

PRISM

Tax Newsletter

4th Quarter 2013

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Australia

Petroleum Resource Rent Tax (PRRT) – Recent updates on Australian Taxation Office's administrative views

Since our previous article about the legislative changes made to the petroleum resource rent tax (PRRT), the Australian Taxation Office has issued an Interpretative Decision (ATO ID 2013/48), a draft Taxation Ruling (TR 2013/D4) and a decision impact statement on the Esso case to promote certainty in the administration of PRRT law. This article discusses the Tax Commissioner's views as expressed in those guidance documents and the potential implications for petroleum companies.

自上一期文章讲解了近期澳大利亚联邦立法局对于「石油资源租赁税法规」所作出的立法修改后，澳大利亚税务局现已颁发解释性决策文章（ATO ID 2013/48）、税收条例草案（TR 2013/D4）及Esso案件判决后的决策影响报告书，明确解释税务局将会如何执行「石油资源租赁税法规」。本文将讨论税务局局长的意见及讲解税务局的行政指引将会对石油企业造成的潜在影响。

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China

Introduction of VAT pilot program in China

The value-added tax (VAT) pilot program for the transport sector and some services sectors was rolled out across China on Aug 1, marking the beginning of the second stage of the program that will be implemented in three steps. According to the plan of The State Council, the program will be completed during the Twelfth Five-Year Plan (2011-2015) and the business tax will be replaced by the value-added tax nationwide finally before the year of 2015.

从8月1日起，交通运输业和部分现代服务业「营改增」试点在中国全国范围推进，中国迈出了「营改增」三步走中的第二步。按照规划，中国将在十二五（2011年-2015年）期间完成「营改增」，最终在全国范围内由增值税取代营业税。

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Cyprus

Advantages of a Cyprus holding company

Cyprus companies have been traditionally used by experienced and sophisticated investors as holding companies for international investments (subsidiaries, associates and other), since Cyprus provides an extensive range of tangible and intangible advantages in comparison with other international investment hubs and financial centers.

与其他国际投资枢纽和金融中心相比，塞浦路斯极宽泛之有型和无形的优点，使塞浦路斯公司一直被经验丰富的精明投资人采用为国际投资的控股公司（子公司、关联公司等）。

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Hong Kong

The case of Nice Cheer Investment Limited

There is now a case before the Court of Final Appeal on Nice Cheer Investment Limited (Nice Cheer). The case is noteworthy because the decision may have significant impact on the tax consequence of fair value accounting in Hong Kong.

Nice Cheer一案现交予终审法院审理。Nice Cheer一案值得注意的地方是，相关判决可能对香港公允价值计算之纳税情况带来重大影响。

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Indonesia

New tax incentives for SMEs through the ratification of Government Regulation No. 46 Year 2013 (“GR 46/2013”)

“GR 46/2013” governs the income tax on the income of the business derived by the taxpayer who has a certain gross turnover, categorized as small to medium sized tax payers. This regulation is effective 1 July 2013. The spirit behind this regulation is for the tax extensification through the introduction of a new simpler tax rule.

2013年第46号政府条例“GR 46/2013”规定中小企业凡是拥有一定的年收入，必须缴纳企业所得税。该条例于2013年7月1日正式生效，条例背后的精神是透过引入简化的税法，以达至扩大税基。

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Japan

Revised Consumption Tax act

The raise of consumption tax rate has been widely discussed since the tax reform bill was promulgated in March 2013. The purpose of the tax rate increase is to get financial source for pension, medical and nursing cares due to the country's declining birthrate and rapidly aging population. 自税制改革法案于2013年3月颁布后，有关提高消费税税率的议题受到广泛的讨论。提高消费税税率的目的在于增加养老、医疗和护理的资金来源，以应付日本出生率下降及人口迅速老化的问题。

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Malaysia

How to pursue tax savings whilst creating wealth in Malaysia?

Malaysia offers a wide range of business incentives that make investing in Malaysia an attractive step for foreign companies. As such, companies should take advantage at the various tax incentives available such as exemption on income, extra allowances on capital expenditure incurred, double deduction of expenses, special deduction of expenses, preferential tax treatments for promoted sectors, exemption of import duty, sales tax and excise duty for their benefit. It is important to learn more about incentives in Malaysia if you are planning to invest in the country.

