



LT In Focus

Review of judicial practice related to personal income tax

On 21 October 2015 the Presidium of the Russian Supreme Court published a review of judicial practice related to the application of Art. 23 of the Russian Tax Code "Personal Income Tax" (hereinafter - **the Review**).

The overview contains a number of clarifications on how to apply provisions of the Russian Tax Code related to personal income tax (hereinafter referred to as **PIT**), including:

- the possibility to receive credit for a property tax deduction withheld for an entire year from a tax agent;
- specifications of the rules for acknowledging income in kind for PIT purposes;
- differentiation between compensatory payments, incentive payments and payments based on the interests of the transferring party for PIT purposes;
- specification of the procedures for calculating the PIT base in cases of i) receiving property under a deed of gift, ii) transferring property under a contract of exchange, iii) obtaining interest-free loans from individuals, iv) receiving income in the form of a penalty or fine due to the infringement of consumer rights and v) writing-off uncollectables from an individual's counter party.

In this edition, we summarize the most interesting issues addressed by the Russian Supreme Court in the Review.

Obtaining property tax deduction via tax agents

The Supreme Court indicated that when an employee files an application to receive a property tax deduction, the tax agent (the employer) is to return to the employee the entire tax amount withheld starting from the beginning of the year in which the application has been filed.

This approach represents a conceptually new approach to this issue. Both the Russian Supreme Court and the Ministry of Finance had stated multiple times in the past that tax agents are not entitled to return any tax amounts withheld and transferred to the state budget prior to the date the application was made (see, for example, the Rejection of the Supreme Court No [307-KG15-324](#) of 13.04.2015 and the Letter of the Ministry of Finance No [03-04-05/51303](#) of 7.09.2015). Previously, tax agents were only required to return excessively withheld tax to taxpayers in cases where the tax had been excessively withheld by mistake.

Under the new approach, the excessively withheld tax is to be returned by a tax agent to a taxpayer within 3 months of the taxpayer's application. The tax agent may preliminarily transfer this payment at his own expense. The tax agent is entitled to return the excessively paid tax or credit the amount toward its future payments according to the standard procedure.

Please note that the total term provided to tax authorities to prove the right of a taxpayer to a property tax deduction at the place of their employment and to the employer to transfer the payment are equal to the term for returning the tax via submitting a tax return.

The employee may file an application to the employer within a calendar year, but not after the end of it. Eventually, the new approach of the Russian Supreme Court will allow employees to receive the property tax deduction in a shorter period of time and avoid the need to submit tax returns.



Specification of the rules for acknowledging income in kind

The Russian Supreme Court drew the attention of the lower courts to the fact that income in kind is subject to taxation provided it is not anonymized and can be allocated to each of the individuals.

In an example provided in the Review, the Court noted that because employers can pay for fitness center services for the benefit of specific employees, a penalty under Art. 123 of the Russian Tax Code (Failure by a tax agent to fulfil his obligation to withhold and (or) transfer taxes) can be calculated based on the entire amount paid for fitness center services.

However, a tax agent cannot be responsible for a penalty under Art. 123 if it is not possible to objectively and practically allocate the income to specific individuals, such as if an employer paid for a party for all employees.

Differentiation between compensatory payments, incentive payments and payments made for the interests of the transferring party

The Russian Supreme Court noted that the range of PIT-exempt compensatory payments does not only include payments reimbursing employees' actual expenses, but also other payments related to the reimbursement of the employees' potential expenses, in particular, various increments, allowances, benefits stipulated by the Russian Labor Code and calculated according to the approved procedures. According to the Supreme Court, it is the nature of the payment that should be taken into account rather than the names stipulated by the Russian Tax Code, which often give a false idea of the nature of the payment.

The Supreme Court also concluded that monetary payments and payments in kind are not acknowledged as incentives and do not constitute income for PIT purposes if their transfer primarily stems from the interests of the transferring (paying) party and not from the satisfaction of individuals' personal needs. The fact that the paid service satisfies individual needs to a certain extent does not suffice to conclude that the individual has derived any income in kind that is subject to PIT.

Using the example of an employer that rents apartments for its employees, the Supreme Court cited a number of factors indicating that the rent payments were carried out in the interests and on the initiative of the employer, and should not otherwise be acknowledged as the employees' income in kind:

- apartment rental agreements were concluded at the employer's initiative due to the opening of a branch office in another city and the need to engage employees who were not local because of their specific experience and qualifications;
- if not for the needs of the business, the employees would not have willingly changed their place of residence;
- the apartments provided to the employees are not categorized as elite, meaning the organization did not pursue the aim of satisfying the individual lifestyle needs of the employees.

Despite the numerous decisions by courts of cassation confirming the above interpretation of the law, the Russian Ministry of Finance had consistently pursued the opposite opinion on this matter - that payments unrelated to actually incurred expenses should to be included into the PIT base. The disagreement between the interpretations forced taxpayers facing this issue to bring their case before a court. We believe the number of lawsuits related to these matters will drop significantly following the publication of this Review.

Given the above, we recommend that employers re-analyze the list of payments to employees to assess the possibility of reducing PIT payments. Whenever necessary, amendments should be introduced to local contracts, labor agreements and lease agreements for the purposes of the correct calculation and payment of PIT.

Defining PIT base when granting property as a gift or under a contract of exchange

The Russian Supreme Court indicated that when an individual receives real estate as a gift, the tax base may be calculated based on its cadaster (inventory) value. In the absence of data proving the invalidity of the official property value used by the individual for calculating the tax, there is no reason for recalculating tax obligations based on the market value of the real estate.

The Review also addressed the question of property received under a contract of exchange. This situation is not covered in any current legislation, but in the Review, the Court described its approach to the matter. According to the court, the value of the property received by an individual under a contract of exchange is considered income, but any expenses related to the purchase of the property reduce the PIT base.

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