# Tax incentives in Russia
Your move in the right direction

2016

# Content





# Introduction

Russia's changing business environment is bringing forth new opportunities for investors. Tax incentives are a useful tool for increasing business profitability and thus maximising the potential of these opportunities.

In this information bulletin, we provide a brief overview of the Russian tax incentives that might benefit your business. We trust you will find this leaflet helpful in planning or enhancing your Russian operations.

The most important tax incentives available in Russia include:

- The standard profit tax rate of 20% can be reduced to 0%;
- The standard property tax rate of up to 2.2% (of the cadastral value or net book value of assets, depending on regional legislation) may be reduced and certain types of assets may even be exempt;
- The standard regressive social security contribution rates may be reduced from:
  - 30% on annual remuneration up to RUB 718k (approx. USD 10k);
  - 27.1% on annual remuneration between RUB 718k and RUB 796k (approx. USD 10.7k);
  - 15.1% on annual remuneration exceeding RUB 796k*;
- Special VAT and customs regimes.

* The relevant caps are effective in 2016 and subject to an annual increase.

**The company may benefit from:**

a 150% super deduction of respective costs to reduce profits tax and federal subsidies

if it is conducting certain activities for development / improvement of new products, services or technologies

the "Skolkovo" regime (reduced burden for almost all taxes)

if it is focusing on developing a new product, technology in the energy efficiency, nuclear engineering, space technology, medicine or IT industries and is ready to move to Moscow

regional tax incentives (profits and property tax reductions)

if it is going to invest in building/ renovating a plant or other equipment or property

0% profits tax rate, reduced SIC rates and wide range of federal and regional subsidies

if it is an agricultural goods producer

Special Economic Zones (reduced burden for almost all taxes)

if it is going to build a manufacturing plant or establish an R&D center / high-technology company or start a hospitality business (in specific locations determined by the Russian Government)

reduced social contribution rates

if it is engaged in software development

0% profits tax rate

if it is engaged in medical or educational activity




# Regional tax incentives

The availability of regional tax incentives, which are provided by the majority of Russia's regions, is an important factor to consider in choosing locations for production facilities.

**Typical requirements:**

- Project fits in with regional business priorities;
- Minimum investment determined by regional law.

**Benefits:**

- Reduction in regional component of profit tax (the maximum reduction is 4.5%; profit tax rate can be reduced to 0% in some regions);
- Property tax reduction or exemption.

**Comments:**

- In some regions, the approval process requires the investor to enter into an investment agreement with the regional authorities, while in other regions tax incentives are provided on a self-assessment basis, with no preapprovals required;
- Movable property recorded in statutory books on or after 1 January 2013 as fixed assets is not subject to property tax, except when it is acquired through transfer (including purchase) from related parties or through reorganization. Thus, regional incentives may only prove beneficial in cases involving significant investments in immovable property or sufficient taxable profits during the incentive application period (usually the first 3-8 years);
- Federal legislation grants the regional authorities broad powers, including the opportunity to provide tax incentives to investors in form of reduced profit tax rate of 15.5% (from the standard rate of 20%) by reduction in the regional component. In some regions profit tax may be reduced to zero due to the special tax regimes. However, some regions do not provide profit tax incentives, but may grant support in the form of subsidies for a certain amount of the profit tax base.
- From 1 January 2014, federal and regional profit tax rates for producers of goods investing in certain regions of Far Eastern Russia and Siberia (i.e. participants in regional investment projects) have been reduced. Each of the 15 selected regions can make changes to regional laws that would adjust the regional part of the profit tax rate so that it may not exceed 10% for the first five years of income generation and will be set between 10% -18% for the following five years. Some regions have introduced additional criteria to qualify for these incentives (e.g. the creation of a certain number of jobs and specification of priority industries).

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# Special Economic Zones (SEZ)

Each of the 26 currently established Special Economic Zones has geographical boundaries and falls into one of four categories: Manufacturing, Technology & Innovation, Tourism & Recreation, and Port & Logistic*. SEZs are established for a period of 49 years. Although originally slow to take off, many of the Technology & Innovation SEZs boast advanced infrastructures, and more than 400 investors – including foreign investors – are now in place.

