Bloomberg BNA

Tax Management International Journal™

Russia Reshapes the VAT Landscape for Electronically Supplied Services: Impact of New Rules on Foreign Businesses in B2B and B2C Markets

By Arseny Seidov, Esq.[*]
Baker & McKenzie CIS Ltd.
Moscow, Russia

On July 3, 2016, President Putin signed into law VAT bill No. 244 (the ''Law'' or ''VAT Bill''), which introduces the concept of ''services provided through the Internet'' or electronically supplied services (''ESS'' or ''electronic services'') and amends the Russian place-of-supply rules for value-added tax purposes accordingly. The Law comes into effect on January 1, 2017, and completely reshapes the economics for electronic services provided by nonresident companies to Russian customers in the business-to-business (''B2B'') and business-to-consumer (''B2C'') segments, both with and without involvement of foreign intermediaries, such as aggregators and payment agents.

This article first summarizes the existing place of supply rules for VAT purposes, the Russia-specific VAT exemption for software use licenses and related key court cases and then addresses the scope of the VAT Bill, lists the types of electronic services covered by the Law, describes the VAT payment and reporting procedure and potential direct tax risks.

PLACE-OF-SUPPLY RULES FOR VAT PURPOSES: OVERVIEW

Under the default place-of-supply rules of the Russian Tax Code, services provided under cross-border agreements are deemed rendered in Russia for VAT purposes if the service provider is located in Russia.[1] However, there are a number of exceptions to this rule. Specifically, with respect to nonresident companies that have no tax presence in Russia and provide services to local customers, Russian VAT may nonetheless apply depending on the nature of these services.

For example, if the services are directly connected with immovable or movable property located in Russia, they are deemed provided in Russia regardless of

[*] Arseny Seidov is a tax partner with Baker & McKenzie's Moscow office. He leads the Working Group on Taxation of E-Commerce at the Tax Committee of the Association of European Businesses and developed comments to the VAT Bill and alternative approaches on taxation of ESS in Russia to the Russian Parliament and federal ministries, including the introduction of the no-PE principle. He also co-chairs the tax subgroup of the Innovation Working Group of Medvedev-Obama Bilateral Presidential Commission aimed at developing legislative initiatives promoting innovation in Russia. For further information, please contact the author by e-mail at arseny.seidov@bakermckenzie.com or telephone at +7 495 787 27 00.

[1] *See* Russian Tax Code, art. 148(1)(5).

ISSN 0090-4600

the location of the parties to the agreement.[2] If the services represent consulting, legal, accounting, marketing, advertising, engineering, data collection or data processing, research and development, or human resources–related services, and certain other types of services,[3] they are deemed provided in Russia if the customer is located in Russia.

With respect to licensing and assignment of intellectual property, such transactions are also deemed provided or assigned in Russia based on the location of the customer. This equally applies to licensing or assignment of trademarks, service marks, patents, know-how, copyrights, etc.[4]

The location of the customer is determined according to the actual presence of the customer in Russia, and in its absence, based on the place mentioned in the corporate constituent documents of corporate entities (Russian branches and representative offices of nonresident entities purchasing respective services or intellectual property are deemed located in Russia for domestic VAT purposes), place of management, place of the permanent executive body of corporate entities, place of the permanent establishment (''PE'') (applies to situations where the works or services are purchased through a PE) and based on place of residence of individuals, regardless of their residency status for tax purposes.[5]

If the services/licenses are deemed provided/granted in Russia, they are normally subject to Russian VAT at the regular rate of 18%. Unlike European jurisdictions, Russia does not have a separate VAT taxpayer registration. Nonresident service providers or licensors are not required to register solely for VAT purposes, nor are they required to self-assess or report Russian VAT to the local tax authorities.

Within B2B transactions, Russia-based corporate customers, including local branches of nonresident companies, and individual entrepreneurs are required to act as tax agents, i.e., withhold applicable VAT on a reverse-charge basis (at a rate of 15.25% of gross outbound payments) and remit it to the federal budget.[6] Within B2C transactions, in the absence of Russia-based corporate intermediaries in the supply chain that cannot act as tax agents, there has never been any statutory VAT payment procedure for nonresident suppliers, and Russian VAT may not be collectible.[7] This procedure is, however, introduced by the VAT Bill with respect to ESS.