为了吸引外资投资马来西亚，政府为企业提供了许多优惠待遇。因此，企业尤其应善用各种税务优惠，让企业制造更多财富。这些优惠待遇包括豁免税务的收入项目、资本开支为生的额外津贴、开支双重扣税及特别扣税、受鼓励行业的税务特惠待遇、豁免进口税、销售税以及关税项目。若贵企业计划到马来西亚投资，那学习了解马来西亚的优惠政策是非常重要的。

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Russia

Russian tax system brief review

Russian taxes are listed and regulated by the Russian Tax Code. The article published in previous issue of PRISM contains general information about taxation in Russia. This article presents more details concerning tax base and exceptions for some taxes.

俄罗斯的税项受「俄罗斯税法」管制。上期PRISM的文章中提供了俄罗斯税项的基本信息，这期的文章将带来更多有关税项的税基及豁免的细节。

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Petroleum Resource Rent Tax (PRRT) – Recent updates on Australian Taxation Office’s administrative views

Over the course of August and September 2013, the Australian Taxation Office (“ATO”) issued a draft Taxation Ruling (TR 2013/D4) and an Interpretative Decision (ATO ID 2013/48), and updated a decision impact statement on the ATO’s view of the Full Federal Court’s decision in *Esso Australia Resources Pty Ltd v Commissioner of Taxation* [2012] FCAFC 5 (“the Esso case”). These guidance documents will clarify the ATO’s position and administrative treatment on the following issues:

- the meaning of “involved in or in connection with exploration for petroleum” in the context of claiming deductions on exploration expenditure for PRRT purposes;
- the ATO’s view of the Esso Case and how the ATO will apply the views of the Full Federal Court when it determines assessments, rulings, objections and appeals; and
- whether an entity hold an interest in a petroleum project under subsection 4A(1) of the Petroleum Resource Rent Tax Assessment Act 1987 (“PRRTAA”) when it receives a right under a production payment arrangement to receive a share of receipts from another entity’s sale of petroleum from the petroleum project.

The recent lack of clarity and certainty has resulted in resource companies facing increasing difficulties in determining and applying the appropriate tax treatment for their exploration expenditure and projects.

Meaning of exploration for PRRT purposes – Draft Taxation Ruling (TR 2013/D4)

The ATO’s view on the meaning of “exploration” aligns with the Administrative Appeals Tribunal’s decision in *ZZGN v Commissioner of Taxation* [2013] AATA 351 (“the ZZGN case”) handed down on 5 April 2013 which held that the meaning of “exploration” for PRRT purposes to its ordinary meaning. This effectively restricts exploration expenditure for PRRT purposes to the discovery and identification of the existence, extent and nature of petroleum which includes searching in order to discover the resource, as well as the process of ascertaining the size of the discovery and appraising the physical characteristics. Determining the economic viability of development

and production is outside the ATO’s view on the meaning of “exploration” for PRRT purposes.

The ATO’s views appears to be much narrower than the industry’s approach to the meaning of “exploration” as noted in industry publications with the consequence that expenditure will be “black-holed”. The ATO has indicated that industry members may have been using the broader approach to the meaning of exploration for PRRT purposes. However prior to the release of the draft ruling TR (2013/D4), the ATO has not been clear in its messaging on the scope of “exploration” while at the same time it has challenged the positions adopted by industry. Therefore if the ATO makes the ruling retrospective (which it has signaled in the draft ruling), this could result in re-categorisation of prior-year exploration expenditure with the implication that there could be a significant reduction in carried-forward PRRT exploration balances.

The draft ruling is open for public comment until 2 October 2013 after which the ATO will issue a final ruling with its conclusive views. No doubt, the industry will try to argue that the lack of clarity on this matter previously would make a prospective application more appropriate. However given the recent decision of the Federal Court in *Macquarie Bank Limited v Commissioner of Taxation* [2013] FCA 887 handed down on 3 September 2013, it would appear that the ATO could make the taxation rulings and decisions to take retrospective effective regardless.

ATO’s views and administrative treatment after the Esso Case


The ATO has confirmed that it will not seek to disturb assessments for the 2012 financial year and earlier years where the taxpayers have self-assessed their expenditure on a basis which is inconsistent with the views of the Full Federal Court in the Esso Case provided the taxpayer’s self assessment is consistent with the ATO’s previous draft Taxation Rulings (TR 2010/D4, TR 2010/D5 and TR 2010/D6).

