

“Special Economic (Tax) Zones in Russia”

- illustration of the special tax zones;*
- concept and constitutional framework;*
- STZs from an international tax.*

*Prof. Dr. Danil V. Vinnitsky
Department of Tax and Financial Law,
Ural State Law University,*

*Director of the BRICS Law Institute
(bricslawinstitute.com)*

**BRICS and Developing Countries
Legal Experts Forum**

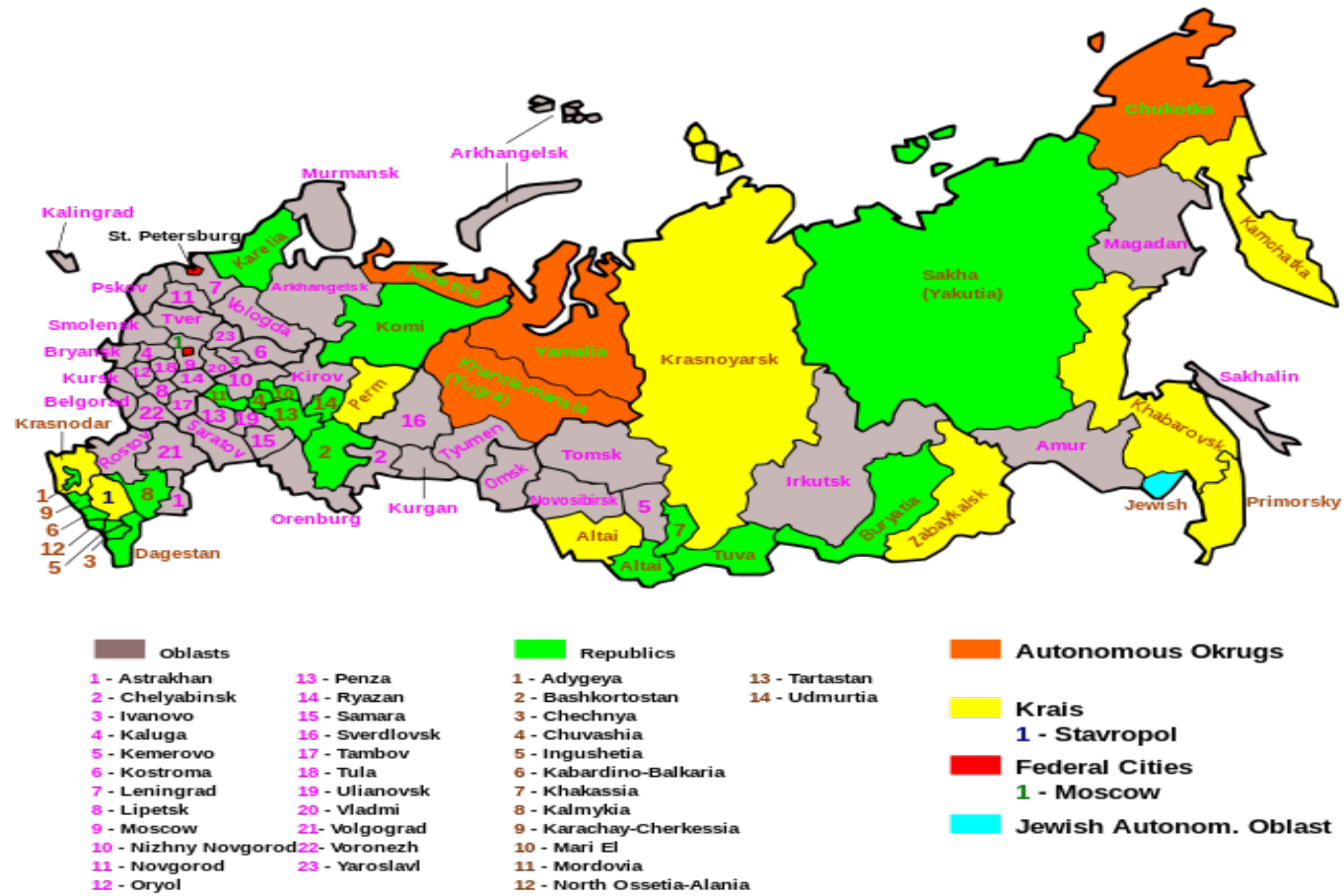
Ekaterinburg, Russia, 8 June 2017

1. Tour de table with the illustration of the special tax zones in Russia

1.1. Illustration of the special tax zones in Russia: Basic Information

- Russia is a federal state comprising **85 regions**; it participates in the Customs Union and Single Economic Space Agreements (EAEU) with the Republic of Kazakhstan, the Republic of Belarus, Armenia and the Republic of Kyrgyzstan (29.05.2014);
- In **2014** the economy of Russia was the 10th largest economy in the world by nominal value and the 6th / 5th largest by purchasing power parity (PPP); **2015 – 2016** - period of economic turbulence;
- **Natural resources** and particularly fossil fuels (oil, natural gas, and coal), etc.;
- **Services** are the biggest sector of the economy (**Retail**, Banking, Insurance, **Telecommunications**; 58% of GDP), **fishing** and forestry, **agriculture**, **defense industry**, **aerospace**, (Sukhoi Superjet 100, space flights, satellites), **automotive industry** (AvtoVAZ, GAZ, KAMAZ (heavy vehicle producer)), electronics, transportation (Russian Railways, etc.), **construction**, **information technology** (the IT market is one of the most dynamic sectors of the Russian economy; e. g. Yandex is used by 53.8% of internet users in the country).