### Requirements:

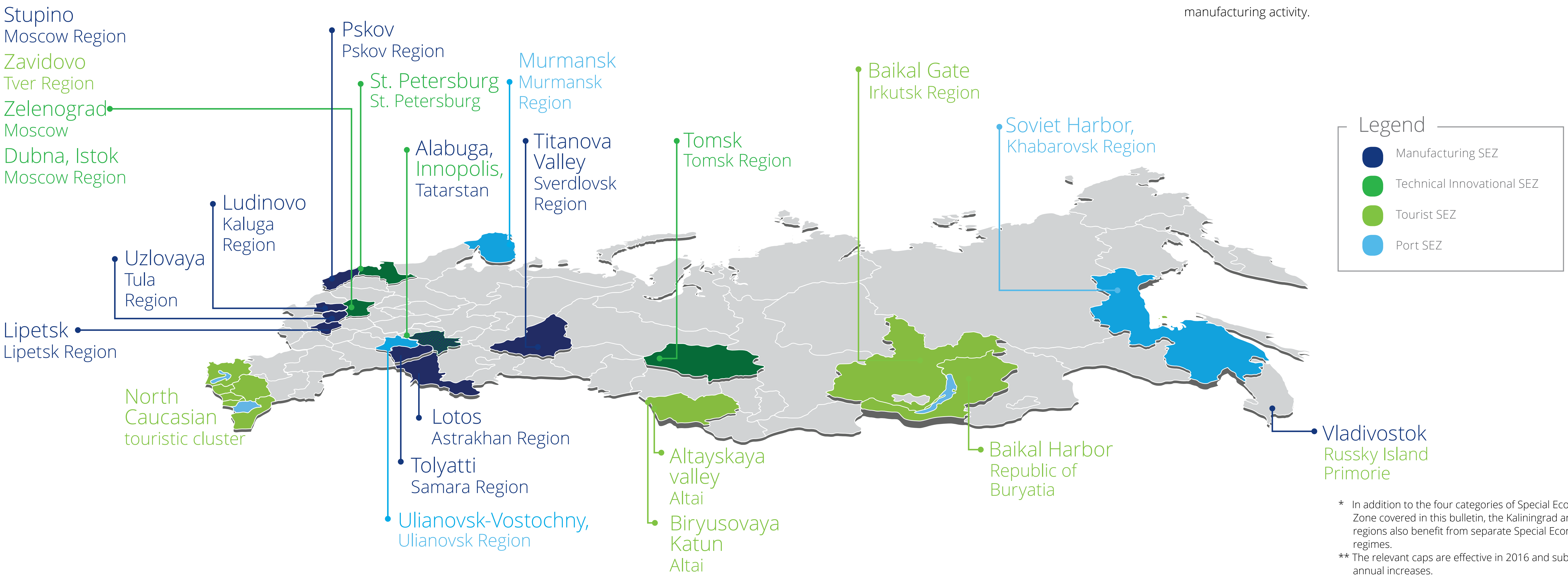
- Russian legal entity incorporated within a Special Economic Zone with no external branches or representative offices;
- Specific qualifying activities, depending on the category of the Special Economic Zone:
  - Manufacturing;
  - Technology & Innovation;
  - Tourism & Recreation;
  - Port & Logistic.

### Benefits:

- Maximum profit tax rate may be reduced from 20% to:
  - 2% (for Manufacturing and Port Special Economic Zones);
  - 0% until 2018 for Technology & Innovation and Tourism & Recreation Special Economic Zones.
- Property tax exemption for ten years;
- "Free customs zone";
- Reduced regressive social contribution rates for Technology & Innovation SEZs (effective until 1 January 2018):
  - 14% on annual remuneration up to RUB 718k (approx. USD 10k);
  - 12% on annual remuneration between RUB 718k and RUB 796k (approx. USD 10.7k);
  - 4% on annual remuneration exceeding RUB 796k**.
- Accelerated depreciation (Manufacturing and Tourism SEZs only);
- VAT exemptions for Port & Logistic Zones.

