

Keeping track

Eastern Europe, Russia and Central Asia Alert

We are pleased to send you the Eastern Europe, Russia and Central Asia Alert prepared by PwC Switzerland in cooperation with PwC firms in the region. In this issue, we report on the key developments taking place in CEE/CIS recently.

Should you be interested in additional information on the developments covered in this issue, please contact your usual PwC client service leader or any of those listed on the last two pages.

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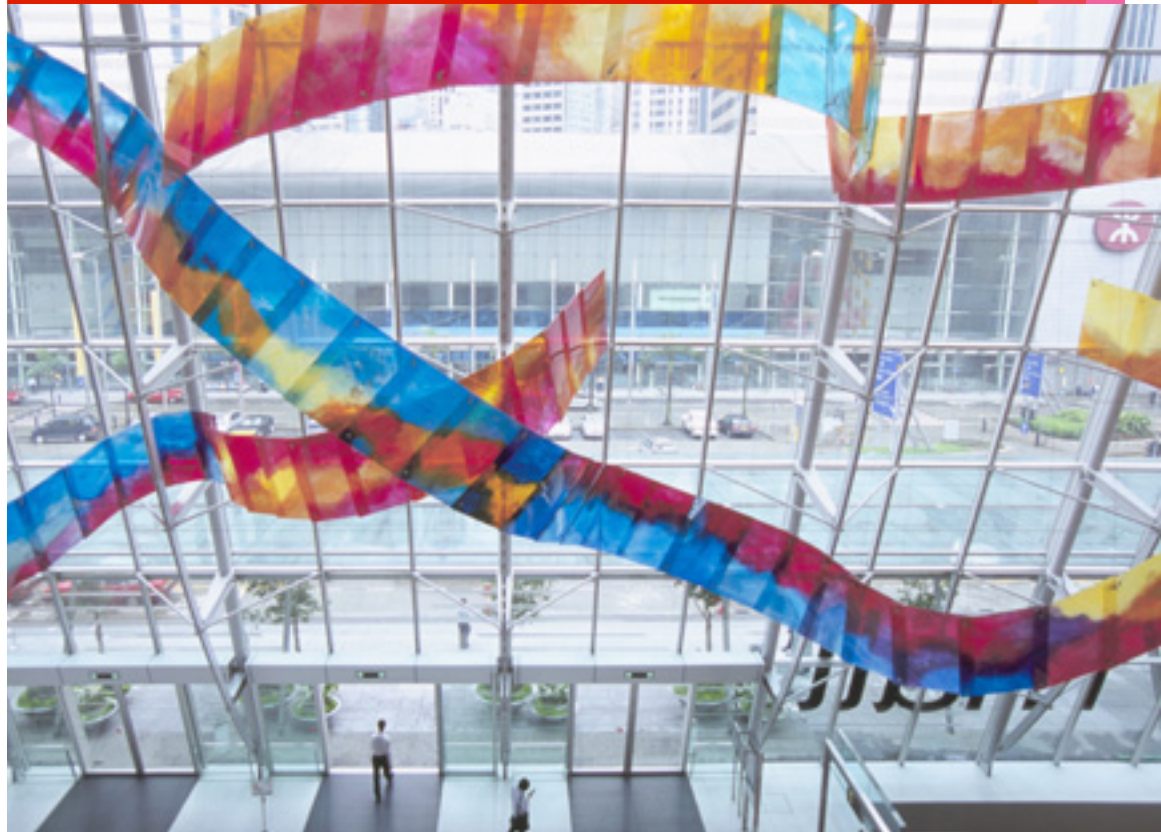


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Bulgaria

Amendments to Corporate Income Tax Act

The Bulgarian Parliament recently adopted amendments to the Corporate income tax act (CITA) most of which will enter into force on 1 January 2011.

Implementation of the EU Interest and Royalties Directive

As of 1 January 2011 Bulgaria will reduce the withholding tax on interest and royalties payable to affiliated EU entities from 10% to 5%. This amendment follows the implementation of the EU Interest and Royalties Directive into local tax legislation. 5% withholding tax would apply for income payable to an EU entity which has held at least 25% of the shares in the local payer for at least 2 years. The same applies if the local entity has held at least 25% of the shares in the EU recipient of the income for at least 2 years. Also, the 5% withholding tax would be applicable if a third EU entity has owned at least 25% of the shares in both the Bulgarian payer and the EU recipient of the income for at least 2 years.

The preferential regime does not apply in cases of profit participation loans, hidden distribution of profits, tax evasion schemes, non-deductible expenses of a local permanent establishment or expenses of a local permanent establishment of a non EU based resident. The Interest and Royalties Directive should be fully implemented as of 1 January 2015 allowing for full exemption from withholding tax on interest and royalties payable to affiliated EU entities.

Broader anti-avoidance rules for income payable to entities in low-tax jurisdictions

As of 1 January 2011 any fees for services and use of rights (in addition to technical services fees and royalties) accrued to entities in low-tax jurisdictions would attract 10% Bulgarian withholding tax unless there is proof of the effective provision of the supply. Subject to 10% withholding tax would also be any accruals for penalties or damages payments to entities in low-tax jurisdictions except for insurance compensations.

The CITA introduces a list of low-tax jurisdictions. These are certain off-shore territories which are explicitly listed, as well as countries with which Bulgaria has not signed a Double Tax Treaty and in which the applicable corporate tax rates are more than 60% lower than the applicable rate in Bulgaria.

Withholding tax obligation for local entities accruing rentals to non-residents

In cases where local companies accrue income for rent and other usage of real estate to non-resident entities, the withholding tax should be withheld and paid to the budget by the resident payers of the income. Until the end of 2010 the payment obligation rested with the non-resident recipient of the income.

Correction of errors related to determination of the taxable result

Errors related to determining of the taxable result should be corrected by recalculating prior years' taxable results as if the error had never occurred. This treatment is currently applicable for correction of accounting errors only.

Correction of errors related to tax depreciable assets

Accounting errors related to tax depreciable assets would be amended by correcting the prior years' taxable results under applicable rules at that time as if the error had never occurred.

Under the 2010 rules it is not possible to amend the values of the assets in the tax depreciation plan in case of accounting errors except for technical mistakes.

Assets distributed as dividends

As of 1 January 2011 assets distributed as dividends would be deemed realised at market values and the related capital gains would be regarded as taxable income.

All temporary tax differences related to those assets would crystallise upon the distribution.

Alternative taxation for shipping activities

As of 1 January 2011 the criteria to apply the alternative tax on shipping activities will be relaxed for the business of managing ships. The treatment for operating own or hired ships will be generally preserved.

Under the new rules, in order to apply the special tax regime for ship management activities at least half of the administrative personnel onshore or ship's crew should be EU/EEA resident persons. Under 2010 rules the ship's crew should have been comprised of wholly EU/EEA residents. Also, the new rules require that at least 2/3 of the total tonnage of the ships should be operated by EU/EEA resident companies. No such requirement is in place as per 2010 rules.

Comments

The amendments in CITA do not substantially affect the existing tax framework. The implementation of the Interest and Royalties Directive into local legislation will allow additional opportunities for withholding tax relief on intra-group

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payments of royalties and interest. Any relations with entities in low-tax jurisdictions need to be reviewed in terms of sufficient documentary support with respect to the application of the broader anti-avoidance rules.

Amendments to Local Taxes and Fees Act

The Bulgarian Parliament recently adopted amendments to the Local Taxes and Fees Act (LTFA) the main provisions of which will enter into force on 1 January 2011.

Increase of the maximum rate of real estate tax

As of 1 January 2011 the maximum real estate tax that could be levied by the municipalities is 0.45% of the tax value of the property (0.25% until end of 2010). The exact rate should be determined by the respective municipality in which the real estate is located.