Holding an interest in a petroleum project under subsection 4A(1) of the PRRTAA – ATO ID 2013/48

In its interpretative decision (ATO ID 2013/48), the ATO has decided that an entity does not hold an interest in a petroleum project under subsection 4A(1) of the PRRTAA when it receives a right, under a production payment arrangement, to receive a share of receipts from another entity’s sale of petroleum from the petroleum project. Rather, an entity holds an interest in a petroleum project if the entity owns and is entitled to sell the petroleum from the project.

Practical Implications

For resource companies wishing to enter into transactions within the petroleum industry, it is important that:

- proper advice is sought on whether their arrangement would be caught by the PRRTAA especially where the profit sharing arrangements are involved; and
- due diligence is conducted on:
 - carried forward exploration expenditure as inherited deductions may increase, decrease or change in classification in parallel with the ZZGN case and the ATO's views; and
 - whether prior treatment of expenditure for the 2012 financial years and earlier is consistent with either the Esso Case or otherwise in accordance with the ATO's previous draft Taxation Rulings (TR 2010/D4, TR 2010/D5 and TR 2010/D6). 

China



Introduction of VAT Pilot Program in China

To further solve the problems of collecting repeated taxes in the cargo and labor tax system, and to improve tax system and support development of modern service industry, the Chinese government introduced the VAT pilot program in the Twelfth Five-Year Plan.


The VAT pilot program first came into force in Shanghai on Jan 1, 2012, with one-plus-six industries included, one referring to the transport sector including land, waterway, air and pipeline transport segments, whereas six representing the modern services sector covering the R&D services, IT services, cultural and innovation services, logistics auxiliary services, leasing of tangible movable assets, attestation and consulting services. The reform was expanded to another 11 regions, including Beijing, Tianjin and Shenzhen later. This is the first of the three steps of the program that will be implemented in stages. In this step, An 11% VAT rate applies to the transport sector, including land transport services, waterway transport services and air transport services; and a 6% VAT rate applies to related logistics supporting services, including aviation agent services, port services, freight & passenger station services, salvage services, freight forwarder services, customs declaration agent services, warehousing services

and handling services. The new VAT regime brings turnovers previously subject to business tax into the charge of VAT which tax applies to other turnovers at the rates of 17% and 13%.

The trial VAT reform is top rated in the tax system reforms of the Twelfth Five-Year Plan, and expressed as "expanding the scope of VAT and adjusting business tax accordingly." After the tax sharing system was implemented in 1994, China pursued the turnover tax system which allowed the co-existence of VAT tax and business tax to protect the local governments' fiscal interests.

The VAT pilot program for the transport sector and some services sectors was rolled out across China on Aug 1 marking the beginning of the second stage of the three-step VAT pilot program. Since the nationwide expansion of the program on Aug 1, the modern services sector subject to the program was expanded to include the broadcasting, film and television services. Additional 740,000 taxpayers were included in the program, more than 90% of which are small taxpayers. Estimates show pilot businesses, new and old, will see taxes reduced by RMB 120 billion in 2013.

According to the plan of The State Council, the reform will be completed during the Twelfth Five-Year Plan and the business tax will be replaced nationwide finally before the year of 2015.

The VAT pilot program, a top priority in the implementation of China's fiscal system reform, will benefit more industries and businesses to boost China's economic transformation and growth. 

Cyprus



Advantages of a Cyprus Holding Company

Cyprus is not considered to be an offshore, but rather onshore European Union jurisdiction and companies registered in the island enjoy the same status as any other E.U. companies. Cyprus has adopted the E.U. Parent-Subsidiary Directive, which prohibits withholding taxes on dividends flowing between E.U. companies when the shareholding is greater than 10%. In addition, Cyprus has in place more than 50 Double Taxation Avoidance Agreements (DTAA) with countries covering more than 80% of the global GDP like China, Russia, United States, U.K., India, Canada, Germany, Ukraine and United Arab Emirates. On the other hand, Cyprus has in effect DTAA's with a number of offshore jurisdictions like Mauritius and Seychelles,

which may facilitate the flow of funds for investments between onshore and offshore jurisdictions.