VAT EXEMPTION FOR SOFTWARE LICENSES: HISTORICAL PERSPECTIVE

Although intellectual property licenses granted or assigned by foreign licensors to Russian licensees are deemed realized in Russia for domestic VAT purposes, not all licenses will be subject to Russian VAT. Since January 1, 2008, licensing or assignment of intellectual property rights to software and databases under a license agreement have not been subject to Russian VAT.[8] This VAT exemption on software licenses was largely aimed at incentivizing the domestic software development industry. It has served as a basis for the development of a formidable subset of guidance letters of the Russian Finance Ministry, the main tax policy-making body in Russia, and has formed a practice of many businesses structuring their software distribution relationships as license relationships.

Specifically, in order to be eligible for the VAT exemption, a license agreement must be in place. Therefore, the exemption does not extend to distributors and resellers in the supply chain where license agreements are concluded between the licensor and end-use customer.[9] The most common example of inapplicability of the VAT exemption is distribution of boxed software followed by conclusion of shrink-wrap licenses by the end-use customer and licensor, while the latter does not recognize any revenues from the licensee.[10]

The exemption does not capture customs VAT payable upon importation of licensed software recorded in tangible media.[11] To minimize exposure to customs VAT, many major software developers in the B2B segment switched to localized production of boxed software. Selling licenses to local customers directly (with activation keys provided electronically) and

---

[2] *See id.*, art. 148(1)(1), (2).

[3] Other types of services include audit services, computer program and database development, adaptation and modification services, lease of movable property (except for ground motor vehicles), agent services where an agent on behalf of a principal solicits a person providing the above-mentioned services, and transfer of emission credits under the Kyoto Protocol to the UN Framework Convention on Climate Change.

[4] *See* Russian Tax Code, art. 148(1)(4).

[5] *See id.*, art. 148(1)(4).

[6] *See id.*, art. 164(4).

[7] *See id.*, arts. 17(1) and 161(2).

[8] *See* art. 149(2)(26).

[9] *See* Guidance Letters of the Russian Ministry of Finance No. 03-07-07/66, dated Oct. 7, 2010 and No. 03-07-14/14317, dated Apr. 1, 2014, and Resolution of the Federal Arbitrazh Court of Povolzhsky District on case No. A49-5352/2011, dated July 13, 2012.

[10] *See* Guidance Letters of the Russian Ministry of Finance No. 03-07-11/648, dated Dec. 29. 2007, No. 03-07-11/68, dated Feb. 19, 2008, No. 03-07-08/36, dated Feb. 21, 2008, No. 03-07-15/44, dated Apr. 1, 2008, and No. 08-14/088321, dated Sept. 18, 2008.

[11] *See* Guidance Letter of the Russian Ministry of Finance No. 03-07-14/14317, dated Apr. 1, 2014.

ISSN 0090-4600

procuring subsequent physical transfer of compact discs or flash drives with recorded software helped many multinationals save on Russian customs VAT and, at the same time, retain eligibility for the VAT exemption.

Technical maintenance, help desk and similar services, if provided for a separate fee, do not fall under the VAT exemption, since they represent service, rather than license arrangements.[12] If provided unconditionally for a bundled fee, they can also jeopardize the VAT exemption on such fee, since the Russian tax authorities may argue that the underlying agreement is of a mixed nature, rather than purely a license agreement, and the fee is not allocated between its license and service elements.[13]

Fees for software updates can be structured as technical maintenance or license fees. Thus, the application of the VAT exemption for software updates can be secured, provided the underlying license agreement has been properly drafted as a license to use subsequent versions of the software and there are no contractual provisions allowing the tax authorities to recharacterize the underlying nature of relationships into service arrangements.[14]

Overall, the 2008 VAT exemption has its history of interpretation by the Finance Ministry and Russian courts. Whether this exemption helped all Russian technology companies is a subject for a separate discussion. Small developers with immaterial fixed costs and little input VAT did indeed benefit, especially if they ultimately sold their software licenses to individuals or VAT-exempt businesses, such as banks or credit institutions. Those who grew bigger and started incurring substantial expenses into fixed assets, office lease, etc., could not recover associated VAT, because their VAT-exempt license revenues did not produce any output VAT flow. As a result, many businesses could not recover their input VAT (unless their total costs incurred for generating non-VAT revenues did not exceed 5% of total costs)[15] and were forced to include it into their cost of goods sold. This, in turn, impacted their pricing structure and made them less competitive in the market. Nonresident companies licensing software directly to local customers typically benefit most from the VAT exemption.