### Comments:

- In practice, the approval process could take 2-6 months;
- In many cases, the construction of production facilities inside the Special Economic Zone is required.
- Starting from 2015, the residents of Technology & Innovation SEZs are allowed to conduct manufacturing activity.




* In addition to the four categories of Special Economic Zone covered in this bulletin, the Kaliningrad and Magadan regions also benefit from separate Special Economic Zone regimes.

** The relevant caps are effective in 2016 and subject to annual increases.

Map as of 31 December 2013.

# Regional investment projects and special investment contracts

Tax incentives were expanded for investors involved in regional investment projects (RIPs) and special investment contracts (SPICs) in 2016.

### Regional investment projects

From 2016 RIPs may be implemented in all Russian regions.

#### Requirements

- Production of goods;
- Specific qualifying activities ;
- Capital investment:
  – At least RUB 50 million (approx. USD 700k) for 3 years;
  – At least RUB 500 million (approx. USD 7.1 million) for 5 years.

#### Benefits

- The profit tax rate may be maximally reduced from 20% to:
  – 0% for the first 5 years after the resident makes a profit and 10% for the next 5 years *(for RIPs in one of the regions of Siberia or the Far East)*;
  – 10% starting from the year in which the resident makes a profit until the year in which the total amount of received tax incentives equals the amount of capital investment *(for RIPs in any region other than those in Siberia and the Far East)*;
- Mineral extraction tax (MET): The effective rate is subject to a coefficient ranging from 0 to 0.8, depending on the period in which this coefficient is applied.

#### Comments:

- Generally, a RIP may only be implemented within a single Russian region;
- An investor may apply for tax incentives if appropriate regional legislation is adopted by the region;
- More than 90% of revenue derives from RIPs, otherwise the application of profit tax incentive is not allowed.

### Special investment contracts

Under a SPIC, an investor agrees to invest in establishing a new production facility or upgrading existing production facilities to achieve a certain production volume with a specific level of localization.

#### Requirements

- Manufacturing industry (expect food processing);
- Capital investments depend on the level at which the SPIC is entered into:
  – At least RUB 750 million (approx. USD 10.7 million) for federal SPICs;
  – Subject to local legislation for regional SPICs.

#### Benefits

- The profit tax rate may be maximally reduced from 20% to:
  – 0% at the federal level;
  – 0% at the regional level;

for 10 years after the investor makes a profit;

- A grandfather clause;
- Other benefits, such as property tax exemptions, depend on the adoption of amendments to the local legislation of the Russian regions.

#### Comments:

- An investor may apply for tax incentives if appropriate regional legislation is adopted by the region;
- More than 90% of revenue derives from a SPICs, otherwise the application of profit tax incentive is not allowed.
- The conditions and procedures for entering into SPICs are set not in all regions.





# Special tax regimes

There are several special tax regimes available for companies that choose to be located in the Far East and Siberia: Territories of Advanced Social and Economic Growth (TASEGs) and the Free Port of Vladivostok.

### Territories of Advanced Social and Economic Growth (TASEGs)

Introduced in 2015, TASEGs are a legal framework that aims to bolster development in the territories of the Russian Far East and in struggling single-industry towns across the country. So far, the regime is spreading rapidly into new territories. Each TASEG will retain this special status for 70 years.

#### Requirements:

- Specific qualifying activities;
- Implementation of an investment project;
- Minimum investment depends on the TASEG.

#### Benefits:

- Declarative procedure for VAT refunds without bank guarantees;
- Reduced profit tax rate: 0-5% for the first five years after the investor makes a profit, 12-20% for the next five years, depending on the region;
- Reduced mineral extraction tax rates for 10 years;
- Reduced regressive social insurance contribution rate for 10 years:
  – 7.6% on annual remuneration up to RUB 718k (approx. USD 10k);
  – 6.5% on annual remuneration between RUB 718k and RUB 796k (approx. USD 10.7k);
  – 0.1% on annual remuneration exceeding RUB 796k.*

#### Comments:

- Regions may additionally provide property tax exemptions (some regions have already adopted the appropriate legislative amendments).
- As of 1 January 2018, TASEGs can be established in all regions across Russia.