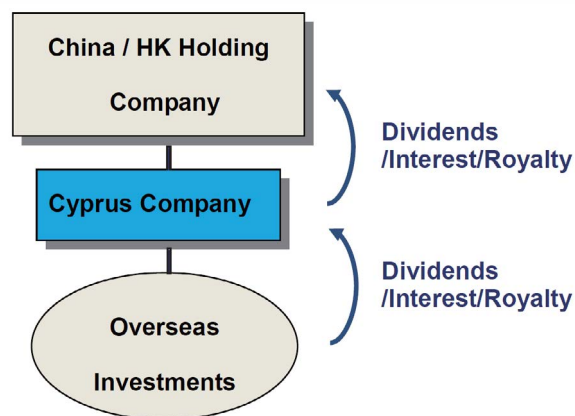
Furthermore, Cyprus unilaterally does not withhold taxes on outbound dividends and dividends coming from abroad are exempted from tax irrespective of the country of origin, unless both of the following conditions are not satisfied, in which case they are taxed to Special Contribution for Defence (SCD) at 20%:

- (1) The company paying the dividend must not engage directly or indirectly more than 50% in activities which lead to passive income (non-trading income), and
- (2) The foreign tax burden on the income of the company paying the dividend is not substantially lower than the tax burden in Cyprus (an effective tax rate higher than 5% in the country paying the dividend satisfies this condition).

As a result, an investor from any country in the world can make an investment within E.U. or any other country and receive the return (dividend) suffering only the withholding tax on the outbound dividend towards the Cyprus company from the end investment, if any. And in that case, a tax credit will be allowed by Cyprus tax authorities according to the DTAA in force. In the absence of a DTAA, Cyprus unilaterally grants a credit for the foreign tax paid on such income.

Besides the tax advantages in relation to the annual return/dividend stream, the Cyprus holding company offers a great investment exit route as well, since the gain on disposal of shares is exempt from taxation, unless the company of which shares are disposed maintains immovable property in Cyprus. Therefore, disposing any type of international investment held under a Cyprus company is virtually tax free.

Given the fact that Cyprus holding companies are used to facilitate international investments, the tax residency status of those companies becomes of crucial importance. The company needs to be a tax resident of Cyprus in order to enjoy the rights of the local taxation system, but most importantly the rights derived under DTAAs. The main determining factor for establishing management and control in Cyprus is to ensure that all board of directors meetings take place in Cyprus. Minutes of such meetings should be prepared and maintained at the company's registered office in Cyprus. In addition, the majority of the board members should be Cyprus tax residents. If the local tax authorities get satisfied by the evidence provided by the company then a tax residency certificate is issued.



Notes:

1. In certain cases no withholding tax on dividends paid by the Overseas Investments (depending on treaty and EU Directives)
2. No Tax in Cyprus
3. No Cyprus withholding taxes
4. No Capital Gains Tax. 🇨🇾

Hong Kong

The case of Nice Cheer Investment Limited

There is now a case before the Court of Final Appeal on Nice Cheer Investment Ltd (Nice Cheer). The case is noteworthy because the decision may have significant impact on the tax consequence of fair value accounting in Hong Kong.

Nice Cheer is an investment company and in accordance with the current accounting standards, it re-values its trading securities at the end of the accounting year; which revaluation is commonly referred to as mark-to-market accounting. The Inland Revenue Department (IRD) sought to tax the revaluation gain and Nice Cheer appealed to the Courts. The amount of tax involved is substantial.

In both the High Court and the Court of Appeal the IRD lost. In other words, unrealized gains resulting from mark-to-market accounting are not taxable.


However, the Court of Appeal in fact also handed down a decision on the other leg of this scenario, namely that unrealized losses are allowable. In other words, there will be asymmetry in tax treatments between unrealized profits and unrealized losses.

The court arrived at this decision on the basis that when stocks are written down to market value, the losses are realised. The loss is an aspect of the cost of an asset which is actually incurred by the act of

purchase whereas a profit is earned by an act of disposition which has not happened at all in this case.

It is envisaged that the IRD will not sit idle if the decision is confirmed by the Court of Final Appeal. We expect the IRD will attempt to bring about legislative changes to re-establish the symmetry between what for the time being can only be called revaluation gains and losses. However, any such legislative changes are likely to be hotly debated in the Legislative Council.

