Deloitte.

By: Alexander Krylov
10 May 2012

Highlights of positive tax reforms by the Russian government

Alexander Krylov

Alexander Krylov, head of the Russian team in the International Core of Excellence program for Deloitte Tax LLP in New York, recentely dismissed tax reform in Russia with ModernRussia.com.

What are some recent reforms to the Russian tax system?

For several years, the Russian government has made a prominent effort to introduce measures that will improve the tax system, bring Russian tax law more in line with international tax standards, make the country attractive to foreign investors and promote innovation and modernization. Most recently, new transfer pricing rules and consolidated taxation rules came into effect. The transfer pricing rules are more in line with the OECD guidelines and the consolidated group rules allow a qualifying group of Russian companies to be treated as a single taxpayer for profits tax purposes.

Starting from 2011, capital gains derived by a foreign entity from the sale of shares in a "real estate rich" Russian entity traded on an "organized securities market," as well as on derivatives of these shares, are exempt from withholding tax. Tax incentives (e.g. tax holidays, benefits for R&D activities and reduced social insurance contributions) are available to investors in special economic zones, such as the Skolkovo Innovation Center. A Customs Union has been formed with Belarus and Kazakhstan. Legislation to relax the visa regime, including the rules for highly qualified specialists, continues to evolve.

What steps is the government taking to ensure that the tax system continues to evolve in line with international norms?

The Russian government is striving to improve both the internal business environment and Russia's position as a developed and investor friendly venue. The government has introduced a variety of tax and non-tax incentives to attract foreign investment and talent, and has exhibited a willingness to reduce administrative burdens, eliminate barriers and provide financial support to foreign business. Notable concrete examples include: Russia's accession to WTO; plans to join the OECD; the above-mentioned Customs Union with Belarus and Kazakhstan; the creation of a Eurasian Economic Union by 2015. The implementation of special economic zones also shows that the authorities are moving in the right direction.

Although progress has been made and the pace of reform measures accelerated, the government needs to ensure that proper implementation measures accompany all legislative reforms (including consistent interpretation of the rules) and that processes are in place to help companies understand the changes and so they are able to adapt their operations accordingly.

What is the perception of foreign investors conducting business in Russia and how can tax reform affect this perception?

Most major U.S. and European companies and some medium-sized companies are already doing business in Russia. Reforms to the tax and legal framework have encouraged companies to expand their operations in Russia and neighboring countries, as well as restructure their business strategies to take advantage of the new investment environment.

Foreign investors conducting business in Russia are becoming increasingly optimistic about the stability and performance of their operations in the country. However, the perception and reality is that barriers and difficulties still exist, including an evolving tax system and the lack of supremacy of the law. A foreign investor needs transparent tax legislation, based on principles applied in other developed countries with clear and fixed "rules of the game." Tax reform is one facet of the changes taking place in Russia that should stabilize the tax legislation and bring it closer to the needs and expectations of investors.

Some companies that have been operating in Russia recognize that profits earned in the country are higher than in other transition economies. There is cash in Russia due to high oil prices, rising salaries, production growth and increasing consumer spending. Furthermore, Russians are prepared to pay for quality products and services leading to more opportunities for foreign companies to have a higher margin from their Russian operations. These factors can mitigate or offset the burdens from challenges typically encountered by foreign companies setting up operations in Russia.

What are some areas that the government should focus on that are not being addressed?

The Russian government seems to be aware of its shortfalls and is addressing the issues step by step, although this often is not an easy process. While there have been some positive changes (tax litigation declined by 20 percent in 2011), more needs to be done to improve the climate for doing business. The greatest challenges continue to be administrative barriers and an extensive bureaucracy. Transparency, clarity and consistent application of the rules is paramount, and for foreign investors, consulting with professionals that have knowledge of the Russian market is critical.

Corruption is another impediment to investor confidence, and one of the main objectives of the president and prime minister is to introduce measures to discourage and fight corruption. On a practical level, foreign investors can mitigate the risks of bribery and other forms of corruption by involving professional and independent consulting companies early in the process.

Language and cultural barriers also can contribute to cautious attitudes of investors, although this is becoming somewhat less of an issue, particularly in the larger metropolitan areas, such as Moscow and St. Petersburg.

This article originally appeared on ModernRussia.com.

Mark Twain said, "Travel is fatal to prejudice," so probably the best way to go forward with Russia is to go there and see it for yourself or, from a corporate perspective, to consider establishing a presence in the country