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What You Need to Know on 2012 Tax Changes

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As always, the new year has ushered in major changes to the Tax Code: some finally enacted after years in development, others legislated swiftly and without fanfare. Here is a brief reminder of some of the most significant changes effective Jan. 1.

After the best part of a decade of drafting, consulting and re-drafting, we now have a new transfer-pricing regime, one which places a much greater burden on taxpayers to document and justify the pricing of controlled transactions. Most taxpayers should be taking steps to assess and mitigate the level of transfer-

pricing risks arising under the new regime. Some are already seeking advance-pricing agreements.

Russia's tax authorities are not accustomed to issuing any kind of binding ruling on the taxation of a taxpayer's future activities, so it will be interesting to see how many advance-

pricing agreements will be issued in practice. The initial signs are that taxpayers need to put significant effort into requests and submit specific proposals for approval, rather than looking to the tax authorities to take the lead in suggesting an appropriate basis for pricing.

It is certain that amendments to the new transfer-pricing regime will be made at some point in 2012, and the implementation of the regime is likely to reveal additional areas for legislative development in the coming years. So transfer pricing will most likely be one of the hottest topics in tax practice for the next few years.

It is less clear how broadly significant the new regime allowing Russian organizations to form consolidated tax groups will be in practice, given the restrictions on participation in such groups and the absence of relief for losses of participants arising before they formed a group. On the other hand, opting in is a way of mitigating transfer-pricing risks in relation to transactions among members of the group. For this reason, some large companies are likely to file consolidated-

profits tax returns.

A closed list of research and development expenses has been prescribed for profits tax purposes together with rules for maintaining tax registers to record expenditure on R&D. A procedure has been introduced for verifying compliance with the list involving the submission of a report by the taxpayer. The tax authorities will have the right to order the performance of an expert examination of this report for the purpose of checking that the research or development performed falls within the list. On a more positive note, provisions can be created for future R&D costs in tax accounting records. Also, more expenditures on R&D will reduce taxable profit of the reporting period in which such research has been completed or the parties have signed the delivery and acceptance certificate, as opposed to being deducted evenly over one year from the first of the month following that date.

In November, a law was passed that enables the establishment of investment partnerships in 2012. The law was developed at the instruction of President Dmitry Medvedev to enable investment by more than one party without forming a legal entity. A number of tax provisions relating to such partnerships were also introduced. From the point of view of taxation, among the key innovations is the ability to deduct partnership losses against a partner's other profits. Services of a partner managing the partners' common affairs under the investment partnership agreement will be exempt from value-added tax. The transfer of property rights as a contribution under the investment partnership agreement and the transfer of property rights to a partner within the contribution paid by said partner in case of apportionment of a participatory share or distribution of such property will also be exempt from VAT. The most widely used form of partnership at present is the simple partnership, also known as a joint activity agreement. Among the many drawbacks of a simple partnership are that a partnership's losses are not tax-deductible by the partners.

Starting in 2012, newly commissioned facilities, which are highly energy-

efficient, are exempt from assets tax for three years from the date of registration of those assets. Qualifying assets will be those included in a list of such facilities to be established by the government and to newly commissioned facilities that have a high-energy efficiency

rating where energy efficiency ratings are determined under Russian law. Unfortunately, the Tax Code does not specify which of the possible energy ratings will be considered "high" for this purpose.

Protocols to Russia's tax treaties with Cyprus, Luxembourg and Switzerland do not have effect in 2012 unless ratification procedures in each case are completed in each of the two contracting states and instruments of ratification were exchanged by the end of 2011. In the case of the protocol to the Russia-Cyprus treaty, the provisions changing taxing rights with respect to certain gains attributable to real estate will come into force four years after the rest of the protocol goes into effect. Then, the protocol to the Luxembourg-Russia treaty may lead to the increased use of Luxembourg as a jurisdiction for companies holding Russian equity investments. In the case of the Switzerland-Russia treaty, the protocol may increase the use of Swiss finance companies to provide interest-bearing debt finance to Russian organizations.

In 2012, companies face much greater uncertainty on tax issues than in recent years, mainly owing to the replacement of the old transfer-pricing regime. It may be years before developments in legislation and practice provide the level of certainty concerning tax risks that taxpayers previously experienced.

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The views expressed in opinion pieces do not necessarily reflect the position of The Moscow Times.

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