1.2. Illustration of the special tax zones in Russia: the Structure of the State



*1.3. Illustration of the special tax zones in Russia:
the role of regional integration (CIS, EAEC /
EurAsEC, Customs Union, etc.)*



1.4. Illustration of the special tax zones in Russia: the List of Taxes (1999 – 2016)

I. Federal taxes and charges:

- (1) **Value-Added Tax (Chapter 21 RF Tax Code/ RF TC);**
- (2) **Excises on goods or services (Chapter 22 RF TC);**
- (3) **Tax on income of natural persons (Chapter 23 RF TC);**
- (5) **Tax on profit of organizations / corporate tax (Chapter 25 RF TC);**
- (6) **Tax on the extraction of mineral resources (Chapter 25 RF TC);**
- (7) **Charge for the right of using objects of fauna and aquatic biological resources (Chapter 25.1 RF TC);**
- (8) **Water tax (Chapter 25.2 RF TC);**
- (9) **State duty (Chapter 25.3 RF TC);**

II. Regional taxes

- (1) **Tax on property of organisations (Chapter 30 RF TC);**
- (2) **Transport Tax (Chapter 28 RF TC);**
- (3) **Tax on gambling business (Chapter 29 RF TC);**

III. Local (municipal) taxes

- (1) **Land Tax (Chapter 31 RF TC);**
- (2) **Tax on property of natural persons (Chapter 32 RF TC, RF Law of 9 December 1991 “On taxes on property of natural persons”);**
- (3) **Trade duty (Chapter 33).**

1.5. Special Tax Zones

(industrial production, technical research and implementation, tourism-recreation, free economic zones in Magadan and Kaliningrad)



