

Global tax warming, or New Year presents from the State Duma

On 28 December 2013 the President of the Russian Federation signed the Federal Law No. 420-FZ "On the Incorporation of Amendments to Article 27⁵⁻³ of the Federal Law "On the Securities Market" and to Parts One and Two of the Tax Code of the Russian Federation" (the "**Law**"). The Law contains a wide range of amendments to the Russian Tax Code. Most of the amendments introduce new tax benefits and clarify provisions regarding formation of the tax base (including booking of losses) with respect to particular types of financial transactions.

New interest deduction rules will come into force in 2015

The existing limits on interest deductibility were only recently prolonged until the end of 2014 (Federal Law No. 306-FZ dated 2 November 2013).

The new Law abolishes these limits, which are set out in Art. 269.1 of the Russian Tax Code, from 1 January 2015. This rule will apply to debt obligations that are not held to be controlled from the standpoint of the transfer pricing rules.

The limits on deductibility of interest will remain in force for controlled

transactions. However, the Law changes the method of calculating such limits, which will now be tied to market indicators.

Interest will be regarded as expenses insofar as it does not exceed the market level determined in accordance with the transfer pricing rules.

Where one of the parties to a controlled transaction is a bank, the parties will have the right to account for the expenses (as well as the income) within the intervals set by the Law. For rouble loans, the value of the interval will depend on the refinancing rate of the Central Bank of Russia (from 0.75 to 1.8 times the refinancing rate in 2015, and from 0.75 to 1.25 times the refinancing rate starting from 2016); for loans in foreign currency, it will depend on LIBOR, EURIBOR or SHIBOR,

Key issues

- Significant changes made to the rules on interest deductibility with effect from 2015
- The second part of a REPO transaction can now be executed more than 1 year after the first part
- Foreign law governed derivatives are equated with Russian law governed derivatives from a Russian tax law perspective
- Taxation of transactions with depositary receipts is regulated
- Rules on calculation of income and expenses of RDR issuers are introduced
- Clarification of formation of the tax base with respect to securities transactions

depending on the particular currency.

Notwithstanding significant changes, the Law maintains the previous limits on the deductibility of interest according to the thin capitalisation rule.

Significant changes in REPO taxation

The Law abolishes the requirement that the execution of the second part (leg) of a REPO transaction cannot take place longer than 1 year after the date of execution of the first part (leg).

Although the Law maintains the requirement that REPO transactions be recategorized if the second part is not duly executed and sets out the procedure for such recategorization, it also introduces a list of cases that will not be regarded as improper execution:

- execution of the second part of a REPO within 10 days as of the date agreed by the parties date for execution of the second part;
- discharge of obligations by set-off in certain cases.

The Law also abolishes the requirement that a prescribed settlement procedure be followed in the event of improper execution of the second part of a REPO (though a reference to the procedure remains). The Law sets out a special method of calculating the tax base in cases where the second part of a REPO was improperly executed, provided that the obligations were terminated within 30 days.

The new tax rules on REPO transactions will come into force in January 2014.

In cases where the first part of a REPO was executed in 2013 and the execution date of the second part takes place in 2014, the old rules are applicable.

Derivatives: abolition of fiscal discrimination against foreign law governed derivatives, and other changes

As the Russian Ministry of Finance confirmed many times, Russian tax legislation did not make the deduction of losses under derivatives conditional upon whether they were governed by Russian or foreign law. The main criterion when determining the deductibility of losses is whether a given derivative may be provided judicial protection. The Law has removed all doubts surrounding this issue, as it confirms that, from a fiscal standpoint, derivatives governed by foreign law are taxable in the same way as derivatives governed by Russian law. The Law clarifies that transactions which are not judicially protected under applicable foreign law cannot be treated as derivatives.

With effect from January 2014 the rule that any transaction whose underlying asset is statistical data or biological/physical/chemical indicators of environmental conditions cannot be considered a derivative is abolished.