In the first draft of the VAT Bill, this exemption was repealed with respect to software and database licenses. Nonetheless, the adopted version of the Law has not affected the VAT exemption at all. Tentatively, according to the press, the Russian government will decide on the destiny of the VAT exemption in the fall of 2016.[16] According to some initiatives, the VAT exemption should be retained for Russian software developers and repealed for nonresident entities. If such an initiative is adopted, this may give rise to indirect tax discrimination concerns for many multinationals that are not captured by double tax treaties.

IMPACT OF 'MAIL.RU GAMES' CASE

Following the adoption of the 2008 VAT exemption, many Russian businesses, especially in the e-commerce industry, restructured their contractual relationships with customers in order to take advantage of the exemption. According to the Russian tax authorities, Mail.Ru Games LLC, a Russian gaming affiliate of the largest Russian IT conglomerate Mail.Ru, converted its user agreements into license agreements for all its B2C customers and started benefiting from the VAT exemption without having substantially modified the terms of the agreements and underlying software architecture of the games. The tax authorities claimed that the template license agreement essentially represented a mixed-type agreement with a free license and disguised paid services for additional in-game functionalities.

In the vast majority of MMO (massively multiplayer online) games, users obtain a license to use all of the game's features for free. When users pay to buy in-game gold and convert it to accelerate in-game experiences (e.g., obtain artefacts, armor, weapon, heroes, etc., without the need to spend hours playing again to get them for free), they would normally have already obtained use rights to such game features (with the same source code) under the original license. Additional in-game functionality subject to monetization was considered a part of the game already licensed for free, rather than of some expanded version of the game that could be licensed separately.

These were the core arguments of the Russian tax administration against Mail.Ru Games. According to the tax authorities, while Mail.Ru Games did grant free-of-charge licenses to use its software and play the games with all their features, it did not create any additional source code that could be licensed during the monetization process. Rather, Mail.Ru Games col-

---

[12] *See* Guidance Letters of the Russian Ministry of Finance No. 03-07-08/284, dated Oct. 11, 2011, No. 03-07-08/07, dated Jan. 15, 2008, No. 03-07-05/01, dated Jan. 12, 2009, No. 03-07-08/36, dated Feb. 21, 2008, and No. 03-07-11/649, dated Dec. 29, 2007.

[13] *See* Guidance Letters of the Russian Ministry of Finance No. 03-07-14/14317, dated Apr. 1, 2014, and No. 03-07-08/134, dated June 2, 2008, as well as the Letter of the Moscow Department of the Federal Tax Service No. 16-15/020629, dated Mar. 10, 2009.

[14] *See* Resolution of the Federal Arbitrazh Court of Moscow District on case No. A40-130312/12-140-876, dated June 11, 2013.

[15] *See* Russian Tax Code, art. 170(2), (4).

[16] *See* Golitsyna A., https://www.vedomosti.ru/technology/articles/2016/06/06/643783-zakonoproekt (June 6, 2016). Deputies postponed the issue on cancellation of benefits for IT companies to the fall. *Vedomosti*.

ISSN 0090-4600

lected fees for ''organizing the gaming process'' which had a services (rather than a license) treatment. This argumentation was supported by the Russian courts in all instances, including by the Supreme Court in 2015, and predetermined the outcome of subsequent tax audits of Russian gaming companies.[17]

As a result, Russian taxpayers forfeited the right to use the VAT exemption in this industry. They paid 18% VAT and 20% corporate profits tax on their monetization revenues. At the same time, in case of proper structuring, nonresident companies could have up to a few layers of defense against the Russian VAT and profits tax.