1.6. Federal Law “On Special Economic Zones in the Russian Federation”

Art. 4 of Federal Law of 22.07.2005 № 116-FZ

**Industrial
Production**

**Technical
Research and
Implementation**

**Tourism and
Recreation**

Free Ports

1.7. Technical Research and Implementation

**Moscow city,
«Zelenograd»**

**Moscow
region,
«Dubna»**

**Saint-
Petersburg**

**Tomskaya
oblast,
«Tomsk»**

**Republic of
Tatarstan,
«Innopolis»**

1.8. Industrial Production

Astrakhan city

Vladivostok city

**Lipetskaya oblast,
«Lipetsk»**

**Republic of
Tatarstan,
«Alabuga»**

**Samarskaya oblast,
«Tolyatti»**

**Sverdlovskaya
oblast, «Titanovaya
dolina» / «Titanium
valley»**

**Pskovskaya oblast,
«Mogilino»**

**Kaluzhskaya
oblast,
«Lyudinovo»**

1.9. Tourism and Recreation

**Republic of Altay,
«Altay Valley»**

**Republic of Buryatia,
«Baikal haven» /
«Baykalskaya Gavan»**

**Altayskiy Kray,
«Turquoise Katun»**

**Stavropolskiy Kray,
«Grand Spa Yutsa»**

**Irkutskaya oblast,
«Gateway of Baikal»**

**Primorskiy Kray,
«Russky Island»**

**Touristic Cluster in the
North Caucasian
Federal District,
Krasnoyarskiy Kray
and Republic of
Adygea**

1.10. Free Ports

**Ulyanovskaya
oblast,
«Ulyanovsk-
East»**

**Khabarovskiy
Kray, «Soviet
Haven»**

**Murmanskaya
oblast**

*II. Concept and constitutional
framework of the special tax
zones in Russia*

2.1. *The Constitutional background of taxation in Russia*

- **1) Article 57 of the RF Constitution:**
“Each person must pay legally established taxes and charges”;
- **2) Articles 34 and 35 of the RF Constitution:**
provide freedom of economic activities and guarantee security of the right of property;
- **3) The RF Constitutional Court considers these articles as a basis for finding the compromise or balance between:**
 - ***public interests*** (that is the necessity of taxes and revenue for budget);
 - and ***private interests*** (that is freedom of economic activities and right of property).
- **4) Tax ability to pay principle and flat tax rates?**

2.2. General conditions for establishment of a tax in Russia

RF Tax Code states some **general conditions for establishment and introduction of any tax in the Russian Federation**. According to Article 17 RF TC tax may be considered to be established only when the legislator determined and described its taxpayers and the following elements of taxation:

- 1) object of taxation
- 2) tax base
- 3) tax period
- 4) tax rate
- 5) procedure for the calculation of the tax
- 6) procedure and periods for the payment of the tax.

Preferential Regimes and Tax privileges (including tax exemptions and tax allowance in SEZs/STZs) may also be established, but they are not obligatory elements of taxation. In general, the legislator is not obliged to establish any privilege; it is left to his discretion.

(Art. 17 (2), Art. 56 of the RF TC; see also Art. 284 of the RF TC)

2.3 The Concepts of Special Tax Regimes and SEZs/STZs in Russian Tax Law

I. Special Tax Regimes are special procedures for the calculation and payment of taxes (Art. 18 RF TC).

The following special tax regimes exist in Russian tax law:

- 1) System of taxation for agriculture producers (unified agricultural tax) – **Chapter 26.1 RF TC**;
- 2) Simplified system of taxation (for small business) – **Chapter 26.2 RF TC**;
- 3) System of taxation in the form of unified tax on presumed income for certain kinds of business activity – **Chapter 26.3 RF TC** and Patent system of taxation – **Chapter 26.5 RF TC**.
- 4) System of taxation when fulfilling production sharing agreements – **Chapter 26.4 RF TC (4.1)**, operator of offshore hydrocarbon field/deposit (**Chapter 3.2 RF TC**).

II. Special Incentives for Investors

- 1) Regime of Regional investment project in Siberia (Chapter 3.3 RF TC, for Russian organizations only, Art. 25.9);
- 2) Special Tax Zones - industrial production, technical research and implementation, tourism-recreation, free ports (for the residents of zones);
- 3) Free economic zones in Magadan and Kaliningrad, Free Port of Vladivostok
- 4) “Skolkovo project”, “Sochi Olympic Games 2014”, “FIFA 2018”.

2.4. *Special Regional Tax Regimes*

(tax on profits of organizations, Art. 284 RF TC, tax on property of organizations)

Tax stabilization clauses could be extremely important for investors in case of unpredictable changes of regional tax legislation, e.g. sudden abolishing of regional tax preferential regimes in the spheres:

- **tax on profit of organizations** (increase of reduced tax rate from **13,5%** to 18 (20)% in accordance with Article 284 of the RF Tax Code)
- **tax on property of organizations** (regional authorities can exclude some categories of taxpayers or tax objects from taxation).

See: case law connected with the application of the **Law of Kaluzhskaya oblast (Kaluga region) “On tax on property of organizations”** (which was changed many times, in particular 3 times in 2013 fiscal period and also in 2014).

