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Self-Regulating Organisations and Their Members: Tax Aspects

What is the position of the Russian Ministry of Finance in the absence of concrete provisions of the Russian Tax Code?

In the framework of the Russian business liberalisation policy, an important reform is the introduction of self-regulating organisations (“SROs”) in specific sectors of the economy to replace the previous license-based regulation systems. The largest experiment in this area is making the construction business a self-regulating one, but self-regulation is also actively used in other sectors, including auditors’, appraisers’ and energy auditors’ activities. The SRO reform is thought to be developing rather successfully, however, there are some major problems.

It is noteworthy that the SRO reform affects only the legal part of the activities of companies involved in self-regulated sectors; the tax aspects are not affected. This means that the general rules of the Russian Tax Code should apply to the costs and profits of the SROs’ members and SROs’ themselves. However, the Russian reality clearly demonstrates that the general provisions of the tax legislation may be interpreted rather differently. Therefore, it is absolutely essential to take into account the official position of the Russian Ministry of Finance when forming the tax strategy of a company in order to minimise the risk of disputes with the tax authorities.

In the sphere of SRO’s, the Ministry of Finance has already demonstrated in Letters issued over the last few months a consistent position on various aspects of the activities of SRO’s and their members. In the present Tax Outlook we explore the opinion of the Ministry on several aspects of the reform which are subject to dispute (i.e. tax treatment of both SRO’s and their members).

Tax aspects for SROs’ members

In the first section of the present Tax Outlook, we cover two main issues which may be important for companies/members of SRO’s: tax treatment of certain costs relating to participation in SRO’s and the necessity to notify the tax authorities of membership in an SRO.

(i) *Tax treatment of fees paid by SROs’ members*

Participation in an SRO usually entails payment by its members of three types of fees: entrance, regular membership and contributions paid to the compensatory fund¹ of an SRO. Thus, the central question for companies participating in SRO’s is whether the said fees are deductible for the purposes of corporate profits tax.

As a general rule (article 270 (4) of the Russian Tax Code), fees and contributions paid to non-commercial organisations and international organisations are not deductible for profits tax purposes. However, article 264 (1.29) of the Tax Code establishes an exception to the general rule and stipulates that **“other expenses relating to production and realisation” which are deductible for profits tax purposes include**, among others, **“fees, contributions and other obligatory payments paid to non-commercial organisations if their payment is an essential condition of realising certain types of activities by the taxpayers effectuating such payments”**.

¹ A compensatory fund serves as a financial guarantee of good standing of the SROs’ members. This fund is intended to secure secondary liability incurred by the SRO for any damage caused by defects in the works completed by its members.

According to the official opinion stated by the Russian Ministry of Finance², this last provision may be applied to the participation fees of SRO members. For example, according to the Russian City Planning Code, in order to be allowed to partake in surveying, designing or construction activities a company is obliged to receive an admission certificate. Such certificates may be issued solely by the relevant SRO's to their members. This means that membership in an SRO is an obligatory condition for companies involved in such types of activities.

The same conclusions may be applied to auditors, appraisers, court-appointed receivers, energy auditors and some other activities. Thus, the participation costs borne by members of the relevant SRO's fall under the criteria of article 264 (1.29) of the Russian Tax Code and, therefore, should be deductible for profits tax purposes.

Additionally, please note that **if a taxpayer enters an SRO on a voluntary basis** (e.g. SROs for companies involved in advertising activities), **relevant costs are not deductible for profits tax purposes**³.

Notwithstanding the above, even if relevant costs of an SRO member are deductible, it is obligatory in each particular case to prove the economic justification of the participation expenses (i.e. that the costs were incurred in the interest of the relevant company) and to document them properly. In this context, if it is rather simple to justify the fees relating to participation in an SRO (e.g. companies are obliged to take part in SROs in order to be allowed to conduct certain types of activities), the documentation of such fees may still cause practical difficulties as it is not clear which documents may be used to prove such fees have been incurred.