First, licensors normally have no presence in Russia and have their terms of use structured as a license, rather than as a service agreement subject to foreign law. Even though Russian law may apply to foreign law–governed end user license agreements (''EULAs'') to the extent Russian consumer rights are effected, the Russian tax authorities have little means to go after a nonresident licensor with no presence or assets in Russia, especially if the licensor collects fees by charging credit cards directly or through a nonresident payment platform. In such a case, in the absence of a Russian tax agent and taxpayer in Russia, there is simply no statutory mechanism in the B2C segment to pay the VAT if that would apply.

Second, if the tax authorities go after intermediary payment partners, such as payment platforms, that help licensors monetize the games and may be considered as tax agents for domestic tax purposes, the licensor can still argue that Russian VAT should not apply under the place-of-supply rules. Specifically, even if the underlying relationships are not licensing relationships but rather service arrangements, and the latter are characterized in line with the approach of the Russian tax authorities within the *Mail.Ru Games* case as ''services for organization of gaming process,'' then such services fall into the default place-of-supply rule, i.e., they are deemed provided based on the location of the service provider.

There might be other arguments on the side of the Russian tax administration and counterarguments on the part of nonresident taxpayers. However, all things being equal, the core outcome of the *Mail.Ru Games* case was that the new court practice put Russian companies in a less advantageous position from a VAT perspective vis-à-vis nonresident companies. It was only a matter of time before VAT discrimination against Russian businesses would be resolved. Surprisingly, the draft VAT Bill was submitted to the Russian Duma, the lower chamber of the Parliament, not by the Finance Ministry (which is what usually happens with drafts of tax bills), the government or the governing party at the Duma, but rather by a small non-governing party ''Fair Russia,'' and only then received support from the Finance Ministry.

SCOPE OF APPLICATION OF THE VAT BILL

With the adoption of the VAT Bill, the place-of-supply rules have been expanded with the list of newly defined electronic services. As of January 1, 2017, they are deemed provided in Russia for VAT purposes if the customer is considered located in Russia. Technically, the VAT Bill requires nonresident enterprises that supply electronic services to Russian customers to register for, pay, and report Russian VAT.

At the same time, for the majority of commercial arrangements, the Law imposes the collection and remittance obligation on platform companies and other intermediaries or customers. In those instances where nonresident enterprises (whether suppliers of electronic services or not) collect payments from individual Russian consumers directly, the nonresidents will be required to report, collect and remit the applicable Russian VAT. Noteworthy, Russian VAT must be paid to the federal budget only in Russian rubles. Hence, some taxpayers will have to consider opening a ruble account with a Russian bank.

The VAT Bill does not impose collection and payment obligations on B2B nonresident suppliers. VAT is collected on such supplies via ''reverse charge.'' While the VAT Bill does not provide detailed guidance on distinguishing between B2B and B2C supplies, Russian business customers are likely to inform nonresident suppliers of their business status, so that the nonresidents do not charge VAT on the supplies. If a nonresident supplier charges VAT on a B2B supply, the customer still remains liable for the VAT before the Russian federal budget as a tax agent. Thus, the customer must effectively pay VAT twice and then seek a refund from the supplier.

The VAT Bill narrows the scope of the electronic services that are subject to extraterritorial VAT, provides guidance on how to determine whether or not a customer is a Russian resident for purposes of the regime, and states that a nonresident enterprise that is deemed to supply services in Russia for purposes of the regime does not automatically have a Russian direct tax PE.[18]

DEFINITION OF ESS

The Law defines ESS as the provision of services performed through an information and telecommuni-

[17] See court decisions on cases No. A40-56211/14, A40-91072/14, and A40-194444/15; and the Decision of the Supreme Court No. 305-KG15-12154, dated Sept. 30, 2015 on case No. A40-91072/14.

[18] *See* Russian Tax Code, art. 306(14).