Please consult your tax engagement partner on the impact of the Nice Cheer case on your company's tax position. We will keep you updated on the decision of the Court of Final Appeal.

If you are in any doubts or have any questions, please contact your engagement tax adviser. 

Indonesia



New tax incentives for SMEs through the ratification of Government Regulation No. 46 Year 2013 ("GR 46/2013")

What is stipulated in GR 46/2013?

It governs the income tax on the income of the business derived by the taxpayer who has a certain gross turnover, categorized as small to medium sized tax payers. This regulation is effective 1 July 2013. The spirit behind this regulation is for the tax extensification through the introduction of a new simpler tax rule.

Under what conditions the GR 46/2013 is applied?

The GR 46/2013 is applied on all income of the business derived by the taxpayer with gross turnover not exceeding IDR4.8 billion (equivalent to USD480 thousands) within a fiscal year, which equates to a calendar year.

The tax rate is 1% of the gross turnover. All businesses are subject to this regulation. Businesses include any types of trading activities, industries, and services.

What is excluded from the application of the GR 46/2013?

Income is not subject to the GR 46/2013 if it meets the following criteria:

- a. Income from services in connection with doing works not tied to any employers, such as: doctors, lawyers/attorneys, accountants, notaries, architects, musicians, masters of ceremony, anchors, and the like; or

- b. Income from the business that is subject to final income tax (Article 4 paragraph 2), such as a dorm room rental, house rental, construction services (planning, implementation and supervision), income tax on oil and gas business, and so forth which are already regulated by particular Government Regulations; or
- c. Income derived from outside the country.

Who are the tax subjects under the GR 46/2013?

The parties subject to the GR 46/2013 are:

- a. Individuals; and
- b. Corporations - excluding Permanent Establishment ("PE"), that receive income with a gross turnover not exceeding IDR4.8 billion (equivalent to USD480 thousands).

Who is excluded as the tax subjects under the GR 46/2013?

The parties not subject to the GR 46/2013 are as follows:

- a. Individuals who conduct trading activities and/or services of which they use facilities that can be assembled and use the business facilities, wholly or partly, for public interests which are not used for commercial activities. Examples of these individuals are itinerant traders and hawkers.
- b. Corporations that have not started a commercial operation or those that within a period of one (1) year after starting a commercial operation have a gross turnover exceeding IDR 4.8 billion.

Those individuals or corporations described above shall implement the provisions of taxation in accordance with the General Taxation Provisions and Procedures Law and General Income Tax Law.

What category of income tax governed under the GR 46/2013?

Income taxes regulated under the GR 46/2013 are categorized as final income tax article 4 paragraph 2. Hence, the taxpayers as mentioned above shall make a monthly payment of final income tax (Article 4(2)), instead of article 25 (a monthly tax installment) since the income is solely subject to final tax.

How to fulfill the tax obligation with regards to the GR 46/2013?

The tax payment must be made no later than 15th day of the following month using a tax payment slip ("SSP"). If the SSP is already validated as "NTPN", taxpayers do not need to report monthly tax return (Article 4(2)). The tax payment must be made using the tax code of 411128 and the tax type of 420.

Furthermore, the income tax paid should be reported in the annual income tax return in the group income which is subject to the final tax.

What is the tax benefit related to the implementation of to the GR 46/2013?

Based on the Directorate General of Taxation ("DGT") regulation No. PER-32/PJ/2013 dated 25 September 2013, the tax payer may apply for the exemption from withholding and/or collection of non final income tax to the DGT. The DGT will then issue an exemption certificate which will be valid until the end of the fiscal year concerned. 🇮🇩

Japan



Revised consumption tax act

Overview

The raise of consumption tax rate has been widely discussed since the tax reform bill was promulgated in March 2013. The purpose of the tax rate increase is to get financial source for pension, medical and nursing cares due to the country's declining birthrate and rapidly aging population.

Major amendments

1. Consumption tax rate

Under the revised Consumption Tax Act, the consumption tax rate is to be progressively raised to 8% (6.3% National, 1.7% prefectural) from April 1, 2014, and to 10% (7.8% National, 2.2% prefectural) from October 1, 2015. As a transitional measure, regarding the transactions of construction work, lease etc., the taxpayers can apply for the old tax rate if such transaction meets certain conditions.