Changes in the terms for payment of real estate tax and vehicle tax

The annual real estate tax will be payable in two instalments – from 1 March to 30 June and by 30 October, instead in four instalments as per 2010 rules. There is also a change in the terms for payment of vehicle tax instalments. The first instalment shall be payable between 1 March and 30 April (currently the term is by 31 March), while second instalment shall be payable by 30 October

(currently the term is 30 September). Discount of 5% is retained for payments of the whole amount of annual real estate tax and vehicle tax if made by 30 April.

Introduction of a tourist tax

A tourist tax is introduced replacing the tourist fee. The tourist tax will be levied with respect to the number of nights spent in hotels and other places for accommodation. The municipalities may determine the tax within a range of BGN 0.20 – BGN 3 per night depending on type of accommodation facility.

The tax shall be payable on a monthly basis by 15th of the following month. The legislation introduces a minimum annual tax calculated at 30% occupancy of the respective accommodation facility. The number of beds shall be declared by end of February 2011.

Transfer of vehicles

The sellers of vehicles should provide to the notaries a certificate from the municipality that the due vehicle tax has been paid. Based on 2010 rules the sellers provide only a declaration for lack of outstanding vehicle tax liabilities.

Increase of penalties

The penalties for not filing a declaration for acquisition or change of value of real estate are increased from BGN 100 – BGN 1,000 to BGN 500- BGN 3,000.

Timeframe for adoption of 2011 levies

The municipalities shall determine the rates for annual real estate tax and garbage collection fees for 2011 by 31 January 2011. If no decision has been taken by that date, the 2010 rate for annual real estate tax shall apply and the 2011 garbage collection fees shall be equal to the amounts due for 2010. The tourist tax shall be determined by 31 January 2011. For January 2011 the tourist tax shall be payable within a range of BGN 0.60 – BGN 1 per night.

Comments

The main amendments to LTFA relate to increase of the maximum annual real estate tax and introduction of a tourist tax. This may increase the tax burden payable by real estate and hotel owners.

Amendments to Personal Income Tax Act

The Bulgarian Parliament adopted recently amendments to the Personal income tax act (PITA) which will enter into force on 1 January 2011.

Broader anti-avoidance rules for income payable to residents in low-tax jurisdictions

Similarly to the amendments in the Corporate income tax act (CITA), as of 1 January 2011 any fees for services and use of rights accrued to resident individuals of low-tax jurisdictions would attract 10% Bulgarian withholding tax unless there is proof of the actual provision of the supply. Subject to 10% withholding tax would also be any accruals for penalties or damages payments to entities in low-tax jurisdictions except for insurance compensations. A list of the low-tax jurisdictions for the purposes of the above taxes is included in CITA.

New compliance requirements for payers of rental income

Bulgarian entities and freelancers who pay rental income to individuals are obliged to withhold the due advance taxes upon payment of the income. The tax is remitted on a monthly basis. Under the 2010 rule, it was the obligation of the recipient of

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the income to remit the advance taxes due on a quarterly basis. The payers of rental income are also obliged to issue an income statement to the recipient (a sample will be published by the revenue authorities) reflecting the amount of the income paid and the amount of the advance tax withheld.

New requirements for payers of income from other sources

Payers of income from other sources are obliged to issue an income statement (a sample will be available) to individuals who receive such income.

New administrative penalties

Recipients of income from other economic activity and rental income who do not meet their existing obligation to issue a document for the amount of income received would be subject to a penalty from BGN 100 to BGN 500. A second breach would be penalised at the amount from BGN 200 to BGN 1,000.

Comments

There are no significant amendments in the personal income taxation. The new rules are generally intended to tighten the control over tax collection and the regime for issuing statements for payment and receipt of income.

Amendments to Tax and Social Security Procedures Code

The Bulgarian Parliament recently adopted amendments to the Tax and social securities procedures code (TSSPC) which will enter into force on 1 January 2011.

Implementation of a definition for “beneficial owner” of the income

As of 1 January 2011 TSSPC introduces a definition of a “beneficial owner” of income for the purposes of application of a tax treaty relief. As per the definition a foreign entity is a beneficial owner of the income when:

- a) It has the right to dispose of the income and has discretion over its use and bears the whole or a significant part of the risk of the activity from which the income is realised; and
- b) Does not act as a conduit company.

TSSPC provides that a conduit company is a company which is controlled by persons who would not benefit from the same type and amount of exemption if the income was realised directly by them and it does not carry out any economic activity except for owning and/or administering the rights or the assets from which the income was realised and the company:

- a) Does not own assets, capital or personnel corresponding to its economic activity; or
- b) Does not control the use of the rights or assets from which the income was realised.

A foreign resident would not be regarded as a conduit company when more than half of its voting shares are traded on a registered stock exchange.

Comments

The newly introduced definition for beneficial owner is very restrictive and it may lead to disallowance of treaty relief for companies without personnel, major assets or those operating under back to back relations. In this respect we would suggest revisiting the grounds for tax treaty application cases with a risk profile in terms of the newly introduced requirements.

Amendments to the VAT legislation

The Bulgarian Parliament recently adopted amendments to the VAT Act (VATA) most of which will enter into force on 1 January 2011.

According to these amendments companies will now be able to claim refund of the VAT charged in 2009 in another Member State until 31 March 2011.

Services related to cultural, artistic, sporting, scientific, educational, entertainment or similar events

The place of taxation of services related to cultural, artistic, sporting, scientific, educational, entertainment or similar events (such as fairs and exhibitions) will be shifted to the country where the customer is established, when the services are rendered to a taxable person.

The current rule for the taxation of such services, i.e. that they are taxable where the event takes place, will continue to apply to:

- Services in respect of admission to the above events (granting access by tickets or other payment, including when the access is granted under subscription) and services ancillary to the admission services when they are rendered to a taxable person; and
- All services related to the above events rendered to a non-taxable person. The above is in accordance with the amendments in the EU VAT Directive that must be implemented in the national legislations of the EU countries by 1 January 2011.

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Supplies of natural gas and electricity, heating and refrigeration energy

The specific regime for taxation of the supply of natural gas would cover imports and supplies of gas through any natural gas system. From 1 January 2011 the above specific rules will also apply to heating and refrigeration energy supplied respectively via heating or cooling networks. The rules generally require that the supply is taxable at the place of the recipient being a trader of such goods, or the place of consumption – in other cases.

Taxation of hotel accommodation

From 1 April 2011 the reduced VAT rate of 7% applicable to hotel accommodation will be increased to 9%. The reduced VAT rate will apply not only to hotel accommodation, where it is a part of a package tour organised by a tour operator or a travel agent, but also to accommodation provided directly by a hotelier to a customer.

Self-billing

With the option for self-billing to be introduced from 1 January 2011 the Bulgarian VAT Act will explicitly provide for the possibility for recipients of supplies of goods/ services to issue invoices or debit/ credit notes in the name and for the account of their supplier. This option could be applied provided that the supplier is a taxable person and that the parties have agreed in writing for this in advance. The terms and procedures for the acceptance of each invoice by the supplier will be defined in the Regulations for application of the VAT Act, which have not been adopted yet.

Taxation of import of goods

The following amendments regarding the import of goods will be introduced:

- Additional requirements for the exemption from VAT on the import of goods that will be subject to a subsequent supply to another EU country – the importer should provide his Bulgarian VAT identification number, as well as the VAT identification number (issued in another EU country) of the customer to whom the goods will be further supplied;
- Additional clarifications are made regarding the types of goods qualifying for exemption from customs duties that are also exempt from VAT upon their final importation in Bulgaria.