### The Free Port of Vladivostok

Introduced in 2015, the Free Port of Vladivostok provides a special customs, taxation and investment regime for investors in the city of Vladivostok and 15 surrounding municipalities. From 2016, four municipalities in other Russian regions in the Far East are also covered by the regime.

#### Requirements:

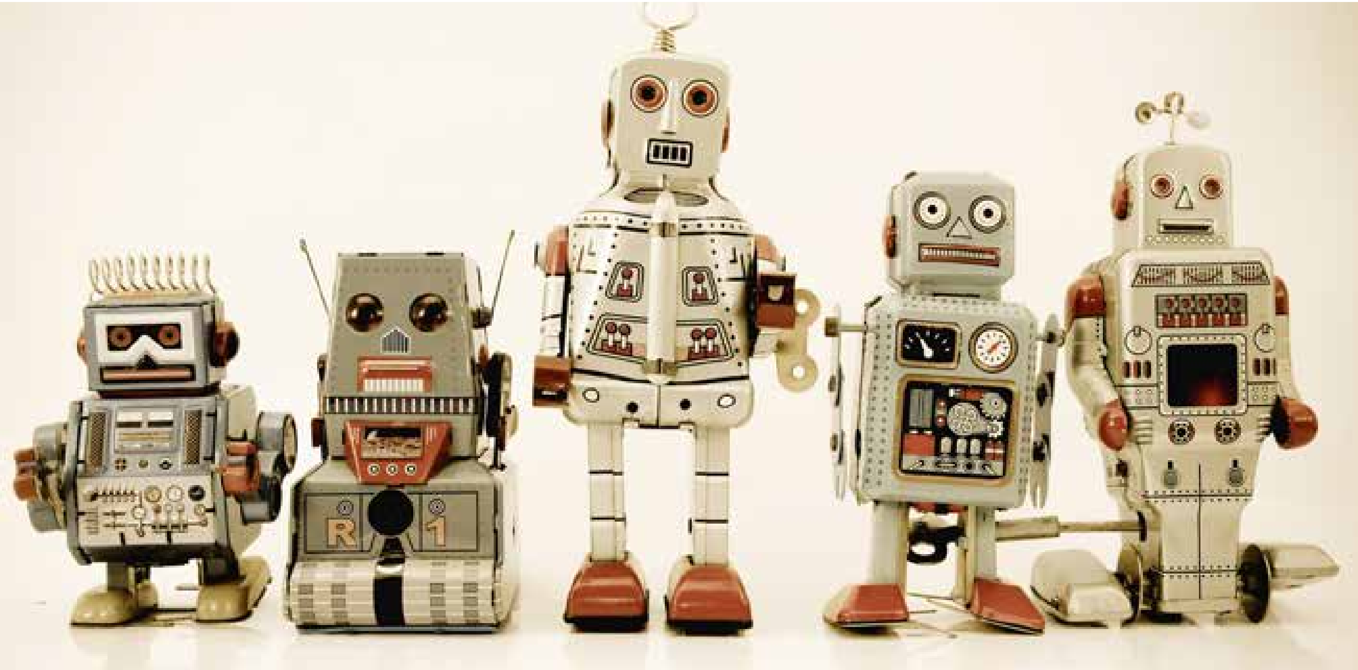
- Investments: minimum RUB 5 million (USD 70k) for 3 years;
- Implementation of a new investment project or a new business activity that has not been carried out previously.

#### Benefits:

- Declarative procedure for VAT refunds without bank guarantees;
- The maximum profit tax rate may be reduced from 20% to 0%** for the first 5 years after the resident makes a profit, and to 12% for the following 5 years;
- Property tax exemption for the first 5 years and reduced tax rate of 0.5% over the next five years (for the territories approved until 2016). For newly introduced territories, appropriate legislative amendments are being considered by the regional authorities.
- Reduced regressive social insurance contribution rate for 10 years**:
  – 7.6% on annual remuneration up to RUB 718k (approx. USD 10k);
  – 6.5% on annual remuneration between RUB 718k and RUB 796k (approx. USD 10.7k);
  – 0.1% on annual remuneration exceeding RUB 796k.*

* The relevant caps are effective in 2016 and are subject to annual increase.
** Organizations working in the financial, insurance, wholesale and retail industries are not eligible for these incentives.

