Amendment to Russian personal income tax legislation

12/10/2020 TAX, RUSSIA

Andrey Morozov

A number of amendments were (or will be) introduced to the Charter 23 "On personal income tax" of the Tax Code of the Russian Federation.

Russian authorities have always been proud to claim that Russian personal income tax is one of the lowest in Europe. A typical example of this is the tax rate for residents, which is flat and equal to only 13%.

Some foreigners were willing to comply with Russian criteria of tax residency (i.e., actual presence in the territory of Russia for a period at least 183 calendar days during consecutive 12 months), in order to become Russian tax resident and pay personal income tax in Russia. However, some of the changes can decrease this attractiveness.

1. ***Tax residency***

   As a general rule, according to Russian tax legislation, an individual may be considered to be Russian tax resident, if he is actually located in the territory of the Russian Federation for at least 183 days during 12 months. Special rules are established for military personnel, state officials, etc.

   The amendments[1] provide that an individual, who during the period from 1 January to 31 December 2020, is actually located in the Russian Federation for a period ranging from 90 to 182 calendar days (inclusive), may be recognized to be a tax resident of the Russian Federation in 2020, if such individual submits to the tax authorities an application to this effect. The application must contain the surname, first name, patronymic

[1] The Federal law dated 31.07.2020 N 265-FZ, applicable starting from 01.01.2020.

name (if any) and identification number of the individual and must be submitted to the tax authorities within the time period provided for submitting a tax return on personal income tax for the tax period of 2020, i.e. before 30 April 2021.

The new rule is obviously advantageous for taxpayers, because it allows some taxpayers in certain situation to obtain Russian tax residency at their own discretion.

Nevertheless, it is worth remembering that double tax treaties between Russia and other countries ordinarily provide for application of standard OECD tie-breaker rules, such as ‘permanent home’, ‘economic relations’, ‘habitual abode’, ‘nationality’, rather than term of presence on the territory of relevant state.

Therefore, in situation, when

a) an individual complies with the above criteria, i.e. (i) presence in Russia for at least 90 calendar days and (ii) submitting an application to authorities),
b) he/she is also recognized as tax resident of another country on the basis of its domestic tax legislation,
c) Russia and such another country entered into double tax treaty (drafted according to OECD Model Tax Convention),

then such an individual shall likely be considered as tax resident of another country due to the abovementioned tie-breaker rules.

2. *Tax rate*

On 23 June 2020 the President of the Russian Federation in his speech to the citizens of Russia announced the introduction of progressive tax rates of personal income tax.

Starting from 1 January 2021 the rate of the Russian personal income tax is supposed to be increased from 13% to 15%. The increased rate (15%) is to be applied to the income exceeding 5 million rubles per tax year (i.e., approx. USD 64,000). The amounts of income below said amount shall still be subject to the 13% tax rate.

The proposed amendments were popularly dubbed as the ‘tax on the rich’.

The President claimed that additional amounts of the tax collected (estimated as 60 billion rubles) would be used for specific purposes, such as treatment of children with rare serious diseases, purchase of expensive medicines, rehabilitation facilities, as well as high-tech operations.

In fact, the idea to introduce a progressive personal income tax rate was in the air for quite some time. The supporters usually referred to the experience of foreign countries and ideas of social justice, whereas its opponents pointed out to the risks that: (a) a progressive tax rate would only result in the departure of wages "into the shadows” and total evasion of the taxation, and (b) the income from the introduction of the progressive scale would be ‘eaten up’ by the increased costs of its administration.

The fact that the progressive rate is higher than the standard rate by only 2% may be seen as some kind of compromise, especially in the light of the abovementioned noble goals for the use of the additional amounts of tax.

So far the amendments were not duly approved by the Russian Parliament and only exist in the form of a draft law (the project No. 1022669-7, submitted to the State Duma on 17.09.2020). However, taking into account the facts that the need for such amendments was declared by the President and the project already received positive opinions from various committees, it has very high chances to be adopted as law.
It seems that in the future further changes in the progressive scale may be expected, such as the introduction

of new additional rates, revision of the thresholds of income taxable at different rates.