This instability creates, in particular, some **procedural obstacles** for major investors in Kaluga region **in the application of the respective preferential regime** (they could not use the previously granted relief from regional tax on property of organizations in regard to the newly constructed objects of investments / plants).

See: Volkswagen, “Industrial park Grabtsevo”, *Decision of the Commercial Court of Saint-Petersburg and Leningrad region on case NA56-37722-2014.*

2.5. Corporate tax: legal forms of companies and constitutional principle of equality

- **1. 2. Incorporation (registration) of legal entities in Russia is usually exercised by territorial bodies of tax authorities.** The procedure of registration is regulated by the Federal law of 8 August 2001 “On state registration of legal entities” (revised on 19 July 2007).
- **2.** According to the Russian legislation, namely Russian Civil Code (Art.50), there are:
 - (1) commercial legal entities (profit organization);
 - (2) non-commercial legal entities (non-profit organizations).
- **3.** The RF Civil Code (Part One) provides for the **following legal forms of commercial companies:**
 - (1) partnership with unlimited liability (Art.69-81 RF Civil Code);
 - (2) limited partnership (Art.82-86 RF Civil Code);
 - (3) limited liability company (Art.87-94 RF Civil Code);
 - (4) joint-stock company (Art. 96-104 Civil Code);
 - (5) state or municipal enterprises (Art.113-115 RF Civil Code);
 - (6) some others.
- **4.** Articles 116-123 of the RF Civil Code and the Federal Law of 12 January 2002 (with latest amendments, revised on 19 July 2007) “On non-commercial organizations” state **different legal forms of non-commercial (non-profit) legal entities.**
- **5. In general, the RF TC establishes the same taxation rules and procedures for all kinds of Russian legal entities (irrespective of their legal forms).**

2.6. Corporate tax: tax rates and constitutional grounds for the differentiation in tax treatment

- **I. The general rate of the corporate tax is 20% consisting of:**
 - 2% to the federal budget;
 - 18% to the regional budget (the regional governments are authorized to reduce their portion of the corporate tax rate maximum to 13.5% or even 0% in some cases). **(Art.284 (1) of the RF TC)**
(different regimes in different regions, special economic zones - 18%, $X < 13,5\%$, $X > 13,5\%$, education, medical treatment; Magadan and Vladivostok special economic zones – 0%);
- **II. Different rates are provided for the following profits:**
 - (1) 20%** - for foreign organizations profits which are received from Russian sources **(18% and 2%)**
 - (2) 10%** - for profits from the use, maintenance or rent of ships, aircraft or other transport means in international traffic; **20%** - for over source incomes; **0% - capital gains in regard to some kinds of shares** and financial instruments;
 - (3) 13%** - for incomes of Russian organizations from the dividends paid by a Russian or foreign organization;
 - (4) 15%** - for incomes of a foreign organization from the dividends paid by a Russian organization (residence criteria);
 - (5) 0% rate** is for incomes of a Russian organization from dividends under the certain conditions:
 - the organization-receiver of dividends has been holding 50% of shares of the organization, which pays the dividends, for not less than 365 days;
 - **jurisdiction of a payer should not be included by the RF Min. of Finance in the black list.**
 - (6)** different tax rates (15%, 9% and 0%) are, exceptionally, provided for interest income on state and municipal securities (tax rate depends on the kind and the issuance date of the securities). **(Art.284 (2, 3 and 4) of the RF TC), etc.**

2.7. Status of the investor in SEZs/STZs and constitutional guarantees

Federal law of 22 July 2005 “On Special Economic Zones” :

The objectives of establishing SEZs are:

- (1) development of new industries of national economy;
- (2) high technology development;
- (3) development of transport infrastructure;
- (4) development of tourism industries, etc.

Subsidiaries with the participation of a foreign company, according to Art.9 of the above-mentioned law, can be the residents of **SEZs**.

I. <13,5% tax rate (Art.284 of the RF TC) some other corporate tax incentives (depreciation - 259.3 (1 (3)), losses - 283 (2) of the RF TC), some VAT exemptions (Art. 149 of the RF TC), privileges in regard taxation of property (Art. 381 of the RF TC).

