Tax Flash Report

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On replacing from 2010 UST with insurance contributions

Two draft federal laws[1], with the aim to replace the Unified Social Tax with insurance contributions to separate pension, social and medical insurances from 2010, were submitted to the State Duma on 30 April. The first reading of the draft laws in State Duma is scheduled for the beginning of June.

The legislative amendments under review, initiated and submitted by the Russian Government, have the support of the Chairman of the Russian Government. In light of this, there is a strong chance that the draft laws will be adopted within the planned deadline—regardless of some opinions being voiced that, during the present economic downturn, such radical measures are ill-timed.

Background and main aims of the legislative initiative

A system of compulsory payments made as contributions to various social funds was first set up in Russia in the early 1990s and continued to exist until it was replaced in 2001 by the Unified Social Tax (UST). The current proposals are essentially a return to the former situation. However, today's changes are taking place within a completely different state pension fund scheme. The requirements of this scheme, which is also being permanently reformed, have brought about the need to make the proposed amendments to the legislation. The declared purpose of the amendments is, in particular, to improve the financial circumstances of pensioners.

The proposed amendments will also enable allowances for temporary disability, maternity leave and childcare to be increased.

Along with reducing the tax burden on the payroll, the following reasons were cited as being key for replacing the insurance contributions of the1990's by the UST 9 years ago: the need to unify tax bases for assessing contributions to various funds, reducing the number of supervisory authorities and the relevant reporting. It is clear that those responsible for developing today's draft laws attempted as far as possible to take into account the disadvantages inherent in a system that requires that a number of mandatory payments are made—not just one.

As for the question regarding reducing the tax burden on a payroll, this problem is currently not being tackled. The Government is only offering to ease to some extent the transition to the new system.

1. Draft laws "On Insurance Contributions to the Russian Pension Fund, Social Insurance Fund and Mandatory Health Insurance Funds" and "On Amendments to Certain Legal Acts of the Russian Federation and Revoking Certain Legislative Acts (Provisions of Legislative Acts) of the Russian Federation in connection with the Adoption of the Federal Law "On Insurance Contributions to the Russian Pension Fund, the Russian Social Insurance Fund and Mandatory Health Insurance Funds".

Key provisions of the draft laws

The draft laws, if passed in their current form, will set a ceiling to be used for the assessment and payment of insurance contributions in relation to an individual's income. The assessment rates will not be regressive, but will be flat. It is proposed that in 2010 the ceiling for calculating contributions will be set at RUB 415,000 pa, and the assessment rates will remain at their current maximum rates set for UST (the first regression threshold), that is, 26%. From 2011 the overall assessment rate will reach 34%, and the ceiling will be adjusted according to an annual index.

One tax base will be established for contributions to all funds.

The provisions of the draft law relating to the following key elements for the new insurance contribution system, in particular,

- The payers
- Tax base
- Assessment procedures
- Reporting periods
- Timeframes for making contribution payments

generally coincide with the relevant provisions of Chapter 24 of the "Unified Social Tax" of the Russian Tax Code.

The following provisions are completely new:

- The draft law does not exclude from the tax base payments that are non-deductible for profits tax purposes;
- Salaries and other forms of remuneration made to foreign nationals temporarily residing in Russia under employment and civil law contracts will be exempt from insurance contributions taxation.

There are no plans to apply the current UST reliefs for certain organisations under the new insurance contributions regime. At the same time, the draft laws provide for maintaining beneficial rates of insurance contributions for a specific period of time for certain categories of payers.

Penalties for violating the legislation on insurance contributions are generally the same as those provided in the Tax Code for corresponding violations.

Control over the assessment and payment of insurance contributions to mandatory pension and medical insurance will be the responsibility of the pension fund; control over social insurance contributions will rest with the social insurance fund. That said, these agencies will be authorised (with some restrictions) to act as a tax authority.

The amount of reporting that the payers of contributions will be required to submit to the authorities controlling the payment of insurance contributions does not substantially differ from the amount of reporting currently submitted by UST payers.

Implications of adopting the draft laws

Beginning in 2010, the tax burden on the payroll will increase for a considerable number of organisations. The tax burden will remain at the same level in relation to an employee whose annual earnings does not exceed RUB 280,000. For those companies that employ a large number of expatriate or well-paid Russian employees, the tax burden on the payroll may even be reduced. For example, in 2010 the employer will pay less "social taxes" than in 2009 if the annual earnings of an employee exceeds RUB 755,000. Employers should take these factors into account when assessing their staff related expenses in order to plan and draw up their budgets accordingly for 2010 and subsequent years.

Another important factor that should be taken into account is that the administrative burden on businesses may potentially increase, as a result of granting the powers of the tax authorities to the pension fund and the social insurance fund. It is expected that the number of inspectors and inspections will increase and that this will require additional efforts on a company's respective subdivisions.

We plan to carry out a more detailed analysis of the implications of the legislative amendments when the respective draft laws are passed by legislative bodies.

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