Mandatory electronic submission of the VIES declarations (EC Sales Lists)

Electronic submission of the VAT declaration, sales and purchase ledgers becomes mandatory when a VIES declaration needs to be submitted for the respective tax period.

Taxable base for barter transactions

From 1 January 2011 the taxable base for barter transactions will be calculated based on the open market value of the goods or services supplied as at the date on which VAT became chargeable (as it was under the VAT Act effective until 31 December 2009). Currently the taxable base for barter transactions is calculated based on the open market value of the goods or services received. For barter transactions for which the tax event of the earlier of the two supplies has occurred before 31 December 2010, and the tax event of the second supply occurs after this date, the new rules for determining the taxable base will apply to the second supply.

Granting of concession right becomes VAT-able

As of 1 January 2011 the granting of concession rights for construction, for services or for extraction will be treated as a taxable supply for state and local bodies (under the rules applicable until the end of 2010 such granting was outside the scope of VAT). For concession contracts signed before 1 January 2011 it will be considered that VAT is not included in an agreed concession fee.

Supplies related to international transport

As of 1 January 2012 the scope of the supplies related to international transport, subject to zero VAT rate, will be extended to include air traffic management services and air navigation services provided to aircraft used by an aviation operator performing mainly international flights. The definition of these services is provided in the supplementary provisions of the VAT Act.

Extension of the period for filing refund claims for VAT paid in other EU countries in 2009

The extension of the period for filing claims for refund of VAT by six months, i.e. until 31 March 2011, refers only to VAT charged in 2009 (for future years the deadline will remain 30 September of the year following the calendar year in which VAT has been charged) and applies retroactively as of 1 October 2010. The standard procedures as set in Ordinance No H-9 shall apply.

Comments

The above amendments to VATA are relatively minor and will not have a significant impact on the VAT compliance of most companies. Most of them are intended to harmonise the Bulgarian VAT legislation with the provisions of the EU Directives and to comply with decisions of the Court of the European Union.

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Amendments to the Excise Duty and Tax Warehouses Act

The Bulgarian Parliament recently adopted amendments to the Excise Duty and Tax Warehouses Act (EDTWA) which will enter into force on 1 January 2011.

Excise duty chargeability

As of 1 January 2011 rules on the chargeability of excise duty in cases of irregularities occurring in the course of cross-border movements of excisable goods will be introduced. The new provisions determine the country which will be entitled to collect the excise duty in cases where the goods dispatched from one Member State to another do not reach their designated destination. The rules generally follow the provisions of the EU legislation.

Exemptions and refunds

From the beginning of 2011 excisable goods under duty suspension would be scrapped under a special procedure to be further envisaged in the Regulation for the application of the EDTWA. As regards the refund of unduly paid excise duty, the Government dropped its initial idea to prolong the term for taking a decision on refund claims. However, as of 1 January 2011, excise duty claimed for refund will be off-settable against any outstanding public liability subject to collection by the Customs Agency (not only against excise duty due to the budget as it is currently).

Place of direct delivery

As of 2011 licensed tax warehouse keepers will be allowed to receive excisable goods at a place of direct delivery not only from a tax warehouse located in another Member State but also from local tax warehouses.

Changes in the form of banderols

New rules in the cases of changes in the statutory form of the banderols will take effect as of the beginning of 2011. The new rules provide for a possibility for taxable persons to have an inventory of goods sealed with the new sample banderol as at the date of its entry into force. Banderols from the new sample may be ordered and goods may be sealed with such banderols (respectively stored) in the tax warehouse 3-months prior to the effective date of the change. Consequently, to enable companies to arrange for the scrapping of excisable goods sealed with expired banderols (as their release for consumption is prohibited) the new rules provide for another 3 months as of the date of entering into force of the new sample banderol in which the goods labelled with the old banderol may be stored in the tax warehouse.

Excise duty increases

As of 1 January 2011 there will be increases in the excise duty rates applicable for unleaded gasoline and petrol with and without bio content, as well as kerosene. There will be an increase in the excise duty taxation also for tobacco. If you would like to receive details about the specific rates, please address such queries to us. In accordance with the latest changes in the EU legislation on taxation of tobacco and tobacco products, there will be changes in the rules on the taxable base for cigarettes depending on their length (without the filter). As a result of the changes the excise duty due for some types of cigarettes will be increased (i.e. affecting their sales price).

Specific rules for penalties in case of settlement

Also, in respect of the excise duty compliance the law will now provide for minimum administrative sanctions to be levied in the cases of administrative penalty procedures settled with an agreement. The minimum amount of the sanction will depend on whether the administrative offence has been committed repeatedly.

Comments

The changes in the excise duty legislation to be introduced effective as of 1 January 2011 are mainly related to the provision of detailed rules for existing regimes and/or procedures or implement existing EU rules in the local excise duty legislation.

Estonia

Tax treaties with Albania, South Korea and Serbia have become effective as of 2011

As of 1 January 2011 the treaties with Albania, South Korea and Serbia are effective bringing the total count of effective Estonian tax treaties to 47. Treaty with Albania was concluded on 5 April 2010 and entered into force on 25 November 2010. The treaty generally limits withholding taxes:

- (a) On dividends to 5% provided that the shareholder is a company holding directly 10% of the capital of the company paying the dividends and 10% in all other cases;
- (b) On interest to 5%;
- (c) On license fees to 5%.

Treaty with South Korea was concluded on 23 September 2009 and entered into force on 25 May 2010. The treaty generally limits withholding taxes:

- (a) On dividends to 5% provided that the shareholder is a company holding directly 25% of the capital of the company paying the dividends and 10% in all other cases;
- (b) On interest to 10%;
- (c) On license fees to 5% on the payments for the use of industrial, commercial and scientific equipment and 10% in all other cases.

Treaty with Serbia was concluded on 24 September 2009 and entered into force on 14 June 2010. The treaty generally limits withholding taxes:

- (a) On dividends to 5% provided that the shareholder is a company holding directly 25% of the capital of the company paying the dividends and 10% in all other cases;
- (b) On interest to 10%;
- (c) On license fees to 5% on royalties for the use of, or right to use any copyright of literary, artistic or scientific work including cinematographic films. Any other royalties, including payments for the use of, or right to use any industrial, commercial, and scientific equipment and computer software may be subject to withholding tax of 10%.

The rules for determination of the value of fringe benefit

On 13 January 2011 the Minister of Finance adopted a regulation “on the rules for determination of the value of fringe benefit”. The regulation replaces the former regulation from 29 December 1999 and is applied retroactively from 1 January 2011.

The regulation does not introduce any material changes, but mainly attempts to reorganize the structure of the earlier regulation. Due to the amendments in the Income Tax Act, the new provision in the regulation deals with the taxation of employer’s stock options. The provision provides that if the fringe benefit consists of the gains received from the alienation of the stock option itself, the value of the fringe benefit will be the difference between the market value of the stock option and the premium paid to the employer for the stock option. If the fringe benefit consists of the income received from the exercise of the stock option, the value of the fringe benefit will be the difference between the market value and the effective exercise price, out of which the premium paid to the employer is deducted.

The guidelines for the use of investment account

As of 1 January 2011 the individuals are entitled to create a separate investment account for tax purposes. Transferring certain securities and financial assets to such investment account would allow individuals to defer their tax liability on income or gains on such assets until the moment the gains are withdrawn from the investment account. Ministry of Finance has issued guidelines on their website explaining the nature and the use of the investment account.

The guidelines on taxation of non-residents in 2011

Tax and Customs Board has issued guidelines dealing with the tax treatment of non-residents in 2011. Guidelines (in English) are available at: <http://www.emta.ee/index.php?id=1759>.