The Law also changes the method of formation of the tax base in relation to derivatives.

A separate tax base for circulated derivatives will cease to exist from 2015. Already from 2014 swaps and options concluded with a central counterparty will be accounted for together with other transactions that are taxed at a rate of 20% (and from 2015 such transactions may be accounted for together with OTC derivatives and unquoted securities).

Starting in 2015, OTC derivatives will be included in a special tax base together with unquoted securities. Previously, OTC derivatives were generally included in a separate tax base, which in practice rendered it impossible for companies with a small amount of transactions with OTC derivatives to fully deduct losses under such transactions from their taxable income. The changes introduced by the Law may increase

the appeal of these instruments for such companies.

The Law also stipulates that from 2016 the pricing of OTC derivatives may be checked by the tax authorities for consistency with market conditions only if such transactions are controlled from standpoint of the transfer pricing rules. Under the current regulations the price of OTC derivatives may be checked on the basis of special rules governing its calculation.

Taxation of transactions with depository receipts is now regulated

The main changes introduced by the Law will take effect on 1 January 2015 and consist mostly of positions previously set out in clarifications of the Russian Ministry of Finance which are now being enshrined in law.

The Law provides that the following will not be treated as sale or other disposal of securities:

- a) transferring underlying securities upon the placement of depository receipts certifying the rights to those underlying securities (placement of securities in the programme);
- b) redemption of depository receipts.

The Law also prescribes the method of determining expenses upon the sale or other disposal of underlying securities, the purchase price of depository receipts, and expenses upon sale or other disposal of depository receipts.

The Law establishes special rules, to come into effect in 2015, on the

calculation of the tax base for issuers of Russian depository receipts ("RDRs").

For such issuers the following will not be treated as income:

- property (including monetary funds) and property rights received by the company in connection with the placement of RDRs (other than remuneration for the issuer's services);
- property (including monetary funds) and property rights received by the company in connection with the exercise of its rights in relation to the underlying securities.

The Law also provides that the following will not be treated as expenses of an issuer:

- property (including monetary funds) and property rights transferred to the issuer or to the owners of the underlying securities in connection with the placement of RDRs;
- property (including monetary funds) and property rights transferred to the owners of RDRs in connection with the exercise of rights related to RDRs.

Transactions with securities

The Law provides that from 2015 a taxpayer will have the right not to apply the special method of calculating the price of quoted securities, but instead use the transfer pricing rules, provided that the transactions meet certain conditions.

The Law also changes the method of calculation of the tax base with respect to securities and the method of allocating losses. The Russian Tax Code currently provides that the tax base for securities transactions should be calculated separately from the tax base for other transactions. Starting from 2015, transactions with quoted securities will be accounted for together with other transactions taxed at a rate of 20% (if no exemptions are applicable), and transactions involving unquoted securities will be accounted for together with income and expenses on OTC derivatives.

Rules on accounting of losses from securities transactions are also set out in the Law. With some exceptions, losses from securities transactions taxed at the 20% rate may be applied towards reducing the taxable income from unquoted securities and OTC derivatives. However the reverse, i.e. applying losses from unquoted securities and OTC derivatives against 'general' income, will not be possible.

Actual expenses on purchasing equity securities, the issuer of which has been liquidated, will be treated as a loss and may be fully included in calculation of respective tax base, depending on the type of securities. In certain cases these losses may be increased by the amount of interest income on such securities which has accrued but has not actually been received.

Furthermore, the Law sets out special rules for losses from transactions with securities. In particular, where a loss arose prior to 31 December 2014 and was not accounted for previously, 20% of the amount of such loss may be included in the tax base annually until 1 January 2025 in accordance with special rules.

The Law also includes special provisions regulating the accounting of losses for professional securities market participants that do not hold a dealer licence, listing authorities, exchanges and certain other entities.

VAT exemption

The Law provides for VAT exemptions with respect to the assignment of claims arising out of derivatives transactions and with respect to clearing operations.

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