# Research & Development tax incentives: 150% profit tax super deduction



The Russian government offers tax incentives first introduced in 2009 to encourage R&D efforts leading to companies' increased domestic business growth.

### Requirements:

- For companies from various industries conducting eligible R&D activities.
- R&D expenditures must relate to the development of new products, the improvement of production processes, or the development of new services.
- A contractor performing R&D for a third party cannot claim the incentive.
- Eligible "R&D activities" must be included in a government-approved list (significantly extended in 2012).

### Benefits:

- Companies conducting eligible R&D activities can apply for a 150% super deduction of qualifying costs to reduce profits tax/increase deferred tax assets
- Application of the R&D tax incentive may lead to the reduction of profits tax in the amount of 10% of qualifying costs.
- Qualifying costs include labour costs, R&D contractor expenses, depreciation of equipment used for R&D, and other relevant expenses, with limitations.

### Comments:

- In accordance with the RF Tax Code R&D activity eligible for tax relief extends to day-to-day operations (activities related to the development or creation of new products and services, technologies and management)
- A super deduction can be claimed even if eligible R&D activities fail to produce a new product or service.
- A super deduction can be claimed for previous and future periods.
- Documentation: R&D reports are to be filed with the annual profits tax return. R&D expense registers should be prepared.
- No preapproval procedure, the reports are evaluated during calculation of profits tax within routine tax audit procedures.



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# Skolkovo

Announced in 2010, the Skolkovo Innovation Centre – dubbed "Russia's Silicon Valley" – is located just outside the Moscow Ring Road. The Centre aims to attract R&D activity in a number of specific technical fields and to increase Russia's innovation potential.

### Requirements:

- Russian legal entity;
- Project company (strictly speaking, no ongoing activity of a supporting nature, such as R&D outsourcing centres, is permitted);
- Eligible activities are limited to research and development within the framework of five priority clusters, as well as the commercialization of the results, which includes the disposal of IP rights, providing R&D consulting services and production connected with the results of R&D activity.
- Targeted industries:
  – Energy Efficient Technologies;
  – Nuclear Technologies;
  – Space Technologies and Telecommunications;
  – Biomedical Technologies;
  – Information Technologies.

### Benefits:

- Profit tax exemption;
- VAT exemption;
- Property tax exemption;
- Reduced social contribution rate of 14% on annual remuneration up to RUB 796k (approx. USD 10.7k)* and exemption for remuneration exceeding that cap;
- Cash grants covering eligible research activity.
  In the majority of cases, the total tax burden will be limited to 14% social contributions on salaries paid.

### Comments:

- The approval process is straightforward;
- The company should be registered within the Skolkovo area;
- Starting in 2019, companies having Skolkovo project participant status will be unable to have branches or representative offices outside of Skolkovo area. Operating such an office would result in the company losing its status as a Skolkovo project participant, thus preventing it from applying the relevant tax and SIC incentives;
- There are generous revenue and profit thresholds in place before tax exemptions are taken away.

* The relevant caps are effective in 2016 and subject to annual increases.

# Reduced social contribution rates

Companies engaged in software development qualify for reduced social security contribution rates.

**Requirements:**

- Russian legal entity;
- More than 90% of revenue derives from software development services and the sale of software; excluding foreign exchange gain;
- More than 7 employees;
- State accreditation from the Ministry of Communications and Information Technology.

**Benefits:**

- Reduced regressive social contribution rate:
- 14% on annual remuneration up to RUB 718k (approx. USD 10k);
- 12% on annual remuneration between RUB 718k and RUB 796k (approx. USD 10.7k);
- 4% on annual remuneration exceeding RUB 796k*.