Art. 36 - 37 of the Law establishes **free customs regime for the residents of a special economic area**.

- **II.** The **regime of stability of investments**, established by Federal law “On SEZs” is applied in regard to all kinds of activities and projects.

*III. STZs in Russia
from an international tax*

3.1. Russian International Tax Treaty Policy

Over the recent years the Russian Federation has pursued quite an active international tax policy:

- signed **85** conventions for the avoidance of double taxation (**DTCs**);
- **82** DTCs in force (including the two with Japan and Malaysia concluded by the former USSR);
- several DTCs have been negotiated and signed, but have not been yet ratified by the RF Parliament. (Laos, etc.)

3.2. The Russian approach to DTCs

1. Generally follows the **OECD model or UN Model**

2. The Russian approach is based on:

- **1) The Russian Model Treaty**, approved by the RF Government Regulation of **28 May 1992 №352** (in force until 24.02.2010);
- **2) The New Russian Model Tax Treaty**, (hereinafter also: RMTT) approved by the RF Government Regulation of **24 February 2010 №84**;
- **3) The OECD Roadmap** for the accession of the Russian Federation, adopted by the Council at its 1163rd session on **30 November 2007**, according to which:
 - international double taxation on income and capital should be countered in compliance with the pattern of the OECD Model Tax Convention;
 - double taxation should be eliminated in compliance with the arm's length principle;
 - an effective exchange of information should be secured;
 - RF should cooperate in countering harmful tax practices;

3. BEPS Action Plan and the New Russian Anti-Offshore legislation.

3.3. *The New Russian Model Tax Treaty (RM TT)*

- **1) no tax treaty benefits for dual resident taxpayers, unless dual residence is effectively solved by mutual agreement (Art. 4 (2) and Art. 4(3) RM TT);**
- **2) supplying services** on the territory of the other Contracting State may in some cases give rise to a **PE** in such country (Art. 5(4) RM TT)

NB: The absence of the concept of service PE at the national level

- **3) neutrality** in outbound flows of dividends, interest and royalties achieved by levying 10% WHT (Arts. 10, 11 and Art. 12 RM TT)
- **4) PE proviso** gives PE State unlimited taxing powers in triangular cases on dividends, interest and royalties attributable to PEs (NB – a possible conflict exists with current interpretation of Russian courts!);
- **5) Limitation of Benefits & Beneficial Owner** provisions included (Articles 29, 10 - 12 RM TT);
- **6) There is no tax sparing credit provision in the RM TT.**

3.4. Subjective Scope of the Russian Tax Treaties and source rule

- **(1)** - In Russian Tax Law the **worldwide income principle** applies to taxing the corporate profits of **resident companies**

According to the general rule, profits of a Russian company (that is a resident company) will be taxed in Russia.

There is no difference from what sources these profits are derived and in what part of the world it could happen

(Art. 247 (1) of the RF TC).

- **(2)** - **Non-resident** legal entities are taxed only on their **Russian-sources income** and income derived through a **permanent establishment situated in Russia.**

Thus, It is necessary to prove a connection between a non-resident company (as a taxpayer) and Russian tax jurisdiction

(Articles 247 (2 and 3), 306, 309 of the RF TC).

3.5. Subjective Scope of the Russian Tax Treaties: Corporate tax taxpayers

- **Articles 11 (2) and 246 of the RF TC provides for the definition of taxpayer of corporate tax, that is Russian and foreign organizations. According to Art.11 (2) of the RF TC:**

(1) - the term **“Russian organization”** refers to legal entities formed in accordance with the Russian legislation.

(2) the term **“foreign organization”** includes:

- **(2.1)** - foreign legal entities and their branches and representatives established in Russia;
- **(2.2)** - companies and other corporate bodies having legal personality under the law of the corresponding foreign state;
- **(2.3)** - international organizations and their branches and representatives established in Russia.

Although the RF TC has not contained a definition of the concept of residence (in regard to companies) until **1 January 2015** (the wording of chapter 25 of the RF TC have only made it clear that **residence is linked to the principle of incorporation**).