ISSN 0090-4600

cations network, including the Internet, and automatically with the use of information technologies. Such services include:[19]

- granting the right to use software (including computer games) and databases through the Internet as well as provision of remote access to them, including updates and additional options;
- advertising services provided through the Internet, including services provided with the use of software and databases that function on the Internet, as well as provision of advertising space on the Internet;
- services for displaying offers for the acquisition (disposal) of goods (works and services) or proprietary rights on the Internet;
- provision of technical, organizational, informational and other possibilities with the use of information technologies and systems through the Internet for setting up contacts between sellers and buyers and conclusion of contracts (including real-time trading platforms on the Internet where potential buyers may offer prices using an automated procedure and the parties to the contract are informed of a sale by messages that are created and sent automatically);
- provision and support of a commercial or personal presence on the Internet, support of users' electronic resources (websites and (or) pages on the Internet), provision of access to them by other Internet users, and provision of options to modify them;
- storage and processing of information if the person that submitted the information has Internet access to it;
- provision of computing capacity in real time for including information in information systems;
- provision of domain names and hosting services;
- information system and website administration services on the Internet;
- services provided automatically over the Internet upon the insertion of information by the user, automated services for on-demand data search, selection and sorting, and provision of data to the user through information and telecommunications networks (including real-time stock exchange data provision and real-time automated translation services);
- provision of rights to use e-books and other electronic publications, informational and educational materials, images, musical works with or without lyrics, and audiovisual works through the Internet, including when provided for watching or listening using remote Internet access;
- services involving searching for, and/or provision of information on, potential buyers for a client;
- provision of access to search systems on the Internet; and
- provision of statistical services on Internet websites.

The VAT Bill expressly excludes the following categories of transactions from the definition of electronic services: (i) online sales of goods or services that are physically delivered/performed in Russia, (ii) sales of licenses for PC software usage rights, computer games and databases on tangible storage media; (iii) the provision of consulting services by e-mail; and (iv) the provision of Internet access services.[20] These transactions are nevertheless still potentially subject to VAT under the general Russian VAT rules. Thus, for example, imports of physical goods that Russian customers purchase online could be subject to customs VAT, notwithstanding the exclusion in the VAT Bill.

SELECTING INCOME CATEGORY: SERVICE vs. LICENSE

With the new VAT rules on taxation of ESS, most electronic services and e-content provided to Russian customers through the Internet and online shops will be subject to Russian VAT.

If the VAT exemption for software use licenses remains in the Tax Code, nonresident software companies selling licenses to Russian customers may still rely on the exemption. Gaming companies in the MMO segment, however, will no longer be able to rely on such exemption, since the Russian tax authorities will likely attempt to extrapolate their approach in the *Mail.Ru Games* case to nonresident licensors' EULAs and consider the monetized revenues as fees for services for organizing the gaming process. Under this approach, such services will be subject to Russian VAT under the new regime.

If the VAT exemption remains intact and nonresident licensors continue applying it, separate attention should be given to the newly introduced domestic beneficial ownership rules that came into effect on

[19] *See id.*, art. 174[2](1).

[20] *Id.*

ISSN 0090-4600

January 1, 2015.[21] According to the new rules, nonresident licensors may need to demonstrate to Russian tax agents, such as payment platforms and B2B customers, that they meet the statutory beneficial ownership criteria set forth in the Russian Tax Code. Specifically, Russian tax agents that may be exposed to tax audits of reduced tax treaty rates for outbound Russia-source royalties may request nonresident licensors to provide evidence of their discretion to determine the economic destiny of such royalties, including the absence of conduit character of upstream distribution of royalty income[22] and, potentially, the operational substance at the level of the licensor.

If the Russian Parliament revisits the VAT exemption so that nonresident enterprises may no longer apply it, there will be no difference from a Russian VAT perspective between selling licenses or services. In either scenario, such sales will be subject to Russian VAT under the new regime. However, there is a difference between services and license treatment from a Russian corporate profits tax perspective. While a licensor will be required to confirm its tax residence for treaty purposes (by way of providing a tax residency certificate, apostilled, translated into Russian and certified by a notary) and beneficial ownership status, a service provider will not be required to meet any of those requirements.