Hungary

New international tax treaties

Parliament has ratified three new tax treaties.

Act CXXIX of 2010 enacted the agreement between the Government of the Republic of Hungary and the Government of the Hong Kong Special Administrative Region of the People's Republic of China for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 12 May 2010.

Through Act CXXXIII of 2010, Parliament promulgated the agreement between the Hungarian Trade Office in Taipei and the Taipei Representative Office in Hungary for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 19 April 2010.

Finally, the Act CXXXII of 2010 promulgated the convention between the Republic of Hungary and the Republic of San Marino for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed in Rome on 15 September 2010.

The agreements with Hong Kong and Taipei are considered important steps in the improvement of business relationships with the Far East.

With these new agreements, Hungary has now expanded the number of countries with which it has signed tax treaties to 67.

Changes to the taxation of benefits in kind from 2011

From 2011, as a general rule, noncash benefits will be treated as income subject to consolidation and will be taxed according to the legal relationship between the provider and the recipient of the benefit (unless otherwise provided by law). Accordingly, in an employment relationship, non-cash benefits will have to be treated as income from normal employment, which will create a significant administrative burden for the provider.

As private individual recipients will be required to include non-cash benefits in their annual tax returns, an income certificate will have to be issued on the benefits concerned. In addition, special rules are in place on the deduction of tax advances, and different administrative procedures will have to be followed depending on whether a given benefit is provided by the employer or the payer. This may be problematic in cases in which the payer does not have all of the information (e.g. tax number) required to carry out payroll functions.

Such benefits include:

- Benefits provided by the employer to certain employees on the basis of internal policies (e.g. previous cafeteria and non-cafeteria items);
- Expensive business gifts (whose value exceeds 25% of the statutory minimum wage);
- Gifts provided in sales promotions, competitions, or prize draws (e.g. a home cinema system offered as a prize in an advertising campaign);
- Services provided to secondees (e.g. related to the schooling of children, relocation, etc.);
- Gifts whose value exceeds 10% of the minimum wage (e.g. gifts provided in recognition of a particular event such as women's day, the birth of a child, employee service anniversaries, etc.);
- Supporting participation in a medical conference;
- Employee discounts on the employer's products, in accordance with internal policies;
- Sports benefits (gym memberships, supporting the company football team, etc.);
- Passenger services (home travel for secondees and their relatives, school bus services, taxi fare to employees who work overtime, etc.);
- Holiday assistance (discounted accommodation at a resort not owned by the employer).

As a result of the above changes, payers are advised to carefully consider the range of benefits specifically covered by the legislation (and on which they will be liable to pay taxes), and which of the benefits will be taxed as income subject to consolidation, as the latter will result in additional tax and administrative burdens.

Payers will also have to decide whether they wish to take on their employees' tax obligations on the benefits provided, and make sure that this practice is in accordance with the applicable regulations.

Social security agreement with Russia in force

On 19 January 2011, the Agreement on cooperation in the field of social security between the Republic of Latvia Republic and the Russian Federation came into force. The Agreement sets out the rules relating to pensions and social security benefits, as well as provides for a possibility to keep the status of a socially insured person in the home country (Latvia or Russia), while temporarily working in the other country (Russia or Latvia, respectively).

Regulated areas

The Agreement applies to the areas governed by the Latvian and Russian legislation on social security benefits and mandatory (national) social insurance, including:

1) In the Russian Federation:

- Temporary sickness (incapacity) benefits and maternity benefits;
- Unemployment benefits;
- Death grants;
- Old age, disability, survivors' pensions;
- Benefits related to accidents at work or occupational diseases;
- Benefits for families with children;
- Social pensions.

2) In the Republic of Latvia:

- Sickness and maternity benefits;
- Unemployment benefits;
- Death grants;
- Age, disability, survivors' pensions, services pensions for individuals employed in certain professions;
- Insurance claims (cash value) related to accidents at work, occupational disease or death, caused by the aforementioned reasons;
- Benefits for families with children;
- State social security benefits;
- One-off benefits to the surviving spouse of a deceased pensioner.

Under the Agreement, the nationals of one country to the Agreement who reside in the territory of the other country to the Agreement must be entitled to the same rights and subject to the same obligations as the nationals of the other country to the Agreement.

The Agreement also provides for exceptions: the above-mentioned does not apply to the procedure under which the Latvian insurance periods prior to 1 January 1991 are calculated for the nationals of the Republic of Latvia.

When relocating to the other country, the first country nationals will continue to receive old-age pension (social pension), the premium payments on old age pensions (Latvia), social pensions (Russia), benefits due to accident at work or occupational disease, except for state social security benefits, from the country which granted the benefit or pension. That is, if a pension retired in Latvia, upon relocating to Russia, the person will continue to receive the pension from the Latvia.

Social insurance contributions

The rules on social insurance contributions under the Agreement are similar to those of the European Community Regulation No. 883/2004: social insurance contributions are generally due in the country in which the person carries out his employment duties.

The general rule applies to the employees employed by transport companies. Under the Agreement, where the employees carry out their employment in both the countries, social insurance contributions are due in the country of the incorporation of the company (employer).

The Agreement provides for a number of exceptions. For example, if a Latvian employer assigns their employees to Russia to carry out the employment activities there for a term not exceeding 2 years, social insurance contributions for employees will still need to be made in Latvia. The Agreement provides for an option to extend the duration of the above posting (assignment) term for 1 year.

According to the information provided by the International Services Division of the National Social Insurance Agency (VSIA), there is currently no guidance on the practical implementation of this exception. It is most likely that, on a case by case basis, after having examined a particular case, VSIA will issue a statement confirming that the holder thereof is subject to the Latvian law.

Sickness and maternity benefits

Under the Agreement, to establish the right of an individual to sickness (temporary incapacity) benefits and maternity benefits, and to determine the amount of the benefit, the insurance (work) periods accumulated in both the countries will be aggregated, except for in the cases where the insurance periods overlap.

In addition, sickness (temporary incapacity) benefits and maternity benefits will be granted and paid out under the law and from the financial means of the country, to the laws of which the insured person was subject during his employment.

Albeit good news, it is, however, unclear how the above piece of legislation will be implemented in practice. For example, if a person assigned to work in Russia gets sick there and gets treatment at a hospital in Russia, will the person be able to claim his sickness benefit, given that the benefit is granted on the basis of a sickness form B issued by a Latvian physician?

Latvia

Pensions

When establishing an individual's entitlement to a statutory pension, and transferring (converting) the entitlement to pension under the laws of the Russian Federation, the insurance periods accumulated in both the contracting states are taken into account except where the insurance periods overlap.

If under the laws of one contracting state a person is entitled to a pension without taking into account the insurance periods accumulated in the other state, the former state is obliged to provide pension on the basis of the insurance periods accumulated therein. Thus, if the insurance period accumulated in Latvia is sufficient for the purposes of the application of Latvian law, the Latvian competent authorities have to take into account only the insurance periods accumulated in Latvia.

The insurance period is calculated and approved under the laws of the state providing the pension.

Under the Agreement, where the total amount of old age, invalidity and survivors' pensions awarded and due for payment is lower than the that of the statutory minimum pension (in Russia – lower than the basic occupational pension, and in statutory cases the aggregate amount of the basic pension and its contributory part) in the contracting state in whose territory the person resides, that state is obliged to compensate for the difference pursuant to its national law:

- In Latvia, being the amount falling short of the minimum pension, before coefficients;
- In Russia, being the amount falling short of the occupational basic pension, and in statutory instances – falling short of the sum of the basic pension and its contributory part.

Unemployment benefits

Latvia finds itself in a less favourable position with regard to unemployment benefits, because under the Agreement the insurance periods accumulated in both the contracting states are to be taken into account when determining the individual's entitlement to unemployment benefit except if the insurance periods overlap.

