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Tax & Legal



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Windfall tax law: final edition

We have been keeping an eye on the new tax initiative since this February, when the Ministry of Finance first announced its plans to withdraw a part of big businesses' windfall profits generated thanks to the favourable market conditions.

The initiative has evolved since then: from a voluntary contribution and an increased income tax rate to a lump-sum mandatory tax payment.

On 4 August 2023, the [law](#) was signed by the Russian President.

We have already scrutinized the first reading version of the bill. Now we present an overview of the final edition.



A new tax type — lump-sum taxes

The [law](#) introducing a new type of charges — lump sum taxes — has not changed significantly from the first reading.

These taxes have the following common features:

- they are introduced by federal laws;
- a special procedure may be envisaged to determine the tax base;
- some of the mandatory taxation elements may be missing (for example, the windfall tax does not have a tax period).

In fact, the provisions of the law establish a legal basis for the windfall tax.

Many fear that the charging of lump-sum taxes will become a regular thing.

Apparently, once the procedure for charging extraordinary taxes has been tested, charging another tax will be easier, so a certain risk does exist.

Although the authorities were originally saying the windfall tax would be a one-off initiative, we now see a change in their rhetoric.

In a recent interview, Russia's Deputy Finance Minister Alexei Sazanov said that "the windfall tax may, hypothetically, be charged again in the future in case of high budget deficit and excess business profits."



Who are the payors?

The tax will have to be paid by Russian entities (including foreign entities having Russian tax residency) and foreign permanent establishments, whose average profit for 2021 and 2022 exceeded RUB 1 billion.

Regardless of the profit amount, exemption will be granted to:

- companies registered as small- and medium-sized businesses as at 31 December 2022;
- Russian entities established after 1 January 2021 (except those created via a reorganisation of companies incorporated before 1 January 2021);
- foreign companies that started operating in Russia via permanent establishments after 1 January 2021;
- companies that were paying the single agricultural tax continuously from 1 January 2018 through 31 December 2022;
- companies that had no sales proceeds in 2018-2019 determined in line with the tax accounting rules;
- credit and non-credit financial institutions that had been subject to bankruptcy prevention measures as at 1 January 2023;
- developers implementing housing projects using shared financing agreements and escrow accounts, provided that they did not pay dividends in 2021 and 2022.

The tax will not be charged on the following mining companies:

- entities producing hydrocarbons in 2022;
- organisations that were, as of 31 December 2022, registered as oil refiners, if in their excise tax calculations for 2022 the value of KdEMp (the 'fuel damper') was other than zero for at least six months;
- companies that in 2022 were members of the consolidated taxpayer groups (CGT) that in 2022 included organisations specified in Paragraphs 1 and/or 2 of this list;
- organisations that, as of 31 December 2022, were registered as oil refiners and had an effective contract for the provision of oil refining services with an organisation specified in Paragraphs 1 and/or 2 of this list;
- Russian entities being direct participants of the organisations specified in Paragraphs 1 and/or 2 of this list with an interest of at least 75 percent as of 31 December 2022;
- companies that produced coal in 2022;
- organisations engaged in the production of liquefied natural gas (LNG), if before 31 December 2022 they exported at least one batch of LNG under an exclusive gas export license.

According to the authorities, exemptions were granted as the tax burden for these companies is already high enough due to the additional mineral tax charges.



How will windfall profits be determined?

The tax will be charged on windfall profits calculated under the following formula:

2022 profit + 2021 profit

2

Profits will be determined as the sum of the CIT bases for the corresponding year (taking into account losses carried forward in accordance with the tax rules).

The following profits **will be excluded** from the calculation of windfall profits:

- CFC profits;
- dividends;
- proceeds from the sale of shares / participation interests, for which income tax is zeroed;
- profit of parties to special investment contracts (SPIC) signed with the Russian Government and taxed at a beneficial tax rate;
- income from certain securities enjoying beneficial tax rates;
- income received from multinational holding companies or by multinational holding companies enjoying beneficial tax rates;
- profit received by parties to investment encouragement and protection agreements (IEPA) from the underlying investment project(s).