Therefore, to the extent nonresident suppliers have a legitimate choice between structuring the transaction as a service or as a license, the services treatment will normally have a more beneficial effect on the administration of the Russia-source income. However, if the same service has a license treatment in other jurisdictions, this may raise consistency issues and give the Russian tax administration a justified ground to use other countries' license agreements as a benchmark to recharacterize service fees into license income. In such a scenario, the Russian tax authorities may go after Russian tax agents, such as payment platforms and B2B customers. If the tax agent is sophisticated enough, it might not want to take unnecessary tax risks and/or will request tax indemnity from a nonresident service provider.

DETERMINING LOCATION OF THE CUSTOMER AND SUPPORTING DOCUMENTATION

Under the VAT Bill, if a nonresident enterprise supplies an electronic service to a Russian customer, the supply is deemed to take place in Russia and the nonresident enterprise is deemed to have a nexus in Russia for VAT purposes. It is critically important to properly determine whether the customer, especially in the B2C market, is deemed located in Russia for the purposes of the Law. Specifically, if, with respect to a supply to an individual not engaged in business, at least one of the following criteria is satisfied, the individual is deemed to be a Russian resident for purposes of the regime:[23]

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

Difficulties are likely to arise in cases where the customer meets one of the criteria for Russia (e.g., IP address), but the second criterion (e.g., payment with a card issued by a non-Russian bank) points to a different country. Some data that is often collected during the monetization process but does not formally meet the above criteria — such as billing, shipping or e-mail address — is irrelevant and should be ignored for this test.

However, the VAT Bill has introduced a tie-breaker rule. Specifically, where one of the above criteria is satisfied, but according to the laws of the foreign jurisdiction which sets out that the place of supply of electronic services is also determined based on the location of the customer, the latter is not considered a Russian resident, the nonresident supplier may use its discretion to determine whether a supply is or is not to a Russian resident.[24] This tie-breaker rule may be considered unusual, as it would ordinarily give deference to one jurisdiction or the other, and would not allow the supplier to discretionally determine which jurisdiction has the right to impose VAT.

Where the supplier uses its discretion to determine that a supply should be subject to VAT in the EU or elsewhere (and not subject to VAT in Russia), the supplier may need to develop certain written policies that

---

[21] *See* Russian Tax Code, art. 7.

[22] One of the latest court decisions against the taxpayer under "beneficial ownership" rules was the *Intesa Bank* case, where a Luxembourg company receiving interest payments from a Russian company was recognized as a "conduit" of the Italian shareholder controlling the Luxembourg company. Therefore, the Luxembourg company could not apply for the withholding tax exemption under the Russia-Luxembourg Tax Treaty. *See* Resolution of the 9th Arbitrazh Appellate Court on case No. A40-241361/15, dated June 14, 2016.

[23] *See* Russian Tax Code, revised art. 148(1)(4).

[24] *Id.*

ISSN 0090-4600

resolve customers' residence conflicts for Russian VAT purposes. In order to avoid double VAT taxation, the supplier may need to communicate to and agree on consistent application of such policies by all platform companies and other intermediaries — that are in fact responsible for collecting and remitting VAT — through respective contractual arrangements and appropriate IT solutions.

For supplies to business customers, the general Russian VAT rules apply to determine whether the customer is a Russian resident or not. If the place of registration of the business customer, as reflected in its corporate documents, is in Russia, then the customer is a Russian resident and a supply to that customer is deemed to take place in Russia for VAT purposes. The Law does not provide criteria on which the supplier of electronic services may rely to establish that the supply is a B2B supply.

Many companies need to develop a process enabling them to distinguish between B2C sales and sales to corporate customers (including individual entrepreneurs). This is especially important in the context of increased focus in Russian tax audits on supporting documentation, such as a written contract, transfer and acceptance statements, invoices and payment documents. The form of agreements for the supply of electronic services in the B2B segment (whether concluded electronically or in writing) does not affect the Russian VAT treatment of underlying ESS, but does matter for Russian tax deductibility purposes.

Ordinarily, a conservative corporate customer would want all above documents in original hard copies in its files in order to be able to deduct the expense for corporate profits tax purposes and recover the VAT withheld. In the e-commerce world, this practice will not be sustainable. It might be possible to automatically generate soft copies of certain documents, potentially with an electronic digital signature, and some may be avoided completely. However, supporting documentation will represent a serious challenge for the Russian B2B market.

