

## Legal Alert

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## VAT on Services Electronically Supplied to Russian Customers: New Rules

On July 3, 2016, the President of Russia signed Federal Law No. 244-FZ “On Amending Part I and Part II of the Tax Code of the Russian Federation”, which introduces VAT on electronically supplied services (the “**Electronic Services**”) provided to Russian customers by foreign companies (the “**Law**”). The Law will enter into force from January 1, 2017.

### Impact on taxpayers

Under the Law, Russian VAT will be imposed on several categories of electronically supplied services based on customer location. Previously such services were not subject to VAT. The new rules will have a direct impact on the pricing policies of foreign companies that provide electronic services to Russian customers (both in the B2B and B2C segments).

The Law introduces a requirement for foreign companies that supply electronic services, as well as for any intermediaries taking part in the provision of such services, to register with the Russian tax authorities. The tax registration requirement applies only to companies that collect payments directly from customers who are individuals. No such requirement is set in other instances.

Under the Law, a wide range of companies and individual entrepreneurs that are directly involved in collecting payments from customers are required to act as tax agents, even if such companies or individual entrepreneurs do not have any intermediary agreement with the non-resident company supplying electronic services.

### Provisions of the Law

#### 1. Types of electronic services subject to Russian VAT

VAT will be due on electronic services automatically supplied to Russian customers through the Internet, including, but not limited to:

- licenses for PC software usage rights, computer games and databases (including SaaS-type services);
- advertising services and provision of advertising space on the Internet;
- services relating to placing proposals for the sale of goods (works, services) on the Internet and electronic trading facility services;
- hosting services and domain name services;
- data storage and processing, and provision of real-time access to computing services (IaaS and PaaS-type services);
- design and maintenance of websites and electronic resources;
- provision of electronic content (books, music and movies); and

- certain other types of services.<sup>1</sup>

The VAT rate will be 15.25% of the gross amount of payment invoiced to a Russian customer, including the applicable VAT amount.

Exceptions to the Law include: (i) sale of goods (works, services) ordered through the Internet that involve physical delivery of such goods (works, services); (ii) sale of licenses for PC software usage rights, computer games and databases on tangible storage media; (iii) provision of consulting services by e-mail; and (iv) provision of Internet access services.

## **2. Determining the place of provision of electronic services**

If at least one of the conditions set out in the Law for determining Russia as the place where a customer who is an individual conducts activities is met, Russia is deemed to be the location of the individual. Such conditions include:

- place of residence of the individual is in Russia;
- payment for electronic services is made through a bank or electronic payment operator located in Russia;
- customer's network (IP) address is registered in Russia; and
- a telephone number with Russia's country code is used to purchase or pay for services.

The confirmation of the place of provision of electronic services to customers who are individuals will be the transaction registers of a foreign company containing data prescribed by the Law.

The place of provision of electronic services to legal entities and individual entrepreneurs shall be determined under the general rules, specifically based on the place of registration of such customers.

## **3. No recovery of input VAT**

The Law does not permit foreign suppliers of electronic services or their foreign intermediaries to claim for the recovery of Russian input VAT. This restriction does not apply to branches and representative offices of such suppliers registered in Russia.

## **4. Limits on exposure to the risk of creating a permanent establishment**

The Law expressly prescribes that the provision of electronic services by a non-resident company with a place of supply of such services in Russia shall not by itself create a permanent establishment.

## **5. Registration of foreign companies with Russian tax authorities**

The Law establishes a requirement for foreign companies that supply electronic services and any intermediaries taking part in the provision of such services to register with the Russian tax authorities. Such entities will be required to file tax returns through online individual taxpayer accounts (e-office) and pay Russian VAT.

The respective requirements apply only to entities that are directly involved in collecting payments from customers who are individuals. No such requirement is set in other instances, as they are overseen by tax agents.

## **6. Discharge of tax agents' obligations to pay VAT**

<sup>1</sup> Paragraph 1 of Art. 174<sup>2</sup> of the Russian Tax Code shall contain the full list of electronic services.

In certain instances the requirement to calculate and pay VAT on the sale of electronic services shall apply to tax agents. The following persons will be required to act as tax agents:

- foreign companies acting as intermediaries that are directly involved in collecting payments from customers who are individuals;
- Russian companies and individual entrepreneurs acting as intermediaries that are directly involved in collecting payments from customers; and
- Russian companies and individual entrepreneurs acting as customers of electronic services.

#### **7. The wording of the VAT exemption on software and database licenses has remained the same**

Initially, it was expected that the Law would repeal the existing VAT exemption on software and database licenses. However, the adopted text of the Law has retained this exemption in its previous wording. It is expected that the final decision on the destiny of this exemption will be taken in the fall of 2016.

### **Recommended actions**

- Check whether the electronic services offered by your company are subject to Russian VAT in accordance with the new rules; consider the need for adapting the pricing of such services offered to Russian customers;
- Analyze existing electronic services payment arrangements to determine whether you are required to register with the Russian tax authorities;
- All intermediaries should analyze their payment arrangements to determine whether they are required to act in the capacity of a tax agent for foreign suppliers of electronic services; and
- Analyze alternative options for structuring your business in Russia.

We will continue to update you on any further changes in tax laws.

*This LEGAL ALERT is intended to notify Baker & McKenzie customers and other interested parties of the changes in laws that may in any way affect their operations or present special interest. The opinions and comments provided in this LEGAL ALERT are not deemed to be a legal opinion and cannot replace the need to seek legal advice in concrete practical situations.*