The Agreement is silent on the insurance periods for the purposes of the Russian unemployment benefit.

Individuals lose their unemployment status and their entitlement to unemployment benefits as of the day they permanently relocate to reside in the other state. The awarding of unemployment status and entitlement to unemployment benefit are determined under the laws of the state of the individual's residence.

If either of the contracting calculates the amount of unemployment benefit by reference to the individual's average monthly earnings, however, the insurance periods as provided for by the laws of both the states are insufficient, the unemployment benefit is calculated as follows:

- In Latvia, on the basis of a double national social security benefit;
- In Russia, on the basis of an amount which is not lower than the statutory minimum unemployment benefit.

Cooperation of competent authorities

The Agreement requires cooperation between the competent authorities of the contracting states. An interesting observation, it will be considered that any application for the provision or review of a pension or benefit, filed under the laws of one contracting state will be considered to have been filed under the laws of the other contracting state, too. Also, any application or claim filed to the competent authority of one contracting state within statutory deadlines is deemed to have been filed to the competent authority of the other contracting state within statutory deadlines.

The documents issued for the purposes of social security and mandatory national social insurance in either of the contracting states do not require legalisation or any other kind of authentication. The individuals are not released from the obligation to provide translated documents.

Furthermore, under the transitional provisions of the Agreement the pensions provided before the enactment of the Agreement can be subject to a review upon the individual's request. The review must not result in a lower pension than that before the review. In addition, the insurance periods can be taken into account for the purposes of the pension, provided the other state has not provided pension in respect for these periods.

Completing the corporate income tax return for 2010

Interest expense deduction

There are new restrictions on the amount of deductible interest expense on loans from Latvian residents other than banks or insurance companies. The amount of deductible interest on loans from financial institutions must be determined using only the first method of calculation provided for in the CIT Act. The Cabinet Regulation No. 556 "On application of the provisions of the corporate income tax act" provides a further clarification that the taxable income must be increased by the greater of the two amounts in instances where non-deductible interest expense is determined due to thin capitalization rules and due to transfer pricing rules.

Undistributed profits

The taxable income may be reduced by a notional interest expense which the company would have paid on a loan equalling the amount of the company's prior year undistributed profits (made after 2009). The applicable interest rate in this case is 5.05%, based on the economic indicators for 2010, i.e. the weighted average interest rate on loans in Latvia issued to domestic non-financial companies.

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Assignments of debt

Unlike in prior years, when any losses arising on assignments of debt were taxable, from 2010 onwards such losses are deductible, upon fulfilling certain conditions.

Use of cars

Provided personal income tax has been paid and mandatory national insurance contributions have been made in respect of the use of the cars for private purposes, fuel expenses related to these cars are deductible for corporate income tax purposes, subject to a limit in fuel consumption rates per 100 kilometres as determined by the employer, provided the fuel consumption deviation falls within 20% of the city cycle consumption rate as determined by the manufacturer of the particular car.

Leasehold improvements

If the lease agreement is terminated before its term expires on account of more than 30% reduction in the lessee's revenues or profits from the leased premises or due to the circumstances beyond the control of the lessee, the latter is eligible to reduce his taxable income by the entire book value of the fixed asset reconstruction costs in the tax period in which the lease agreement is terminated. The above does not apply if the lease agreement is terminated upon the lessor's initiative.

Representation expenses

The taxable income may be reduced by 40% of the amount of the company's representation expenses instead of 60% previously. Beware that the tax return form still refers to the old percentage.

Non-business expenses

When calculating the taxable income, the factor of 1.5 must be applied to the following positions in the CIT return:

- Non-business expenses (the factor is not applied to the amounts donated to public charities, in respect to which the taxpayer uses a CIT relief);
- Losses related to the maintenance of social infrastructure objects.

Transfer pricing adjustments

There are a number of significant changes regarding transfer pricing adjustments. A Latvian company may reduce its taxable income by the difference in transfer prices provided its related company (resident in Latvia, EU/EEA country or in the country with which Latvia has an effective double tax treaty) has adjusted its taxable income by a transfer pricing difference.

Payments to the EU/EEA residents (dividends, interest, royalties)

Under the new requirements of the CIT Act, the Latvian company must avail itself to the statement issued by the tax authorities of the respective foreign state confirming the recipient's compliance with legal requirements under Parts 11 and 12 of Article 3 of the CIT Act. To mitigate a lot of issues related to the above statement, the CIT Act now clarifies that if the tax authorities of the recipient's country do not issue a separate statement, then it is possible to use the certificate of residence form together with a written confirmation by the authorized representative of the recipient of dividends, interest or payment for intellectual property in the recipient's to the State Revenue Service, supporting that the recipient of income has fulfilled other requirements provided for in the law.

Tax arrears

When preparing CIT return, in some cases, it is important for the company to double check non-existence of tax debts. Under Cabinet Regulation, if the taxpayer has adjusted the CIT return for prior tax years resulting in additional tax liability, and remitted the additional tax liability and associated interest to the tax authorities, no tax debt is considered to exist.

We would like to draw your attention to the fact that the new rules relating to doubtful debt provisions and adjustments for the debt not settled in time, will apply from 2011 to 2013.

Deductibility of input VAT

On 2 December 2010, the European Court of Justice (ECJ) ruled in the case of C-438/09 that the right to deduct input VAT exists also in a situation when an invoice with VAT on taxable supplies is issued by a person which is not registered for VAT purposes, albeit the person was required to register. It can therefore be concluded that the provisions of the Latvian VAT Act restricting the right to deduct input VAT charged in an invoice by a person not registered for VAT purposes, are not in line with the ECJ practice and the provisions of the EC Council Directive 77/388/EEC (Council Directive 2006/112/EC since 28 November 2006). The Latvian VAT payers are advised to ascertain if the State Revenue Stated has refused their right to deduct input VAT in similar circumstances in the past 3 years, and consider applying for a tax refund.

Amendments to VAT Act: tax representative

In the beginning of 2011 the amendments to the Value Added Tax Act (VAT Act) were enacted, one of the major changes being the introduction of the notion of a tax representative. This and subsequent articles will deal in more detail on how Latvian VAT payers can obtain the status of a tax representative, on VAT rate applicable to the transactions performed by tax representatives, as well as on VAT saving opportunities stemming from optimising the arrangement of cross-border supply of goods.

Tax representative

Under VAT Act, a tax representative is a taxable person established in Latvia, who, on the basis of a written agreement, represents the taxable person of another European Union (EU) Member State or a person of a third country, and is the person liable for the payment of VAT to the Latvian tax authorities in respect of the transactions listed below:

- Importation of goods and a further supply (transportation) of the goods to another EU Member State,
- Importation of goods with a further supply (transportation) of the goods within the Latvian customs territory (inland),
- Acquisition of goods within the EU territory for the purpose of re-exporting the goods (transporting outside the EU territory) and
- Receipt of goods inland for further re-export.

Tax representatives are obliged to comply with the legislation governing VAT and excise tax (for excise goods).

Registration of tax representatives

To be eligible to act as a tax representative, the Latvian VAT payer is required to register in the Register of VAT Payers with the State Revenue Service (SRS) and obtain a separate registration number as a tax representative. The VAT payer must meet seven statutory criteria before the registration will be effected. The key criteria are:

1. The VAT payer applying for the registration as a tax representative must have been engaged in a continued business activity for at least two years prior to the application date;
2. The VAT payer does not have tax arrears on the day of submitting the registration application, or tax payment deadlines have been extended pursuant to the procedure prescribed for in the tax law,

3. The applicant (an individual or a legal entity) seeking a tax representative status has not been convicted for fraud, falsification of documents, tax evasion or other illegal offences which can impact the calculation of the tax liability,
4. The VAT payer has a history of submitting tax returns, reports and other information requested by the SRS within the statutory deadlines, and is a user of the Electronic Declaration System with the SRS,
5. The VAT payer submits a confirmation regarding his ability to meet the potential tax liability.