Another piece of supporting documentation that must be in place at the level of nonresident suppliers of electronic services and payment platforms is the so-called ''transaction register.'' According to the VAT Bill, nonresident enterprises that supply electronic services to Russian B2C customers and collect, report and pay Russian VAT are required to maintain separate transaction registers, which must contain data regarding these supplies. This includes data on the cost of the supplies to customers and data on meeting the above residence-related criteria. The VAT Bill is expected to serve as confirmation of a customer's residence.

The Russian tax authorities have fairly broad powers to request additional documentation from both nonresident taxpayers and Russian entities involved in the monetization process, including any data on payments made to nonresident suppliers, payment platforms or other intermediaries from the national system of payment cards, payment and e-money operators, clearing centers and their counteragents, mobile service providers and others.[25]

INTERMEDIARIES AS TAX AGENTS

In certain instances, ''tax agents'' of nonresident suppliers, as opposed to the suppliers themselves, are required to calculate and pay VAT on supplies of electronic services to Russian customers. In these cases, the payment and reporting burden therefore shifts from the supplier to the agent. The VAT Bill defines the following persons as ''tax agents'' for purposes of the regime:

- nonresident enterprises acting as platform companies and other intermediaries that are directly involved in collecting payments from individual Russian consumers;
- Russian companies and individual entrepreneurs acting as intermediaries that are directly involved in collecting payments from Russian customers; and
- Russian companies and individual entrepreneurs that are customers of nonresident suppliers of electronic services.

Under this framework, even though the regime technically applies to both B2C and B2B supplies of electronic services, the requirement for nonresident enterprises to pay VAT applies exclusively in the context of B2C supplies, as VAT in connection with B2B supplies is collected via ''reverse charge'' by Russian intermediaries or corporate customers and individual entrepreneurs.

Importantly, the VAT Bill refers to nonresident platform companies and Russian companies and individual entrepreneurs as tax agents if they act pursuant to agency, commission or similar agreements with nonresident suppliers. If there are several nonresident intermediary companies in the supply chain, the lower-tier nonresident company that collects money from Russian individuals is deemed a tax agent even if it does not have a direct agreement with the nonresident supplier.[26]

The Law does not provide further guidance on the nature of agreements that can be captured by the term ''similar.'' Thus, banks, card acquiring companies and

[25] *See id.*, art. 93.1(2).

[26] *See id.*, arts. 161(5) and 174^2(3).

ISSN 0090-4600

other intermediaries, even if not retained by suppliers directly and in the absence of agency or commission type agreements, might end up undertaking the full scope of obligations of a Russian tax agent being required to register with the tax authorities, report and pay the VAT to the Russian budget.

REPORTING, COMPLIANCE AND ENFORCEMENT ISSUES FOR NONRESIDENT BUSINESSES

There are no statutory thresholds within which the VAT payment or reporting requirements do not apply. Nonresident suppliers, platform companies and intermediaries that collect fees, regardless of their amount, for electronically supplied services are subject to a special reporting regime. They are not required to issue special VAT invoices (''schet-fakturas'') and maintain purchase and sales ledgers,[27] but are required to file VAT returns (by the 25th of the month following the reporting calendar quarter) electronically. By default, such e-filing may take place either through a special personal account of the taxpayer or, provided such e-account cannot be used, through an authorized operator of e-communication with the tax authorities.[28]

The Russian Tax Code does not set forth any statutory mechanisms enabling collection of VAT from nonresident suppliers or payment platforms that have no assets in Russia. Given that the vast majority of double tax treaties address only direct taxes, expectations that other jurisdictions will assist the Russian government in collecting unpaid or non-withheld VAT would be excessive. There is simply no effective and enforceable mechanism on collecting extraterritorial VAT with respect to electronic services supplied by nonresident enterprises in Russia.

