

Newsletter

New era of taxation for the IT industry

September 11th, 2020

Dear Ladies and Gentlemen,

To create the most favorable environment for the intensive development of the IT industry and pooling resources for the new projects, the Russian Government has adopted a Law¹ introducing a number of changes and tax incentives for the IT and Technology Companies. It will be effective starting from January 1st, 2021.

Below, we provide our consolidated analysis of the new rules and recommendations on steps to be taken to prepare for the forthcoming changes.

• WHAT WILL CHANGE?

(A) Preferential tax regime for the IT and Technology Companies

To increase the attractiveness of the Russian Federation for the IT developers, the Law provides for the following preferential tax rates:

- 1) 3% for the profits tax (instead of the standard 20% rate); and
- 2) 7.6% for the social security contributions (instead of the 14% rate, applicable to the IT Companies now).

In addition, certain companies will be able to apply the current VAT exemption for the provision of rights to use software and databases (please see part (B) of the Newsletter).

Entities entitled to apply the new incentives

The following Russian companies will be entitled to apply the reduced tax rates:

- 1) companies carrying out activities in the field of information technology ("**IT Companies**");
- 2) companies designing and developing electronic-component base products and electronic (radio electronic) products ("**Technology Companies**").

Since the Law refers only to "Russian companies", (i.e. companies incorporated under the laws of the Russian Federation), branches and other subdivisions of the non-Russian companies, registered in the territory of the Russian Federation, are not allowed to apply the incentives.

At the same time, the Law does not restrict participation of the non-Russian entities in the IT and Technology Companies.

Conditions for application of the new incentives

- 1) *obtaining the state accreditation* of the Ministry of Digital Development, Communications and Mass Media of the Russian Federation (for the IT Companies);

or

including the company in the special register of the Ministry of Industry and Trade of the Russian Federation (for the Technology Companies);

- 2) *generating at least 90% of total revenues from the following activities*²:

- sale of copies of the software and databases developed by the IT Company;
- sale of exclusive rights on the software and databases developed by the IT Company;
- provision of rights to use the software and databases developed by the IT Company under the license agreements;
- developing, adapting and modifying the software and databases;

¹ The Federal Law dated July 31st, 2020 N 265-FZ "On amendments to the part two of the Tax Code of the Russian Federation".

² Apart from revenues from the advertising and online marketplace software.

- installing, testing and supporting the mentioned software and databases (for the IT Companies);

or

- designing and developing the electronic products (for the Technology Companies);

3) *employing at least seven employees.*

As it follows from the Law, the tax incentives apply only to the IT Companies dealing with the software and databases (a) developed (or adapted/modified - with respect to income from installing, testing and supporting) by them and (b) not having an advertising character.

As a result, the following companies will not be entitled to apply the new incentives:

- 1) companies reselling IP rights purchased from the other companies;
- 2) companies testing and supporting software and databases not developed/adapted/ modified by them;
- 3) companies developing mostly the Advertising Software as defined below.

(B) Restrictions of the VAT exemption

Currently, the existing VAT exemption applicable to the sale of exclusive rights to the software and databases and rights to use them, in accordance with their license agreements, will be restricted starting from January 1st, 2021.

According to the Law, the VAT exemption will apply only to the so-called "national software and databases" included into the Unified Register of the Russian Software and Databases ("**Register**").

The following criteria shall be met by the Russian company to include the developed software, or database, into the Register:

- 1) the Russian company has *an exclusive right to use the software, or database, all over the world and for the entire duration of the exclusive right;*
- 2) *non-Russian entities own less than 50% of shares (interests) in the Russian company, while the Russian Federation, or Russian citizens, owns more than 50%;*
- 3) *license and support fees (e.g. for the development, adaptation and modification of the software, or database) payable by the Russian company, in favor of non-Russian entities, is less than 30% of the proceeds from the sale of software, or database (i.e. the software, or database, should be developed, or*

mainly modified, in Russia, by the Russian developers).

Separately, the Law states the list of cases when the VAT exemption cannot be used, irrespective of other conditions. This list includes software and databases ("**Advertising Software**") used to

- 1) distribute advertising information on the Internet, or gain access to such information;
- 2) post offers for the purchase (sale) of goods (works, services), property rights in the Internet;
- 3) search for the potential buyers (sellers) and conclude contracts.

As a result of the changes upcoming in 2021, the substantial part of companies that currently use the VAT exemption will lose it, in particular:

- 1) *non-Russian companies (including providers of software / SaaS)*

Many of them are already registered as suppliers of e-services with the Russian tax authorities and apply the VAT exemption for the rights to use their software and databases under the license agreements.

Starting from 2021, they shall start charging and paying VAT on the respective services, similar to other non-Russian e-services suppliers.

- 2) *Russian companies, which are*

- not recognized as IP right holders (e.g. distributors – resellers) or
- closely affiliated with foreign companies (e.g. 100% Russian subsidiaries of multinational groups) or
- developing the Advertising Software (e.g., online marketplaces); as well as

- 3) *Russian companies which did not register their software, nor database, with the Register.*

• WHAT SHOULD BE DONE?

Considering the upcoming changes, it may be recommended to:

- 1) assess whether the described criteria are met and preferential rates of the profits tax and social insurance contributions can be applied;
- 2) assess whether the existing structure can be, or should be, changed, considering the respective tax issues;
- 3) consider the possibility and expediency of inclusion of the software, or database, in the

- Register to apply the VAT exemption (registration of the software takes 2-3 months);
- 4) analyze and revise, if necessary, the terms of existing contracts (in particular, VAT provisions), and determine whether your price is exclusive, or inclusive, of VAT;
 - 5) assess the overall amount of tax burden to be increased, starting from 2021, if your company is not able to apply the new tax incentives.

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