The final version of the law clarifies an important issue pointed out by many businesses: How to determine windfall profits in case of further adjustments to prior period CIT, that is when a taxpayer files an amended CIT return or the tax authorities assess taxes after a tax audit? The answer is as follows:

- If the tax authorities make an additional assessment of profit tax that impacts profit used to calculate windfall tax, then, for the purposes of calculating windfall tax, the amount of profit for the corresponding period must be increased by the amount of such additional tax multiplied by five;

It is not entirely clear when exactly a taxpayer should adjust the windfall tax base.

For instance, the question remains as to whether a taxpayer is obliged to adjust the windfall tax liabilities if a tax audit has been completed but its findings are disputed.

Neither it is clear how to adjust windfall tax if a tax audit was completed after the windfall tax payment.

Does a taxpayer need to file an amended tax return? Will there be a penalty for underestimating the windfall tax base? Is a taxpayer required to adjust the windfall tax when a tax audit results become known in a later period (for example, in 2027 for the 2022 audit)?

2019 profit + 2018 profit

2

- If a taxpayer files an amended CIT return for 2021 and/or 2022, windfall profits must be determined taking such amended tax return into account.

It is not clear what a taxpayer should do if its income tax return was amended after the windfall tax had been paid.

This issue will be even more relevant if the taxpayer takes the opportunity to halve the tax by way of making a security deposit in 2023.

For instance, if windfall profits subsequently increase, the effective tax rate will be higher than 5% because the increase in windfall profits will always have to be taxed at a rate of 10%.

Therefore, we recommend double-checking the income tax returns for 2021 and 2022 before making a security deposit so that these returns do not have to be subsequently amended.

The final edition of the law contains another interesting nuance regarding the calculation of windfall profits.

In essence, if the amount of windfall profits is more than half of the 2022 profits **and** profit grew more slowly than assets (the ratio of the average profit for 2021-2022 to the average profit for 2018-2019 is less than the ratio of the average book value of assets as at the end of 2021 and 2022 to the average book value of assets as at the end of 2018 and 2019), windfall profits will be deemed to be equal to half of the 2022 profit.

This benefit will **not be available to** members of the consolidated taxpayer groups (CGT), credit and non-credit financial institutions, as well as organisations that have allocated their profit for 2021 and/or 2022.

If interpreted literally, the exception from exemptions refers to the distribution of profits **for** 2021 and/or 2022, and not **in** 2021 and/or 2022.

It is not entirely clear whether the distribution of profits for 2021 and/or 2022 in subsequent periods (after the payment of the windfall tax) will require an adjustment of the tax under the general formula.

Please note the nuances of calculating the windfall tax:

- the CIT base will be used; therefore, if a company is loss-making, the tax base will be deemed to be zeroed and the taxpayer will be unable to fully offset the losses received in one period against the profit of another period;

- the exemption is granted only to the companies that did not report any sales proceeds in 2018 and 2019; therefore, the companies that reported any (even insignificant) sales revenue in 2018 or 2019 will not be exempt;
- businesses normally taxed at lower rates (IT, health, residents of advanced development territories and special economies zones) will not be exempt;
- the windfall tax cannot be expensed;
- a full deduction in 2022 of exchange losses without adjusting for a positive exchange effect on the same foreign exchange assets/liabilities may lead to an underestimation of the 2022 taxable profit and, as a result, to a miscalculation of the windfall tax.

For clarity, we outline the windfall profits calculation procedure in the table on the right.

| Scenario | Calculation of windfall profits |
|---|--|
| Average profit for 2022 and 2021 < RUB 1 billion | Windfall profits = 0 |
| Average profit for 2022 and 2021 < average profit for 2018 and 2019 | Windfall profits = 0 |
| Average profit for 2022 and 2021 > average profit for 2018 and 2019 | Windfall profits = average profit for 2022 and 2021 – average profit for 2018 and 2019 |
| Average profit for 2022 and 2021 – average profit for 2018 and 2019 > half of the profit for 2022 and Average profit for 2022 and 2021 / average profit for 2018 and 2019 < average book value of assets as at the end of 2021 and 2022 / average book value of assets as at the end of 2018 and 2019 and No distribution of profit for 2021 and/or 2022. | Windfall profit = half of the profit for 2022 |

Calculation of windfall profits in case of restructuring

In the event of restructuring, the average profit for the periods preceding the restructuring is determined as follows:

- in case of a merger, based on the data of merged entities;
- in case of a split up, based on the data of the reorganised entity whose assets are transferred to a

newly created organisation, in a pre-agreed proportion

- in case of an acquisition, based on the acquired entity's data;
- in case of a reorganisation, based on the data of the reorganised organisation.