While compliance with local laws is normally the only possible course of action for the vast majority of multinationals, for some small and medium-sized enterprises (''SMEs'') such compliance could become an impediment to entering the market. If some market players do not follow the Russian VAT registration, payment and reporting rules, this might lead to certain behavioral distortions among electronic service suppliers and give some SMEs *de facto* ''benefits'' — in the form of unpaid VAT and absence of associated costs on administration and compliance — over large corporations. However, this might be a short or mid-term gain, because Russian tax laws are constantly changing and could be expanded with more severe rules on blocking access to suppliers' websites, as is already the case with respect to noncompliance with Russian personal data laws.

PE CONSIDERATIONS

The Law expressly states that the supply of electronic services by a nonresident enterprise to a Russian customer does not give rise to a Russian direct tax PE of the nonresident. This provision should, in theory, resolve concerns about whether the VAT Bill increases nonresident enterprises' direct tax exposure in Russia.

At the same time, in the long run, a nonresident supplier might have some exposure to a PE in Russia if it uses a Russia-based server for the monetization process and/or processing of customer data. For example, if the supplier collects and stores personal data — due to domestic localization requirements — on Russia-based servers that the supplier owns or leases, such servers might be considered to be at the disposal of the supplier and create a nexus with the Russian taxing jurisdiction.

The Russian tax laws do not contain any provisions on server-based PEs. The statutory definition of a PE in Russia goes beyond the PE definition reflected in the OECD Model Tax Convention and captures sales of goods from locally owned or leased warehouses.[29] Obviously, in 2002, when this statutory rule came into effect in Russia, the e-commerce market was not developed at all. Going forward, there is a potential that the Russian tax authorities and courts will consider legitimate an idea of extrapolating this provision to the digital economy and consider a server (if owned or leased) an analogue of e-warehouse for domestic PE purposes. Such risk is low, but cannot be completely discarded. And even if such interpretation does not materialize, there is no guarantee that the Russian Finance Ministry or the Federal Tax Service will not, at some point, develop a fiscally driven position with reliance on approaches adopted by the Organization for Economic Cooperation and Development (OECD) or used in court precedents of developed tax jurisdictions.

According to the Commentary to the Model Tax Convention, ''the server on which the website is stored and through which it is accessible is a piece of equipment having a physical location and such location may thus constitute a ''fixed place of business'' of the enterprise that operates that server.''[30] ''If the enterprise carrying on business through a website has the server at its own disposal, for example it owns (or

[27] *See id.*, art. 169(3)[2].

[28] *See id.*, arts. 174[2](7), (8).

[29] *See id.*, art. 306(2).

[30] *See* Commentary (p. 42.3) to paragraph 7 of Article 5 of OECD Model Tax Convention on Income and on Capital (Condensed Version 2014), OECD Publishing, p. 112.

ISSN 0090-4600

leases) and operates the server on which the website is stored and used, the place where that server is located could constitute a permanent establishment of the enterprise if the other requirements of the article are met.''[31] With respect to other requirements, it is important to consider long-term impact, such as a new nexus based on the concept of ''significant economic presence,'' with a focus on the revenue-based factor, and the digital and user factors analyzed by the BEPS Report (Action 1) Addressing the Tax Challenges of the Digital Economy.[32]

There are no signs yet that the Russian Finance Ministry has analyzed this issue in great detail and will shortly form an official position with respect to server-based PEs or whether ''disposal'' might exist in cases where the server with localized personal data is not in the ownership or lease of the licensor. At the same time, there is no guarantee that, in an attempt to bridge budget deficit gaps, the Russian tax administration will develop a pro-fiscal position based on some of the approaches reflected in the Commentary or BEPS Report.

There are legitimate structuring opportunities that can be explored in order to build additional layers of defense against potential PE claims from the Russian tax authorities. Obviously, each case is different and it is often a matter of specific facts and associated arguments, with documentation support, that sophisticated taxpayers work on in advance of a potential tax audit in order to make their case unique, or at least very different from others that may be in the focus of the tax administration.

---

[31] *Id.*, p. 113.

[32] OECD, Addressing the Tax Challenges of the Digital Economy, Action 1 — 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris (2005), p. 107. Retrieved from http://dx.doi.org/10.1787/9789264241046-en.

ISSN 0090-4600