Confirmation on the ability to meet tax liability

Availing oneself to the above confirmation can prove to be a serious obstacle hindering the registration as a tax representative.

The following documents may serve as the confirmation:

- A confirmation issued by the bank supporting that the trader has cash savings in his bank deposit account for the purpose of carrying out the activities of a tax representative, or
- The confirmation issued by the bank (or an insurance company) on a guarantee for meeting the potential tax liabilities of the tax representative.

The taxpayer's savings in his deposit account must be at least 10,000 LVL on the date of registration, and at least 20% of the average total value of taxable transactions reported by the tax representative for the past three tax periods (months), however, not less than 10,000 LVL, during the time the trader carries out the activities of a tax representative.

Instead of making saving for a potential tax liability in his deposit account, the trader may negotiate a guarantee agreement with a credit institution or an insurance company. In such a case, the tax representative is required to submit the confirmations of the credit institution or insurance company regarding the guarantee for the tax representative's activities. The value of the guarantee must be at least 200,000 LVL.

The traders who are already using bank or insurance company guarantees to secure their business activities (for example, for the operation of customs or excise goods warehouses, or customs brokerage operations) should note that a further guarantee will be required for them to be eligible to carry out the activities of a tax representative.

There are currently no guidelines on the procedure of submitting, accounting for and waiving of the guarantees. The Ministry of Finance officials justify such an approach by the need to first gather relevant information on practical implementation issues from businesses, and thereafter develop additional legislation aimed at resolving the practical issues.

The next article will deal with the VAT rates applicable to the transactions carried out by a tax representative: acquisitions and supplies of goods.

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Transactions and their disclosure in VAT return

A taxable person who has also obtained the VAT number as a tax representative, is required to file two VAT returns, one return in respect of the transactions carried out in his capacity as a taxable person and another in respect of the transactions carried out in the capacity of a foreign person's tax representative.

In the tax representative's VAT return, the transactions carried out by the tax representative who has a VAT number must be reported, such as transportation of imported goods to another EU Member State and transportation (supply) of such goods in the Latvian customs territory, EU customs territory, and exports of the goods acquired inland, exports of goods provided a special tax regime is being applied.

For VAT reporting purposes, the tax representative should use the customary VAT return form and its appendices, and additionally prepare the statement PVN 7 to report the value of goods received, exported and stored in the customs or excise warehouses at the end of the reporting period in a particular tax period (month).

As the customary VAT return form should be used for reporting, there are no major differences in its completion procedure, except that the tax representative is not required to complete Part II of the form PVN 1 of the VAT return.

The tax period for tax representatives is one calendar month, thus, he must submit both his VAT returns on or before the 20 day following the end of the reporting month.

Importation of goods intended for transportation to another EU Member State

Under Article 33 of the VAT Act, 0% VAT rate is applied to the goods cleared by the tax representative into free circulation within Community territory, provided these goods without being subject to any alteration are transported (dispatched) to another EU Member State within 30 calendar days of the date the goods are cleared into free circulation, to a person who has a valid VAT number in the relevant Member State.

Importation of goods for supply of the goods in the Latvian customs territory

If the tax representative, fulfilling the order of the possessor of the goods, clears the goods into free circulation in the Community territory with a view to sell them inland, VAT exemption on importation of the goods only applies if the tax representative has obtained an approval from SRS for the application of a special tax regime on imports of goods pursuant to Article 12.3 of VAT Act and the related Cabinet regulations.

In the tax representative's VAT return, the calculated VAT must be reported as output tax and input tax.

If the goods have been cleared into free circulation for the purpose of selling them in Latvia, the tax representative issues a tax invoice in its name to the buyer of the goods, and reports VAT chargeable on the supply of the goods in the tax representative's VAT return.

Intra-community acquisitions for exportation

Under Part 10 of Article 28 of VAT Act, the tax representative applies 0% VAT rate on intra - Community acquisitions of goods. A mandatory prerequisite for the application of 0% VAT rate in the above case is placement of the goods in a customs or excise warehouse.

Acquisition of goods must not be reported in the tax representative's VAT return, nor is he required to complete Part II of the form PVN1 of the VAT return in respect of these transactions. The tax representative, however, must report exports of the goods in his own VAT return.

Receipt of goods in the Latvian customs territory intended for exportation

Similarly as described above, 0% VAT rate applies to inland supply of goods to the tax representative, provided the goods have been transported into a customs or excise warehouse for the purpose of their exportation, i.e. removal from the Community territory. The vendor of goods, however, must be able to provide documentary evidence that the sold goods had been placed in the customs warehouse or excise warehouse for the purpose of subsequent exportation. The vendor of goods is required to report such transactions in row 43 of his VAT return.

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Amendments to the Law on Personal Income Tax (PIT)

On 11 December 2010 amendments to the Law on PIT came into force. The essential amendments are related to the changes of main definitions, PIT rates, certain conditions applied for non-taxable income and the peculiarities in the taxation scheme of individual activities.

Starting from 2010 the definition of individual activities is changed – it no longer includes income from rent and sale of immovable property. Thus, the taxpayers who registered the individual activity of rent or sale of immovable property in 2010 will be obliged to declare income as derived from the rent or sale of immovable property but not as derived from the individual activity.

On 7 January 2011 by letter the Tax Authorities provided explanation on the taxation of income derived from individual activities in 2010 and further tax years.

Moreover, the new definition of “free profession” is established which is one of the types of the individual activities and includes the activities of accountants, tax consultants, architects, engineers, psychologists, etc.

When calculating and declaring the income derived from individual activities in 2010, the new PIT rate of 5% will be applied except for the income derived from free professions and sale of securities.

Furthermore, the opportunity to reduce the income by bad debts is included in the taxation scheme of the individual activities.

The condition for non-taxable income derived from the sale of immovable property is expanded to the 5-year period being in ownership prior to the sale if the property is acquired after 1 January 2011. When the immovable property is acquired before this date, the relief of 3 years will be applied. Moreover, the list of individuals from who a gift granted would not be taxable is expanded – it additionally includes gifts from grandchildren.

According to the amendments to the Law on PIT, on 30 December 2010 by Order the rules on completing of FormGPM308 were updated.

Amendments to the Law on Real Estate Tax

On 23 November 2010 amendments to the Law on Real Estate Tax were adopted.

Amendments establish that real estate tax on real estate purchased under a contract of financial lease (leasing) has to be paid and exemptions of real estate tax may be used by the

person who purchased such real estate but not by the formal owner (leasing company), provided that information about appropriate contract is registered with the Real Estate Register.

Moreover, terms of tax assessment were changed. Real estate tax is not assessed from the month when ownership rights to the real estate are transferred, when the rights to obtainable real estate are transferred or lost or when the estate is rever-sionary. Individuals also do not assess this tax from the month when the rights to the real estate are transferred or when they ended using estate for economic or individual activities.

Amendments establish that when a municipality board does not establish a tax rate for the next tax period in time or establishes it after the deadline, the tax rate of 0,3% is applied in such a municipality.

Companies that have an obligation to pay real estate tax for the purchase of real estate from 1 January 2011 are allowed not to pay advance real estate tax for such real estate for the tax period of 2011.

These amendments took effect from 1 January 2011.