2. Interim tax filing

Under the current Consumption Tax Act, filing interim tax returns is a must if the annual national consumption tax of previous fiscal period exceeds JPY 480,000. The interim tax payment amount is 1/2 of the previous fiscal period's consumption tax payment amount.

According to the revised Consumption Tax Act, after filing the "Optional Interim filing Application Form", the taxpayer can choose to file and pay interim tax even its annual national consumption tax of previous fiscal period does not exceed JPY 480,000

3. Use of exemption enterprise system to be restricted for certain type of Specified newly incorporated entity

The current Consumption Tax Act allows specified newly incorporated entity to be exempted from consumption tax payment obligation if such entity's capital is less than JPY 10 million at the beginning of the fiscal period and has no base period (*note: base period for corporation is normally a fiscal period of two years prior to the current fiscal period). This is called exemption enterprise system.

However, under the revised Consumption Tax Act, the use of exemption enterprise system will no longer be applicable to entity incorporated on or after 1 April 2014 if:

- i) more than 50% is directly or indirectly owned by another company or individual (Parent shareholder) at the beginning of the fiscal period.
- ii) taxable sales for either its Parent Shareholder or special related parties of its Parent Shareholder during the corresponding period to the base period of such newly incorporated entity exceeds JPY 500 million. Newly incorporated entity which satisfies the above mentioned conditions must submit registration form to the competent tax office. 🇮🇩

Malaysia



How to pursue tax savings whilst creating wealth in Malaysia?

Malaysia offers a wide range of business incentives that make investing in Malaysia an attractive step for foreign companies. As such, companies should take advantage at the various tax incentives available such as exemption on income, extra allowances on capital expenditure incurred, double deduction of expenses, special deduction of expenses, preferential tax treatments for promoted sectors, exemption of import duty, sales tax and excise duty for their benefit. It is important to learn more about incentives in Malaysia if you are planning to invest in the country.

Companies may seek expert opinions and relevant authorities on all available tax incentives before they make their move to invest, because the incentives vary according to the business' structure.

Although Malaysia is being viewed neither a tax haven nor a low tax jurisdiction, however for companies which are eligible for a certain tax incentives might only pay an average effective tax rate of 7.5% as only 30% of its profit are subject to tax. It is significantly below the normal corporate tax rate of 25%!

In the past, these tax incentives were directed to encourage the manufacturing and agricultural sectors, but now they are being extended to the service sector that has emerged as a significant player as well, in the country's economy.

Below are some of the major tax incentives available in Malaysia, i.e. Pioneer Status (PS), Investment Tax Allowance (ITA) and Reinvestment Allowance (RA).

Pioneer Status (PS)

A company that is granted standard PS will enjoy tax exemption on 70% of the statutory income for 5 years. The balance 30% of the statutory income will be tax at 25% and the effective tax rate is only 7.5%. Notwithstanding the standard rate, some PS companies enjoy tax incentives up to 100% for a period of 5 or 10 years.

The PS is available to companies engaged in promoted activities or producing promoted products. A long list of activities and manufactured products as "promoted activities" and "promoted products" has indentified by the Malaysia Industrial Development Authority (MIDA) at www.mida.gov.my.

Investment Tax Allowance (ITA)

As an alternate to PS, a company that are eligible and engaged in the production of promoted products or activities may apply for ITA. A company can only enjoy either one of the incentive and not both.

ITA is an addition to the capital allowance claimed by the companies on qualifying plant and equipment acquired by the company during the tax relief period, usually from 5 to 10 years. The normal rate of allowance is 60% on the qualifying capital expenditure. ITA can be offset up to 70% of the statutory income of the company. A 100% ITA may be utilised to reduce 100% of the statutory income of a company for certain promoted product or promoted activities.

Unutilized ITA and capital allowances during the ITA period may be carried forward for an indefinite period to set off against the future business income in the post ITA period.

