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Companies set to enjoy new tax benefits for intellectual property

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Introduction

In early April 2022, Parliament adopted a law to create VAT exemptions for the transfer of exclusive rights to:

- inventions;
- utility models;
- industrial designs;
- integrated circuit topographies;
- know-how under a franchise agreement; and
- the use of the results of intellectual activity based on a franchise agreement.

Such exemptions will apply only if a fee for the transfer of exclusive rights to the above IP items is allocated in the franchise agreement price.

VAT exemptions

The need to make such changes is caused by the government's intent to support companies that scale up their businesses using the franchise model and to remove uncertainty in the legal regulation of transactions in the transfer of IP rights within franchise relations.

Russian tax legislation has long included a provision on VAT exemptions of the assignment of rights to the above items. However, until recently, there has not been any complete regulation on whether this exemption may be extended to franchise transactions.

A franchise agreement is specified in the Civil Code as an independent type of agreement, although it contains the mandatory elements of a licence. Thus, in accordance with article 1027 of the Civil Code, a franchise agreement stipulates that only the rights holder (ie, the franchisor) has the ability to grant another party (ie, the franchisee) access to their exclusive rights. This includes the right to a trademark or a service mark and the rights to other subject matters that the agreement sets out – in particular, trading names and know-how. Therefore, a franchisee can obtain various IP items for use under a franchise agreement.

Under this new law, the key items that will not be VAT-exempt are trademarks and service marks. This has given rise to a problem of the use of tax benefits, particularly where the royalties under the franchise agreement have been set out as a single amount for the entire scope of rights granted. Under national tax legislation, there is a provision in clause 4 of article 149 of the Tax Code that a VAT exemption may be used only when keeping separate records of taxable transactions and transactions that are exempt from that tax. Thus, when determining the total royalties for all rights transferred under the franchise agreement, such an exemption from VAT could not apply.

However, even when the parties to the franchise agreement have shared the total royalties for certain types of IP items, taxpayers could have conflicts with the tax authorities when trying to apply a previously effective exemption from VAT. In the opinion of the tax authorities, the wording of the previously effective provision of the Tax Code stipulated that a benefit could be used only where the rights had been granted under a licence agreement but not under a franchise agreement. The newly adopted law removes this uncertainty and contains an express provision that will prevent VAT assessments of transactions in the above IP items and when transferring rights to them under franchise agreements.

Comment

The new rules will become effective on 1 July 2022 – that is, the first day of the new VAT tax period. However, as mentioned, the benefit may be used only if a fee for the transfer of exclusive rights to the exempt IP items is allocated in the franchise agreement price. In this regard, parties to franchise relations in Russia that plan to use this benefit should revise the financial terms and conditions of the franchise agreements and to divide a royalty rate into various items of the rights granted.

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