How will the tax be calculated for members of consolidated taxpayer groups?

The law sets the following rules for the CGT members:

- the tax base is determined for the CGT as a whole;
- the tax base is determined by a company that in 2022 was the CGT's responsible taxpayer;
- the tax base is determined by the CGT's responsible payor with regard to the companies being members

of the CGT as of 31 December 2022;

- such companies must provide the responsible taxpayer with the information necessary to calculate the tax.

At what rate will the tax be paid?

The tax will be charged at a rate of 10 percent; a sort of a discount will be available for the early payment of tax (by way of making a security deposit): the tax can be reduced by the amount of deposit transferred in October— November 2023.

The deduction will be limited at 50 percent of the tax amount.

Effective from the tax payment deadline (28 January 2024) the same security deposit will be counted towards the payment of the tax.

Thus, the effective tax rate in case the tax is actually paid in 2023 (via a security deposit) can be five percent.

However, in the event of a full or partial return of the security deposit based on the taxpayer's request submitted before the tax payment deadline (28 January 2024), the tax deduction will be zeroed.

This mechanism of discounting tax rates for early payment is a brand-new taxation approach which is why some taxpayers are worried how it would work in practice.

Also, even after some technical amendments

introduced in the final version, the law is still somewhat ambiguous on the terms of the proposed security deposit scheme.

For instance, if the windfall tax base is adjusted following adjustments to income tax, "the amount of the security deposit, for the purpose of calculating the tax deduction, is reduced by the amount recognised as a single tax payment in connection with the taxpayer's request to refund the overpaid tax."

This rule is not quite clear and may require application guidance.



When will the tax be paid and filed?

The tax will have to be paid by 28 January 2024.

At the same time, as we noted above, the amount of the security deposit made in October— November 2023 will be counted towards the payment of the tax.

The tax will be fully paid to the federal budget.

The tax return will have to be filed by 25 January 2024.

[A draft windfall tax return](#) has been already developed.

The draft contains only three pages.

Taxpayers will have to report:

- the profits for 2018, 2019, 2021 and 2022;
- the amount of security deposit and the details of the respective payment document;

- the average book value of assets as at the end of 2018 and 2019 and the average book value of assets as at the end of 2021 and 2022 (if the taxpayer intends to apply the provisions that allow calculating the tax using the tax base not exceeding half of the 2022 profit).

In addition to introducing a draft CIT form, the law suggests to approve its completion and filing procedure.

The tax return is not required from the taxpayers whose assessed tax amount is zero, i.e., when:

- the average profit for 2021 and 2022 does not exceed the average profit for 2018 and 2019;
- the average profit for 2021 and 2022 does not exceed RUB 1 billion.

We recommend assessing the potential impact of the law on your tax burden.

In view of the guidance on how to account for further adjustments to the CIT base, we also recommend reviewing tax records for 2021 and 2022 before a security deposit is made and filing amended tax returns if necessary.

Our team will be happy to assist you with reviewing CIT returns for 2021 and 2022, analysing disputable positions and (if necessary) preparing amended CIT returns and liaising with the tax authorities.

Please feel free to contact us should you have any questions.

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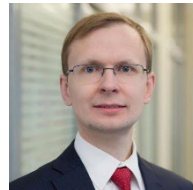
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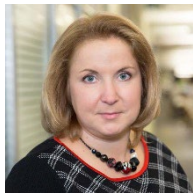
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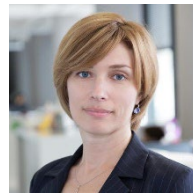
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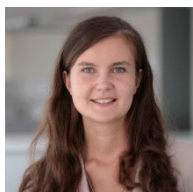
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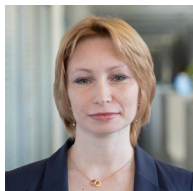
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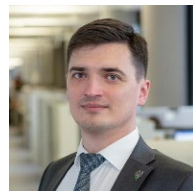
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