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Regional tax incentives for investors in Russia

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Today, companies are increasingly seeking opportunites to develop their businesses in the Russian regions. Regional governments in turn, are keen to attract businesses and are offering a range of administrative and tax advantages for investment projects. When selecting a location for the regional expansion, issues related to land utilisation, permits for construction, infrastructure and utilities are hugely important. But in addition to this, many regional goverments now offer a range of tax incentives to sweeten the deal.

A company planning to invest in fixed assets (construction, reconstruction or modernisation of production facilities or real estate; acquisition of equipment) could benefit from regional tax incentives in the majority of the regions of the Russian Federation.

Advantages

Federal legislation has granted the regional and local authorities broad powers, including the opportunity to provide tax concessions to investors. Among the most significant regional tax concessions are the following:

- *property tax reduction or exemption for certain types of property*
- *profits tax rate reduced to 15.5% (from the standard rate of 20%) by reduction in the regional component (in some regions profit tax may be reduced to zero)*

Local authorities may also set advantageous rates for transport and land tax for investors, or even exempt certain entities from them altogether.

Property tax incentives are particularly appealing to investors, as this tax is payable on the property irrespective of any profits generated by a company, and therefore constitutes a real cost for business. As an example, tax breaks in the form of a five-year property tax exemption for a building with an assigned useful life period of 30 years, and a construction cost of USD 20 million, could be as high as USD 2 million.

Standard requirements

Regional governments have the power to grant incentives. Most regions have an approval process for claiming tax incentives which requires the preparation of a package of documents, including a business plan that must be approved by the government. An investment project agreement must also be concluded.

A few regions grant tax incentives without the prior approval, on the basis of self-assessment by the taxpayer (for example, **St. Petersburg, Leningrad region and Tula**). Regional governments may place restrictions on investors on the type of business activity undertaken, and set minimum levels of capital investment. The duration of any tax incentive may be dependent of the amount invested and the project's pay-back period.

Exceptions to the rules – examples

Far East and Siberia regions

Three special tax regimes are available in the Far East and Siberia: for regional investment projects (RIPs), for Territories of Advanced Social and Economic Growth (TASEG) and for the Free Port of Vladivostok. For participants in a regional investment projects, the regional profit tax rate may not exceed 10% during the first five years after the participant of regional investment projects receives its first profit, and will be between 10%-18% during the next five years. Minimal profit tax rates (between 0% and 10%) have been set in 13 of the 15 regions in the Far East and Siberia. For residents in TASEG, the profit tax rate may not be more than 5% during the first five years after the resident receives its first profit from operations and at least 12% during the next five years. Residents of the Free Port of Vladivostok are granted tax benefits in the form of an exemption from profit tax during the first five years after receiving their first profit, a reduced profit tax rate of 12% in the following five years, exemption from property tax during the first five years and a reduced property tax rate of 0.5% for the next five years.

No limitation for investor's sector of industry

In **St. Petersburg**, a profits tax incentive is available, which does not depend on the investments or the industry of the company but is granted upon compliance with a certain number of employees and minimum salary. Companies with an average headcount of over 400 employees and an average salary exceeding the minimum salary set for the region by seven times are granted a 18.5% profits tax rate; companies with an average headcount of over 100 employees and an average salary exceeding the minimal salary set for the region by twelve times are granted a 15.5% profits tax rate.

Support of IT companies

Penza, Novosibirsk and Ulyanovsk have adopted specific incentives for IT companies that are accredited by the Ministry of Communication and Information Technology (the rate of profits tax is reduced to 15.5% with no investment requirements). It is expected that other regions will adopt similar measures to support the IT sector.

Changes in tax benefit legislation

Regions are often able to modify tax benefit eligibility conditions, either for better or for worse. For example, in 2015, the Moscow region removed from the list of eligibility requirements for investors the minimum wage requirement and the requirement of a minimum percentage of revenue in the entity's total revenue from the sale of goods (work, services) produced as a result of the investment project. Also last year, the Bryansk and the Volgograd regions extended the period during which property tax benefits are available. On the other hand, St. Petersburg introduced a requirement for the average monthly wage to be higher than the statutory minimum to quality for tax benefits, while the Chuvash Republic more than doubled the minimum investment requirement and introduced a permit-based procedure for claiming tax benefits instead of a declarative one.

Comments

Applying for tax incentives granted by regional governments can be a time-consuming and administratively difficult process requiring specialist skills. The incentives often remain unclaimed because companies do not have the time or skills necessary.

Legislative loopholes, selecting the wrong or risky investment, poor project structuring options, ineffective communications with the regional government and regular inspections from the tax authorities can all offset the positive effect of tax incentives.

To claim an incentive, a company must have the following expertise:

- Legal (analysis of regional legislation)
- Financial (investment analysis, calculation of the payback period and other calculations)
- Experience of negotiations with local authorities and knowledge of specific regional factors.

How we can help

We have extensive experience, gained from helping our clients to obtain various forms of government support, including regional tax incentives. We will be happy to use this experience to help you.

Our integrated approach includes:

- 'Turn-key' solutions for obtaining tax incentives
- Preliminary analysis of the regional tax legislation in the area of tax incentives, to identify potential risks (noncompliance with federal legislation, ambiguity of terms and provisions, etc.) and its applicability to businesses and projects (minimum investment, priority industries etc.)
- Design and implementation of an efficient tax and operational structure for the purposes of an investment project and the use of tax incentives
- Assistance in negotiations with regional and local authorities, drafting and review of investment agreements
- Preparation of business plans, forecasts and calculations regarding tax incentives
- Preparation and review of documentation supporting the rights to tax incentives
- Review of the effectiveness of the application of current tax incentives
- Assistance with tax audits and dispute resolution in the area of tax incentives.

A step ahead

- Deloitte has a special R&D and Government Incentive practice, specialising exclusively on utilising R&D and government incentives
- Our team has helped to successfully claim tax incentives for companies in a wide range of industries in more than 20 regions
- We assist the governments of various regions in developing basic principles for the granting of regional tax incentives.

Contacts

Should you have any questions on any of the issues covered in this guide, please email or call your tax consultant or Vasily Markov, Director, who leads the Research & Development and Government Incentives programme in Russia.

Vasily Markov
Director
Tax & Legal
Head of R&D and Government Incentives Group
+ 7 (812) 703 71 06 (ext. 2556)
+ 7 (911) 840 80 77
vmarkov@deloitte.ru

Anna Vorontsova
Manager
Tax & Legal
R&D and Government Incentives Group
+7 (495) 787 06 00 (ext. 1371)
+7 (910) 499 84 01
avorontsova@deloitte.ru

Yana Butrimovich
Senior Consultant
Tax & Legal
R&D and Government Incentives Group
+7 (495) 787 06 00 (ext. 5168)
+7 (915) 154 80 94
ybutrimovich@deloitte.ru

Diana Agarkova
Senior Consultant
Tax & Legal
R&D and Government Incentives Group
+7 (812) 703 71 06 (ext. 2595)
+7 (981) 851 63 09
dagarkova@deloitte.ru

deloitte.ru

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