

Moscow, August 3, 2016

Russia

Digital products and online services

Foreign suppliers have to pay VAT

On **03 July 2016** the president signed a law stating that foreign suppliers of internet services who provide consumer services (B2C) are required to create a tax-register and pay VAT on electronically supplied services in Russia. Furthermore, the rules for the place of performance of web services have been extensively reorganized, so that cross-border B2B services, for example, intragroup IT services, are affected by the changes. The law comes into effect on **1 January 2017**.

The existing legal framework

Until now Russian VAT applies when Russian companies provide electronic services, regardless of whether the buyer is a consumer or a company. VAT is not applicable, for example, on licenses for software and databases when a licensing agreement is concluded. However, if foreign companies offer digital products and services, the Russian tax authorities will only receive the VAT if the recipient is a company that removes the VAT via a reverse charge procedure. If a customer is a person, the state gets nothing, because a consumer cannot pay VAT via the reverse charge procedure. Thus, foreign suppliers enjoy a tax advantage for digital services for private clients as compared to the Russian party.

New rules

Subject to new regulations are digital products and services which are sold via the Internet. It concerns:

- Sales of software, e-books, photos, music, movies etc.
- Web hosting, server capacity and storage
- Information and data processing, provided electronically
- Database access
- Webdesign
- Online administration and remote maintenance of IT systems and programs
- Online games
- Digital marketing services, internet advertising
- Providing online trading platforms
- Social media services
- Search and directory services

The following transactions will be applied for digital products and services, and the general VAT rules will be also applied for:

- Distribution of goods and services on the internet (for example distribution of goods via Internet shops)
- Sales of software on the Internet, if the delivery of the software will be done via a data carrier
- Consulting services via email
- Internet access

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Since 2017 VAT is calculated based on where the services were rendered, i.e. depending on the recipient's place of residence (at the place of destination of the digital product or service). If the beneficiary is a Russian entrepreneur and service provider is a foreign supplier (B2B), the removal of the VAT reverse charge procedure will be carried out by the recipient. Existing contracts are to be checked to see whether the clause regarding VAT is still correct for 2017.

Example: for web hosting services the place of supply is currently the service provider, but in 2017 it will be the service recipient. If a Russian entrepreneur is supplying such services to a foreign beneficiary, the performance is currently burdened with Russian tax, but starting from 2017 they must be calculated without Russian VAT.

B2C business

The core of the new regulations is that digital products and services which will be provided by foreign suppliers to Russian consumers (B2C business), will be subject to VAT in Russia, and the foreign suppliers are obliged to be registered for VAT purposes, submit VAT returns and pay VAT to the Russian tax authorities.

The service is considered to be rendered to the Russian consumer, if he lives in Russia, paid for service with the Russian credit card or used a Russian IP address.

In contrast to the regular Russian VAT rate of 18%, a special rate of 15.25% will be applied on digital products and services supplied by foreign suppliers to Russian consumers. However, foreign suppliers are not authorized to make input tax deductions.

Mandatory registration of foreign companies

Affected foreign suppliers are obliged to register for VAT purposes. The registration procedure, intended to take place via the website of the Russian Tax Services, is currently being drafted. Registered companies must submit their VAT returns on a quarterly basis via a special login area on the website of the Russian Tax Services.

The measures that can be taken against foreign suppliers that fail to comply with the registration and payment of VAT is currently not clear. It would be conceivable that at least the blocking of the relevant websites and internet services may take place. Also, the OECD Convention on Mutual Administrative Assistance in Tax Matters, which Russia has ratified, provides for the enforcement of tax claims abroad. However, some countries have concerns about such enforcement of foreign tax claims, and some countries such as Germany have not yet ratified the Convention.

What to do?

The new rules of the place of performance for digital products and services has an impact on whether such services between Russian and foreign companies are to be calculated with or without VAT. Therefore, contracts for

internet services should be checked and adjusted if appropriate with effect from 1 January 2017. It should be noted that not only pure IT services, e.g. hosting or storage space in central data centers, may be affected, but even contracts for intermediary services (for example when booking portals), internet marketing or data processing with electronic transmission of the data may be affected.

Foreign companies which offer digital products and services to Russian consumers should consider tax registration in Russia and check in time, after notification of the registration process, the form in which the registration and subsequent filing of tax returns can be made. Typically, an adaptation of the IT systems for the identification of benefit receipt by Russian consumers will be necessary, as well as a change in final consumption prices for Russian customers.

SCHNEIDER GROUP is happy to offer assistance with

- Analysis and adaptation of contracts for digital products and services
- VAT registration and filing of tax returns
- IT support for compliance-oriented adaptation of your system

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