**Comments:**

- The regime is applied automatically**

### Additional opportunities

There are various opportunities that provide for the reduction of the social insurance contributions that generally apply to large manufacturing companies (especially, in the mining and milling industries):

### Reduction of SIC rate for compulsory social insurance against industrial accidents and occupational illnesses

Internal restructuring can bring about different SIC rates for compulsory social insurance against industrial accidents and occupational illnesses. This could decrease SIC rates against industrial accidents and occupational illnesses by as much as 0.2% (while maximum overall rate is 8.5%) for individual business units within the company.

### Reduction of additional SIC rates

Additional SIC rates in excess of standard SIC rates are set for a limited list of professions (such as those that include particularly dangerous or difficult working conditions). These higher SIC rates can be reduced by holding a special assessment on a company's working conditions. Depending on the assessment's outcome, this option could eliminate the additional SIC rates.

### Reduction of standard SIC rates for unexperienced employees

In accordance with tax and labor legislation, companies that offer apprenticeships agreements to unexperienced employees (e.g. students, entry-level job seekers) do not have to pay social insurance contributions during the employee's training period. This could impact the payroll budget for such employees by 30%, providing all legislation requirements are met and the process is properly documented.

* The relevant caps are effective in 2016 and subject to annual increases.

** The incentive is granted upon the submission of specific documents to the tax office, with no preliminary permission or agreement required.





# 0% profit tax rate


A 0% profit tax rate was introduced in 2011 to support companies engaged in high-priority medical and educational activities, as well as producers of agricultural goods.

**Requirements:**

- General:
  - State license;
  - More than 15 employees;
  - Limitations for financial transactions;
- For companies engaged in medical or educational activities:
  - Engagement in medical or educational activities included in a government-approved list;
  - More than 90% of revenue derives from medical or educational services;
  - More than 50% of employees are medical specialists (medical activity only).
  - For companies engaged in producing agricultural goods only:
  - More than 70% of revenue derives from the production and processing of agricultural goods;
  - A 0% rate is applicable for revenue derived from the production of agricultural goods only.

**Benefits:**

- 0% profit tax rate.

**Comments:**

- No preapproval procedure.

# Other tax incentives and grants

### Tax incentives

- VAT exemption
  There is an import VAT exemption for technological equipment, no equivalent of which is produced in Russia, as determined by a government-approved list (an 18% import VAT normally applies). Applying this regime may improve working capital positions for a VAT-payer, or reduce equipment costs for VAT-non payers;

- Exemption from import customs
  Exemptions from import customs are provided for goods imported by a foreign investor as a capital contribution to its Russian subsidiary;

- Accelerated depreciation
  Accelerated depreciation can apply to fixed assets used in R&D activities. However, the definition of R&D for purposes of accelerated depreciation is not clear.

- Property tax exemption for energy-efficient assets
  A property tax exemption is available for energy-efficient assets (including buildings) for 3 years, starting from the date of the asset's entry into operation, with no preapproval from the tax or any other authorities. In practice, the application of this incentive is thus far very limited.

### Grants and subsidies

- Direct grants are provided by the federal government, ministries and other state bodies upon the carrying out of tender procedures for R&D in strategic areas, such as energy efficiency, IT, medicine, life sciences, etc.

- Partnership with Russian state universities
  These grants are usually provided with respect to collaborative R&D in partnership with a Russian state university, provided that at a minimum, the company's investment in the project matches the amount of funds granted. Project implementation timelines range from 1-3 years, with grant amounts ranging between USD 1 and 5 million.
- Subsidies provided by Federal target programmes (size of subsidies and project timelines depend on the programme):
  – "Pharmaceutical Industry 2020;"
  – "Research and Development in Strategic Areas of Science and Technology 2014 -2020" – covers a broad range of research. The scheme allows applicants some freedom to propose their own innovative topics within the priority areas defined by the government;
  – "Development of the Industry and Increasing its Competitiveness."

- Subsidies covering interest expenses for manufacturing companies
  Basic requirements:
  – subsidy covers interest expense for loans in Russian banks;
  – the project is aimed at the creation of a manufacturing facility (list of industries is limited);
  – fixed assets became or will become operational after 1 Jan 2014.





# 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 group in Russia.

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