New maps indicating taxable values of land and buildings announced

On 4 January 2011 the Tax Authorities informed that from 1 January 2011 new maps indicating taxable values of land and buildings came into force and new taxable values were established for real estate valued according to the massive assessment method. The new taxable values will be applicable for 2011-2015.

Real estate tax for 2010 must be reported and paid by 1 February 2011 according to the taxable values applicable before.

Amendments to the social security contributions (SSC) for 2011

On 9 December 2010 by Law on the Confirmation of the Annual Rates of the Year 2011 of the State Social Insurance Fund of the Republic of Lithuania the rates of SSC for 2011 were confirmed. The main amendment is related to the increased SSC for individuals working under copyright agreements, performing sports activities, performers' activities and working under employment contracts simultaneously. Instead of 17% payable on behalf of a company and 8% SSC withheld from an individual, there will be 30,98% payable on behalf of a company and 9% withheld from an individual starting from 2011.

Commentary on the Personal Income Tax Law regarding the sale of Securities

On 27 December 2010 the Tax Authorities informed that the Commentary on Art. 17 Part 1 Item 30 of the Law on PIT was

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prepared. The Commentary explains taxation of income derived from the sale of securities which were acquired after 1 January 1999.

VAT treatment of imported goods that are to be supplied to another Member State

On 28 December 2010 by Order No. 1B-773/VA-119 of the Head of the Customs Department and the Tax Authorities amendments to the rules on VAT treatment of imported goods that are to be supplied to another Member State were adopted.

Amendments state that goods imported are exempt from import VAT if they are to be supplied to another Member State in the same state (unchanged). The previous edition of the rules allowed exemption from import VAT for goods supplied to another Member State if they were repaired and/or processed.

Moreover, the amendments specify guidelines that should be followed when applying for an extended period before transporting imported goods to another Member State.

Recognition of bad debts

On 30 November 2010 the Lithuanian Supreme Administrative Court (SACL) adopted a decision in case No. A575-1725/2010, where it has explained the procedure of recognition of bad debts.

Beforehand, the tax dispute settlement authorities (i. e. the Commission on Tax Disputes (CTD) and the Court of First Instance) hearing this tax dispute did not agree with the Tax Authorities' statement that the documents provided by a Lithuanian Company did not form the basis for recognizing a Kazakhstan Company's debt amount as bad debt and attributing it to the allowable deductions of limited amounts.

However, the Lithuanian Company is of the opinion that the Tax Authorities' requirements to collect more evidence concerning the substantiation of bad debt, when the debtor (Kazakhstan Company) is liquidated and deregistered, seem irrational and conflicting with the economic logic. The fact of liquidation and deregistration is an objectively existing reality which witnesses that the debtor, who could be demanded to pay back the debt, does not exist anymore and these facts themselves mean that such the debt is bad.

The CDT and the Court of First Instance supported the position of the Lithuanian Company and stated that the documents in the case (such as documents from competent Kazakhstan institutions confirming the fact of company's liquidation,

appeal to the Court of Arbitration regarding the possibilities of debt recovery, documents related to the travels of company's representatives to Kazakhstan, etc.) not only confirm the fact of the Kazakhstan Company's debts, but also the actions that were taken by the Lithuanian Company in order to recover the debt.

Meanwhile, the jury of the SACL did not agree with the conclusion provided by the CDT and the Court of First Instance. Having systemically evaluated the provisions of the Rules on the Proof of Bad Debts and Effort to Recover These Debts and Calculation of Bad Debts, approved by Order No. 40 of the Minister of Finances of the Republic of Lithuania dated 11 February 2002 (wording relevant to this dispute) the SACL concluded that in order to prove an bad debt and effort to recover this debt, the

Lithuanian Company had to provide specific documents, i.e. (I) final judicial decision of the court of the Republic of Lithuania or a foreign country (or other institution hearing the appeal), which confirms the Company's right to recover the debts, and also – (II) documents that were officially issued by court bailiffs or by other state institutions which prove the non-fulfilment of the decision or partial fulfilment and the reasons it happened (in the cases when a judicial decision (or decision of an institution hearing the appeal) is fulfilled in a foreign country).

The Lithuanian Company did not provide the Tax Authorities with such documents and did not start a judicial or equivalent process of debt recovery and therefore the SACL stated that the Tax Authorities reasonably did not allow the Lithuanian Company to accept the Kazakhstan Company's debt as an bad debt and attribute it to the allowable deductions of limited amounts.

The right to apply zero-rated VAT

The SACL in the abovementioned administrative case Nr. A575-1725/2010 also resolved a dispute whether the Lithuanian Company justified the application of zero-rated VAT to the supply of goods.

The SACL agreed with the assessment of the evidence collected in the case made by the Tax Authorities, the CDT and the Court of First Instance and concluded that the abovementioned institutions reasonably stated that the Lithuanian Company had not justified (I) that the goods were actually dispatched from the territory of Lithuania and (II) the facts of supply of these goods to the party indicated in the documents.

The SACL noted that if the goods were actually dispatched from the territory of Lithuania, the issue of the justification of such a fact is not very complicated. In order to prove this (which had to be done), the taxpayer has to provide written evidence, starting with those related to the procedure of transportation and finishing with the confirmation from the consignee (these documents can also be transport documents naming the vehicles the goods were transported by, their identification data, identification data of persons who transported the goods, etc.).

The SACL stated that such evidence was not presented in the case and, therefore, the Lithuanian Company unreasonably applied zero-rated VAT to the supplies to Latvian companies.

This decision of the SACL is final and conclusive.

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State Budget Law and Social Security Contributions Law for 2011

The 2011 State Budget law and the Social Security Contributions law were published on 28 December 2010.

For 2011, the quota of individual social security contributions re-directed to private pension funds has increased to 3% from 2.5% in 2010.

The average gross monthly salary used as reference for the social security budget has increased to RON 2,022 for 2011 (from RON 1,836 for 2010).

The contribution rates for the social security fund, health fund, unemployment fund, work accidents and occupational diseases insurance and for the salary guarantee fund remain at 2010's levels.

Amendments to the Fiscal Code

Government Ordinance amending the Fiscal Code and introducing other financial-fiscal measures was published on 30 December 2010. Government Decision amending the Fiscal Code Norms was published on 31 December 2010. The main amendments brought by the Ordinance are:

Corporate income tax

Fuel expenses incurred for vehicles weighing less than 3,500 kg with a maximum of 9 passenger seats and which are owned and used by taxpayers exclusively for the purpose of people transport will continue to be considered as non-deductible for profit tax or income for tax purposes (with certain exceptions) for the period 1 January 2011 – 31 December 2011.

Tax on micro-companies' income

The Ordinance reintroduces provisions regarding taxation of micro-companies' income. The tax rate is 3%. According to a press release issued by the Ministry of Finance, all micro-companies that pay profit tax can choose to pay income tax from 1 January 2011, if as at 31 December 2010 they met the subject conditions provided by the law. Micro-company status until 31 December 2009 is not relevant.

Tax on non-residents income

The tax rate for dividends paid by a Romanian legal entity or a legal entity with the legal headquarters in Romania to a legal person resident in a EU or EFTA member state has been increased from 10% to 16% (for situations where the exemption provisions cannot be applied).