The Russian Ministry of Finance in its recent Letter⁴ stated that the following documents are considered suitable to prove participation costs incurred by an SRO member:

- copies of certificates of membership of an SRO;
- payment orders for the bank transfer of fees; and
- invoices and other documents issued by the relevant SRO (if any).

(ii) *Notifications to tax authorities*

According to article 23 (2) of the Tax Code, companies are obliged to notify the tax authorities of all cases of participation in Russian and foreign organisations. On the basis of this legislative provision, the Russian Ministry of Finance⁵ considers that it is **obligatory for all members of SRO's to notify tax inspection departments of such participation** in writing within 1 month of the commencement of the participation. The forms of such notifications are established by a special Decree of the Federal Tax Service.

Please note that non-compliance with the obligation to notify the tax authorities entails a penalty in the amount of RUR 200 (approx. EUR 9.50).

² See, for instance: Letters of 22 July 2010 No. 03-03-05/150, of 10 August 2010 No. 03-03-06/4/75, of 22 September 2010 No. 03-03-06/1/608.

³ See Letter of the Russian Ministry of Finance of 22 September 2010 No. 03-03-06/1/608.

⁴ Of 10 August 2010 No. 03-03-06/4/75.

⁵ Letters of 17 July 2009 No. 03—02-07/1-369, of 10 August 2010 No. 03-03-06/4/75.

Tax treatment of certain SROs' profits

In the second section of the present Tax Outlook, we review the tax treatment of profits received by SRO's, including participation fees and income received from investment of compensatory fund proceeds.

(i) *Taxation of entrance, membership fees and contributions to the compensatory fund received by SROs*

According to article 251 (2) of the Russian Tax Code, special purpose proceeds (such as non-commercial organisations admission fees and regular membership fees which are aimed at the maintenance of activities of such organisations and are made in accordance with Russian law) shall not be taken into account when determining the profits tax base.

On the basis of this provision, we can conclude that **entrance and membership fees received by SRO's from their members are not taxable.**

As for the contributions to the compensatory fund of an SRO, the Russian Ministry of Finance, in its recent Letter⁶, indicated that as, firstly, Russian law does not expressly define the term "non-commercial organisation admission fees" and, secondly, the payment of fees to the compensatory fund is a mandatory condition for joining an SRO, **fees payable by the members of an SRO to its compensatory fund** which are used for the maintenance of activities of such SRO shall be regarded as a part of the respective SRO admission fees and **shall not be treated as taxable profit of such SRO.**

The Ministry of Finance has further clarified that taxpayers which obtain special purpose proceeds are obliged to keep a separate account for revenues (costs) obtained (incurred) by such taxpayers.

(ii) *Taxation of profit received from the investment of the proceeds of a compensatory fund of an SRO*

As a general rule, SRO's are entitled to use the proceeds forming their compensatory funds by investing them. The profits obtained from the disposal and investment of such proceeds should be used, as a general rule, to supplement the relevant funds. Therefore, the main issue arising in this respect is whether the profits tax is imposed on the proceeds in question.

According to the position of the Russian Ministry of Finance⁷, article 251 of the Tax Code in its entirety provides for a comprehensive list of income which should not be taken into account when determining the profits tax base. This means that proceeds obtained by non-commercial organisations which are not listed in the said article (including proceeds obtained from placement of monetary funds at bank accounts or share investment) are **subject to profits tax.**

⁶ Of 10 August 2010 No. 03-03-06/4/75.

⁷ Of 10 August 2010 No. 03-03-06/4/75; of 10 September 2010 No. 03-03-06/4/87.

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- Assistance in negotiations with the Russian tax authorities, to achieve early tax settlements and resolve pending issues; and
- Representation of your company in disputes with the tax authorities.



If you have any questions on the matters referred to in this **RUSSIA TAX OUTLOOK**, please do not hesitate to contact Dominique Tissot, Partner, or Anastasia Prozor, Associate, or your regular contact at CMS, Russia.

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