Reinvestment Allowance (RA)

Reinvestment Allowance or RA is an incentive granted under Sch 7A of the Income Tax Act 1967

to companies in the manufacturing sector that reinvest their capital to embark on a project for either expansion of existing production capacity, modernisation or automation of the production facilities or diversification into related fields. RA is also available to companies engaged in agricultural projects such as cultivation of rice, maize, fruits, vegetables, tubers and roots, livestock farming, spawning, breeding or culturing aquatic stocks, and rearing of chickens and ducks.

The rate of RA is 60% on the qualifying expenditures, including factory premises, plant and machinery. The RA to be deducted against the statutory income but is restricted to 70% of the statutory income. Any not absorbed RA may be carried forward and deducted against the statutory income of the company in the following year of assessment. A company may claim up to 100% RA if the qualifying project has achieved the level of Process Efficiency Ratio exceeds the industrial average for the year. The period of this incentive is 15 years from the first year of claim by the company. Like the PS and the ITA, company cannot claim RA if they are also claiming other incentives. 🇲🇾

Russia



Russian tax system brief review

Russian taxes are listed and regulated by the Russian Tax Code. The article published in previous issue of PRISM contains general information about taxation in Russia. This article presents more details concerning tax base and exceptions for some taxes.

Corporate income tax

Exempt income

The most significant exemption provided by the Tax Code is the exemption for funds received by Russian organization without consideration (gratuitous financing) from its parent (an entity or a physical person), if the parent owns more than 50% of charter capital of the Russian organization, or from its subsidiary, if the Russian organization owns more than 50% of this subsidiary.

Other exemptions provided by the Tax Code include, in particular, an exemption for contributions to the charter capital, credit facility or loans received, reimbursement of agent's expenses, and assets received as a pledge or deposit as security for an obligation, as well as other specific exemptions.

Deductible expenses

Generally, expenses are considered to be deductible for profits tax purposes if they are “economically justified” and supported by proper documentation (drawn up in accordance with the laws of the Russian Federation), unless specifically disallowed by the Tax Code. The Tax Code contains a list of tax-deductible expenses, but this list is explicitly open and is secondary to the primary business purpose criteria.

In practice, form over substance has been the standard approach by the tax authorities, and the inability to support an expense by contract and invoice (plus other supporting documentation for certain expenses) tends to result in a non-deductible expense.

Interest

Interest expense deductibility is subject to arm's length and thin capitalization tests.

Thus, interest on any type of loan taken to finance business-related expenses (current or capital expenses) is in principle fully tax-deductible provided the interest charged is at an arm's length rate, i.e., does not deviate more than 20% from the interest charged for comparable loans as defined by the Tax Code.

Dividend income

Dividends received by Russian companies are subject to a 9% tax rate. In order to prevent double taxation of dividends, the tax base on domestic dividends paid is determined as the difference between dividends paid to Russian organizations by the taxpayer and dividends received from Russian organizations; i.e., further distribution of dividends received by Russian organizations from other Russian organizations to their own Russian investors is not taxable.

VAT

Only goods and services which are deemed to be sold in Russia are the subject for VAT. Goods are classified either they are situated in Russia and are not shipped or transported or these goods are situated in Russia at the time of the commencement of shipment or transportation.

Services are deemed to be provided in Russia in the following seven situations:

- the services are directly connected with immovable property situated in Russia;
- the services are connected with movable property situated in Russia;
- the services are actually rendered in Russia in the sphere of culture, art, education, tourism, leisure, or sport;

- the purchaser of the services carries out activities in Russia;
- transportation services and related services provided by Russian organizations or private entrepreneurs, where the point of departure and/or destination point are in the territory of Russia;
- services which are directly connected with transportation of goods placed under the international customs transit regime and are provided by organizations or private entrepreneurs whose place of activity is deemed to be the territory of Russia;
- the activities of the organization or a private entrepreneur which performs the work (renders the services) are carried out in the territory of Russia (with respect to the performance of work (rendering of services) not envisaged in points above).

The point concerning “purchaser of the services carries out activities in Russia” relates to the following types of services: the transfer and licensing of intangible property; the provision of consulting, legal, accounting, advertising, marketing, engineering, and information processing services; the rent of movable property (with the exception of land motor vehicles); the provision of services related to the development of computer programs and databases as well as their adaptation and modification; and certain other types of services.

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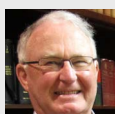
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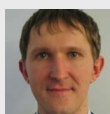
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