

## LT in Focus

# Russia's State Duma approves revised draft law introducing VAT on e-services

The State Duma approved [the amended draft law introducing VAT on e-services](#) in a third reading on 15 June 2016. To become effective, the law will need to be approved by the Federal Council (the upper house of the Russian parliament) and signed by the president. It is not expected that further amendments will be introduced into the draft law after its approval by the State Duma.

The law would require foreign businesses supplying electronic services (e-services) to private customers (i.e. business-to-consumer or B2C supplies) in Russia to register for VAT purposes and charge VAT at a rate of 15.25% (applied to VAT-inclusive service fees). The first draft law was approved by the State Duma on 26 February 2016, but following discussions with the government and businesses, the State Duma Committee on Budget and Taxation made some changes to the draft.

The amended draft law clarifies technical issues relating to registration and communications with the tax authorities via the taxpayer portal, amends some areas that were unclear and introduces some new provisions. The fundamental concept that VAT would apply on the B2C supply of e-services by foreign businesses, however, remains substantially unchanged.

As with the previous draft law, the revised version has similarities to the EU rules on the supply of e-services by non-EU providers, as well as to recent rules introduced in Korea, New Zealand and South Africa.

The law is expected to become effective on 1 January 2017, and affected foreign suppliers of e-services would be required to submit their registration applications within 30 days from the effective date.

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## Tax registration and permanent establishments

The amended draft law would eliminate the separate registration by foreign businesses for VAT purposes. Instead, the regular tax registration would apply. Further, the draft law specifically states that the provision of e-services deemed to be supplied in Russia by a foreign entity would not create a permanent establishment for the entity.

A foreign supplier would be required to register for tax purposes in Russia if it:

- Provides e-services (as defined in the draft law) to private individuals (other than private entrepreneurs) and the services are deemed to be supplied in Russia;
- Does not have a fixed place of business ("separate division") in Russia; and
- Is involved in "direct" settlements with private customers (the law does not define a direct involvement in settlements, but presumably this means receiving payments directly from private customers).
- Notably, there is no specific sales threshold in the draft law for the obligatory registration of foreign suppliers of e-services.

Foreign intermediaries (which, together with registered business customers, would be defined as the tax agents for VAT collection) would be subject to the tax registration requirement if the entity:

- Acts under a commission, an agency or a similar arrangement with foreign entities rendering e-services deemed to be supplied in Russia;
- Is involved directly in settlements with private customers (if there are several intermediaries in the supply chain, the intermediary that is directly involved in settlements with private customers would be required to register, regardless of whether it concluded an agreement with the foreign supplier of e-services<sup>1</sup>); and
- Does not have a fixed place of business through which it carries out activities involving direct settlements with private customers.

Alternatively, if a Russian intermediary is involved in the provision of e-services (based on commission, agency or other similar agreements) and proceeds settlements with private customers, such intermediary should act as a tax agent, allowing foreign intermediaries and service providers to skip tax registration in Russia.

<sup>1</sup> The draft law does not specify whether receiving payments from payment aggregators not acting on the basis of agency or similar arrangements with the foreign supplier of e-services would be deemed to constitute "direct involvement in settlements" with private customers.

## Amended list of e-services

The amended draft law clarifies the e-services that fall within its scope, and adds some new services that were not present in the first draft of the law. The list of e-services that would fall within the scope of the proposed rules is extensive. E-services would be defined as services delivered over the internet or similar electronic networks that are automated and that rely on information technologies, such as the following:

- The provision of the right<sup>2</sup> to use software, including online games and databases, in particular, by providing remote access, as well as updates and additional functions;
- The provision of advertising services on the internet, including the use of web-based software and databases and the provision of advertising space on the internet;
- The provision of services for placing offers for the acquisition (sale) of goods, work and services and property rights on the internet;<sup>3</sup>
- The rendering of services relating to the provision of web-based platforms for establishing contacts and/or concluding transactions between buyers and sellers, including the provision of a web-based online trading facility where potential buyers offer their price through an automated procedure and the parties are notified of a sale by an automatically generated message;
- The provision and/or maintenance of a commercial or personal presence on the internet, electronic resource support (such as a website and/or web page support), securing access to websites/web pages for other web users and the provision of facilities that allow users to modify such resources;
- Data storage and processing, where a person who provided data<sup>4</sup> has access to the data through the internet;
- The online provision of a computing capacity to place information in an information system;<sup>5</sup>
- The provision of domain names and hosting provider services;
- Remote system administration and support of information systems and websites; Services performed automatically through the internet once a purchaser inputs data; provision of automated data searches, their sorting upon a specific request and the provision of sorted data through an information and telecommunications network (examples cited in the draft law include online stock exchange reports and online automated translations);
- The provision of rights to use e-books and other e-publications, information and educational materials, images, music with or without lyrics and audio-visual content through the internet, including by providing access to watch or listen through the internet;<sup>6</sup>
- The provision of search services and/or information to the purchaser on potential customers;<sup>7</sup>
- The provision of access to internet search engines;<sup>8</sup> and
- Web-based statistics management.

