately upon receipt.

• If there is interaction with an authorized CFC official, the taxpayer has the right to **submit a letter signed by the authorized CFC official** regarding the impossibility of submitting and the absence of primary documents regarding:

- financial and economic operations;
- current accounts in force during the specified period;
- cash flows on open accounts.

• Circumstances indicated by the taxpayer that arose for reasons beyond his control and that impede the receipt of supporting documents in relation to the CFC may be accepted by the tax authority as excluding the person's guilt in committing a tax offense provided for in Part 1.1 Article 126 of the Russian Tax Code. The list of circumstances excluding a person's guilt is established by Article 111 of the Russian Tax Code and remains open. Thus, the tax authority considering the case has the right to determine other circumstances that may be recognized as excluding the person's guilt in committing a tax offense.

According to Russian Finance Ministry Letter No. 03-12-11/2/126754 dated 27.12.2023, the legislation of most foreign states allows drawing financial statements in accordance with IFRS. If personal law of a controlled foreign company is appropriately authorized, **the IFRS financial statements of the said foreign company can be considered as prepared in accordance with its personal law.**

Thus, in the absence of financial statements of a CFC according to its personal law, it is necessary (1) to make sure that it is not possible to provide financial statements in accordance with IFRS, and also (2) to make sure that there are no other documents confirming the revenue (loss) of such a company for the fiscal year. In the absence of the above documents, it is necessary to prepare written explanations to the tax authority about the reasons for the impossibility of providing financial statements (on behalf of the CFC official or on the controlling person).

Next issue announcement

The next issue will continue to analyze tax abatements for foreign investors in Russia and the relevance of tax gross-up amid the suspension of international tax agreements between Russia and unfriendly countries, while the Taxation Practice section will comment on the Russian Supreme Court ruling adjusting the approach to the concept of the actual right to income.

About us

The National Coordination Center for International Business Cooperation provides comprehensive support for operations of foreign companies in the Russian market. In particular, it ensures risk reduction for foreign investors, manufacturers and suppliers, protection for the interests of parties, verification of counterparties, guarantees, and process management.

The Business Adaptation Center (BAC) operates within the NCC framework to this end. Tax Compliance, a leading law firm in the field of law disputes and consulting, according to Russian and international ratings, such as World Tax, Pravo-300, Best Lawyers, Kommersant and Forbes, is the tax partner of BAC.

Business Adaptation Center services:

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