3.6. The New Domestic Rules concerning Residence

New residence rules for companies (Art. 246.2 of the RF TC, introduced by the law 376-FZ).

Since **1 January 2015** the following rules should be applicable:

- 1) the effective management test for foreign legal entities;
- 2) the place of corporate situs for Russian legal entities.

Specifically, Art. 246.2 (1) of the RF TC provides for that the term "**Russian tax resident**" for corporate tax purposes will mean:

- 1) **Russian organizations**;
- 2) **Foreign organizations** recognized as tax residents of Russia **according to the relevant double tax treaty** in place and for the purposes of applying this double tax treaty; and
- 3) **Foreign organizations whose effective place of management is the Russian Federation** unless otherwise established by an applicable double tax treaty.

3.7. Effective Management Test and its possible relevance for the companies incorporated in SEZs

Effective Management Test Criteria (1) «First tier» Rule

The place of effective management will be recognized as being in Russia provided that at least one of the following three criteria is met:

- The executive body (or the executive bodies) of the organization regularly performs its (their) activities in relation to this organization within Russia.

(The Law refers to the term «extent» of activities which must be substantial (rather than time length or other factors) defining the «regularity» aspect).

- The top executives (management) of the organization (i.e. the people who, by the definition of the new Law, are authorized to take and, accordingly, to bear responsibility for taking corporate decisions) **predominantly carry out their activities in Russia** and this is done in the form of «lead management” over this foreign organization.

«Lead management» is defined as it extends to making decisions and carrying out actions relating to the matters of the current activities of an organization where these matters are placed within the competence of the executive bodies of the organization.

3.8. «Second tier» rules and «Fall-out» rules for the effective management test

«Second tier» rules:

- The financial accounts or management accounts of the foreign organization (except for consolidated financial statements purposes) are kept in Russia.
- Document flow is organized in Russia.
- Operative management of the personnel is carried out in Russia.

«Fall-out» rules for the effective management test:

The following activities shall *prima facie* fall out from the definition of the effective management place:

- Preparation of and (or) making decisions on matters relevant to the competence of the General meeting of Shareholders (participants) of the foreign organization.
- Preparation for conducting the Board of Directors meetings.
- Executing certain functions in the Russian Federation within the framework of planning and control over the foreign organization.

3.9. Self-Claim of Russian Tax Residency Status is not applicable for SEZs

Self-Claim of Russian Tax Residency Status

Unless otherwise stated in the relevant double tax treaty a foreign organization can self-claim the recognition of the Russian tax residency status.

- This is possible where
 - (i) the foreign organization is permanently located in a treaty country with Russia (?? After June 2015?); and
 - (ii) operates in Russia via a **permanent establishment / subdivision**. The organization is free to both self-claim the tax residency status and cancel it in accordance with the special procedure to be established by the tax administration.

If the foreign organization has recognized itself to be a Russian tax resident, it will no longer, by virtue of Art. 246.2 of the RF TC, be treated as a CFC for tax purposes in Russia.

Special Tax Residency Recognition Rules

Art. 246.2 of the RF TC introduced by the new law No. 376-FZ refers to special rules where a foreign organization can be recognized as a Russian tax resident. These rules entail that obtaining the residency status **may only be achieved via a self-claim by those organizations** (production sharing agreements, etc.).

3.10. Tax Sparing Credit and cross-border taxation in the Russian SEZs

Russian tax treaties with tax sparing credit provision:

- Tax treaties with Cyprus, Arabia Saudi, Singapore, Cuba, **Malta (see the first version of the tax treaty which was not ratified)**, Thailand and Ethiopia;

- Russian residents may apply tax sparing credit provision in accordance with all the above-mention tax treaties except for the tax treaties with **Cyprus and Singapore** (i.e. they can apply for this purpose the respective provisions of the tax treaties with **Arabia Saudi, Cuba, Thailand, Ethiopia**).

THANK YOU!

Prof. Dr. Danil V. Vinnitsky
Department of Tax and Financial Law,
Ural State Law University,
BRICS Law Institute
(bricslawinstitute.com)