3. *Taxation of interests.*

A number of changes to the taxation on interest were introduced into the Russian tax code by the Federal law No. 102-FZ of 01.04.2020 and will come into force starting from 1 January 2021.

The legislator cancelled the exemption from taxation of interests (coupon, discount) on bonds of Russian companies denominated in rubles and issued after 1 January 2017. It is worth mentioning that currently interests on bonds of Russian companies are subject to personal income tax only in the amount exceeding the key rate of the Russian Central bank increased by 5%. Starting from 27 July 2020 the key rate is equal to 4.25% [according to the Informative message of the Russian Central Bank dated 24 July 2020]. Therefore, currently interests below 9.25% are exempt from Russian personal income tax.

This means that nowadays (until 31.12.2020) only interests paid on bonds without credit rating (so-called 'junk bonds') at 12-13% are actually taxed.

The amount of interests exceeding the exempt amount is subject to 35% personal income tax.

A similar approach is currently used to calculate the exempt amounts of interests paid on deposit in banks:

- interests on deposits (in rubles) are exempt within the amount calculated at the key rate of the Russian Central Bank increased by 5% (i.e. currently 9.25%), and
- interests on deposits in foreign currency are exempt within the amount calculated at 9%.

Since banks pay interests on deposits in rubles at 5% (on average), individuals are actually not obliged to pay personal income tax on such interests.

Starting from 1 January 2021 this situation will change. The exempt amount of interests will be calculated as follows:

EI = TaD x KR, where,

- EI is the exempt amount of interests,
- TaD is the total amount of deposits (including money on bank accounts) in banks located in the territory of Russia, but in any case no more than 1 mil. rubles,
- KR is the key rate of the Russian Central bank at 1st day of the tax period in which interests are calculated.

Assuming that the key rate is not be changed and at 1 January 2021 will still be equal to 4.25%, the amount of interests, which may be exempt from tax, will be equal to 42,500 rubles. The amount of interests exceeding the exempt amount, calculated as described above, shall be subject to personal income tax at the rate of 13% (or 15%).

The above rules shall not be applied to:

(i) interest calculated on deposit in rubles (including money on bank accounts) at rate, which does not exceed 1% during the entire tax period of deposit, and
(ii) interests calculated on escrow account.

Such interests are not taken into account for calculation of the tax base.

The personal income tax on interests is to be calculated by the Tax Authorities on the basis of information, which banks shall report to Tax Authorities no later than 1 February of the year following the relevant tax period.

Taxpayers are expected to pay the tax on interests on deposits in banks no later than on 1 December of the year following the relevant tax period.

The tax shall be paid on the basis of a tax notification sent by the tax authorities.

* * *

The above amendments will certainly lead to an increase of the tax income of the Russian State (and of the tax burden for taxpayers). It can be argued that probably the timing for introducing these changes was not that appropriate. In fact, these changes could be the direct result of Covid-19 and the need of the Russian State authorities to find additional resources to finance public expenditures. Nevertheless, even with the increased tax rate and amended rules of calculation of tax base, the Russian personal income taxation may still be considered as relatively low and thus attractive for foreigners.

Andrey Morozov
ASSOCIATE

a.morozov@dejalex.com
+7 495 792 54 92
Ulitsa Bolshaya Ordynka 37/4
119017 – MOSCOW

MILANO
Via San Paolo, 7 · 20121 Milano, Italia
T. +39 02 72554.1 · F. +39 02 72554.400
milan@dejalex.com

ROMA
Via Vincenzo Bellini, 24 · 00198 Roma, Italia
T. +39 06 809154.1 · F. +39 06 809154.44
rome@dejalex.com

BRUXELLES
Chaussée de La Hulpe 187 · 1170 Bruxelles, Belgique
T. +32 (0)26455670 · F. +32 (0)27420138
brussels@dejalex.com

MOSCOW
Ulitsa Bolshaya Ordynka 37/4 · 119017, Moscow, Russia
T. +7 495 792 54 92 · F. +7 495 792 54 93
moscow@dejalex.com