The broadcast of TV and/or radio channels through the internet and telecommunications services provided through the internet are excluded from the list of e-services. In addition, the following services do not constitute e-services:

- The sale of goods and services ordered over the internet, where the supply is made without using the internet;
- The sale or transfer of rights to use software (including online games) or databases on tangible media;
- The provision of consulting services via e-mail; and
- The provision of access to the internet.

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<sup>2</sup> The first draft used the language “transfer of nonexclusive rights to...”

<sup>3</sup> “Placing such offers within software,” used in the first draft, has been eliminated but, in practice, may be covered by the previous bullet.

<sup>4</sup> The first draft used the language “the purchaser who has access to data.”

<sup>5</sup> The possibility to “process the data that allows the user to increase the data access speed” has been eliminated, but is likely covered by this new bullet.

<sup>6</sup> The first draft contained a broader definition, “any information, including...” The revised draft contains an exhaustive list of content.

<sup>7</sup> The first draft did not contain this point. It should be noted that these services will be treated as e-services even if they are supplied not through the internet, but through any other electronic network.

<sup>8</sup> The first draft referred to the “provision of search engines and other portals for accessing the internet.”

## Place of supply of e-services

Similar to the first draft law, e-services would be subject to VAT in the country in which the customer (whether an individual or a business) is located. The amended draft law clarifies that a private customer purchasing e-services would be deemed to be located in Russia if one of the following conditions is fulfilled:

- The individual (other than a private entrepreneur) is resident in Russia;
- A bank or e-payment operator through which payment is made for e-services is located in Russia;
- The customer's IP address that is used for the purchase of e-services is registered in Russia; or
- The country code for a telephone number used for the purchase of, or payment for, e-services is assigned to Russia.

At the same time, if, under the legislation of a foreign country, the place of supply of e-services is deemed to be the place of business of the customer and that place is the territory of the foreign country, the supplier of the e-services would have discretion to determine the place of supply.

The place of supply of e-services should be confirmed by the "registers of operations" (as defined for accounting purposes) evidencing that the e-services are supplied in Russia according to the above conditions and disclosing the service fees charged.

## Taxable base, tax point and tax period

The amended draft law provides that a foreign supplier of e-services would be required to pay VAT itself, unless the obligation to pay VAT is imposed on a tax agent.

Similar to the first draft law, the taxable base for B2C e-services supplies made by foreign entities would be the VAT-inclusive service fees, and the VAT amount due would be calculated at a rate of 15.25% applied to the taxable base. VAT returns would have to be submitted via the taxpayers' portal or, for the period when the portal cannot be used, via telecommunications channels by an e-document operator. The returns, as well as the payment of VAT, would be due by the 25th day of the month following the reporting quarter.

The revised draft law, however, states that the tax point is not the date when payment is received from the customer (as was provided in the first draft law), but rather the last day of the calendar quarter in which the payment/partial payment from the customer is received. Where service fees are quoted in foreign currency, the taxable base would be calculated in Russian rubles based on the exchange rate established by the Central Bank of Russia as of the tax point.

The first tax period for foreign suppliers of e-services would be the period from the day the supply of e-services in Russia commenced (but no earlier than 1 January 2017) until the end of the relevant calendar quarter.

## Input VAT credit

Similar to the first draft law, foreign suppliers of e-services would not be able to claim Russian input VAT for offset against the output VAT charged on taxable supplies of e-services, unless e-services are provided through the separate divisions of foreign suppliers.

Unlike the first draft law, however, the amended draft law would not establish any input credits related to e-services deemed to be supplied outside Russia for Russian suppliers of e-services. Therefore, the existing rules would apply, i.e. supplies "outside the scope of VAT" would be exempt without the possibility to apply input credits.

## VAT exemption for software licenses

The first draft of the law would have eliminated the VAT exemption for the transfer of rights for the use of software and databases. However, following discussions with Russian information technology (IT) companies, the exemption applicable to a transfer of rights to use software, databases, know-how and other qualifying intellectual property would not be repealed. Consequently, the “super deduction” of expenses for corporate income tax purposes that would have been provided as a compensatory measure

for abolishing the VAT exemption for IT companies is eliminated in the amended draft law.

It remains to be seen whether, in practice, foreign businesses will be able to substantiate the application of this VAT exemption to (and not account for Russian VAT on) the transfer of software and database rights to private customers on the basis of a contract of adhesion, where a license contract exists for online supplies but usually is not made in writing.

## Enforcement and payment mechanisms

The amended draft law does not clarify how the Russian tax authorities would enforce the obligation of a foreign e-service provider to register for Russian tax purposes and ensure the collection of VAT in the absence of Russian bank accounts and property owned by the foreign entity.

The draft law would not specifically allow foreign

e-service providers to pay VAT to the Russian tax authorities from their foreign bank accounts (this currently is impossible in practice). However, the amended draft law provides that overpaid VAT could be refunded to any bank account (presumably including foreign bank accounts), unlike the first draft that would have allowed VAT refunds to be paid only to a Russian bank account.

## Comments

Foreign companies supplying e-services in Russia should assess the potential impact of the proposed VAT rules on their existing businesses and technology; adjust their business models and documentation framework as needed to mitigate potential tax risks; and prepare to register with

the Russian tax authorities, unless the registration obligation would be imposed on foreign or Russian intermediaries involved in the supply chain.

# Contacts

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