Personal income tax

- For independent activities, the period for applying the non-deductibility provisions regarding fuel expenses incurred is extended for the year 2011.
- Coupons representing gift tickets offered free of charge to individuals are no longer tax-free.
- Specific rules for computing/withholding tax derived from the income association of an individual and a micro-company have been reintroduced.
- For certain independent activities, for which there is the requirement of paying 10% anticipated tax, the possibility of withholding a final tax of 16% is introduced. These types of income are excluded from the "other types of income" category.
- For capital gains, other than shares and securities in case of closed companies, the obligation for the taxpayer to declare and pay tax on a quarterly basis is maintained.
- A new article is introduced regarding the definition and taxation of income for which the source has not been identified. In order to establish the taxable basis, indirect assessment methods are used, such as: source and expenditure method, cash-flow method and patrimony method.
- The option to recalculate advanced income tax payments in the case of temporary interruption or cessation of independent or agricultural activities is reintroduced; the procedure will be published by Order of the National Agency for Fiscal Administration.
- The obligation to declare and pay annual income tax by 25 May is repealed. The Ordinance reintroduces the annual income declaration procedure (for income derived from Romania and from abroad) of 15 May of the year following that in which the income was obtained, with the difference to be paid within a maximum of 60 days from the date the tax assessment decision is communicated by the authorities.

Social contributions

Social contributions will be covered by the Fiscal Code. According to the new Title IX2, taxpayers who contribute to social security systems covered by the Fiscal Code are:

- a) Residents who receive income under an employment contract (or a work relationship or special status) as well as income treated as wages (directors' incentives/single associate/director on mandate contract, etc.).
- b) Residents who receive income mentioned above under letter a), while respecting international juridical arrangements in which Romania takes part.

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- c) Individuals who derive income from professional activities (copyrights and civil conventions).
- d) Retirees with pension incomes above RON 740 per month.
- e) Individuals and companies which act as employers and entities similar to employers;
- f) Public institutions;
- g) Any payer of salaries or revenue similar to salaries.

Individual social contributions:

The monthly assessment base is the gross income derived from dependent activities, in Romania and abroad, respecting international juridical arrangements in which Romania takes part.

The individual pension contribution is capped at five times the average gross salary for each place of revenue gain, for all taxpayers; for 2011 the level of five times the average gross salary is RON 10,110.

Social contributions due by employers:

The monthly assessment base is the amount of the gross revenue gained by individuals, resident and non-resident, based on a work contract (or a service report or special status) as well as revenues treated as salaries (directors' incentives/single associate/director on mandate contract, etc.).

The pension contribution is capped at five average gross salaries multiplied by the number of insured individuals.

The employee and employer health and unemployment fund contributions remain uncapped and are computed by reference to the relevant assessment bases stipulated by the Fiscal code.

Certain exceptions from social security contributions are provided, including:

- Social security contributions are not paid for salaries which are non-taxable, but the exemption only applies for the individual;
- Some benefits are exempt from the payment of social security contributions, even though they are considered taxable benefits (gift vouchers, childcare vouchers, company phones and vehicles for personal use, etc.);
- Specific exemptions are introduced regarding the pension contributions and work accidents and occupational disease contributions for directors' allowance, as well as the income from the net profit due to company directors; the exception applies both for the individual contributions and for the contribution due by the income payer.

Amendments are brought to certain provisions of the special laws regulating social contributions, especially regarding the assessment base and compliance obligations, in accordance with the provisions of the Fiscal Code.

Tax returns:

- single tax return is introduced for social security and income tax liabilities and the name list of subscribers, (Form 112) for employers and payers of professional income.
- In addition, employers have now to submit, by 15 February 2011, an inventory statement regarding holiday and allowances for health insurance contributions, outstanding as at 31 December 2010 and unpaid by 31 January 2011.

Value Added Tax

The period for which the input VAT related to the acquisition of vehicles and fuel for these vehicles is not deductible has been extended until 31 December 2011, while the initial conditions and exceptions regarding the special limitation of the right to deduct VAT is maintained.

The VAT amounts to be reimbursed or to be paid to the State Budget reported in the VAT return will also include the VAT liabilities towards the State Budget, established by tax inspectors through an assessment decision issued by the date of submission of the VAT return.

A taxable person who does not exceed the exemption threshold of EUR 35,000 during a calendar year may request by 20 January the following year deregistration from the records of the persons registered for VAT purposes in order to apply the special exemption regime.

The simplification measures will also apply to the transfer of Greenhouse Gas Emission Certificates. Thus, for transactions involving such certificates between persons registered for VAT purposes in Romania, the beneficiaries will be liable to pay VAT by applying the reverse-charge mechanism.

The deadline has been extended until 31 March 2011 for submitting the refund applications for the VAT amounts paid during 2009 in a Member State, other than the state where the taxable persons who apply for refund are established and registered for VAT purposes.

Excise duty and special taxes

The level of excise duties on gasoline increased from EUR 452/tonne to EUR 467/tonne and on diesel from EUR 347/tonne to EUR 358/tonne.

The total level of excise duty on cigarettes increased from EUR 74/1,000 cigarettes to EUR 76.60/1,000 cigarettes. In addition, the minimum excise duty has increased from EUR 67.34/1,000 cigarettes to EUR 73.54/1,000 cigarettes.

Starting with 1 July 2011, the method for computation of the specific excise duty for cigarettes is amended. Thus, the specific excise duty will be determined annually, based on the legal percentage assigned to ad valorem excise duty, the total excise duty and also based on a weighted average retail price. The latter is established by 1 March of each year and represents the ratio between the total value of cigarettes released for consumption (based on retail price) and the total amount of cigarettes released for consumption.

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The characteristics of cigars and fine cut smoking tobacco for handrolled cigarettes are redefined.

The exemption from excise duty for tobacco processed solely for the purpose of scientific and product quality testing is eliminated.

The level of excise duties for coffee remains unchanged for the year 2011 at EUR 153/tonne for green coffee, EUR 225/tonne for roasted coffee (including coffee with substitutes) and EUR 900/tonne for instant coffee.

Fiscal Procedure code

For taxpayers with a secondary headquarters, the payer of the tax obligations is the taxpayer and not its secondary headquarters, including for the income tax due by the employees of the fiscally registered secondary headquarters.

The possibility for the tax authorities to use indirect methods for retracing the income and expenditures of taxpayers, if documents do not exist or are not made available to the tax authorities, or if the documents which are presented during a tax inspection are incorrect, incomplete or false.

Special provisions regarding the preliminary examination of the fiscal status of individuals regarding the income tax described under Title III of the Fiscal Code, by comparing the fiscal status with the income declared by the taxpayer or the income payer, in order to determine the real fiscal status of the taxpayer.

For cases in which the tax authorities establish a significant discrepancy of at least 10%, but no less than RON 50,000, between the income declared by the taxpayers or by the income payers and the real personal status of the individual paying the income tax, the tax authorities will continue the tax inspection (by sending an examination notice) in order to set the taxable amount by using indirect methods (the source and expenditure method, the treasury flow method, the patrimony method) whose procedure is to be described by a future Government Decision.

Under penalty of being forfeited, within 60 days from the examination notice, the taxpayer or the income payer is entitled, and the tax authorities are bound to allow them, to present all relevant documents or clarification for the fiscal status. The said 60-day term may only be extended once, by 30 days, and only after a justificatory request by the taxpayer and the tax authority's agreement.

The tax examination results will be included in a written report which will be the basis of the decision to stop the examination procedure if the taxable amount remains unmodified or of the tax assessment deed if additional tax obligations are established for the taxpayer.

Organising gambling activities

Gambling activity organisers will allow access to their authorised venues only with an entry ticket valid for 24 hours, between 8.00 – 8.00. The access fee is:

- RON 20 for casino specific gambling activities;
- RON 5 for slot-machine games.

The amounts collected from this fee will be transferred entirely to the state budget by the 25th of the following month, for the previous month.

The Ordinance also presents the fines for non-complying with these provisions.

Abatement of the legal provisions regarding registration of employment agreements and employee records

Government Emergency Ordinance was published on 30 December 2010 regarding the abatement of Law on measures of protection of the employees.

- The new provisions remove the obligation, as of 1 January 2011, to register individual employment agreements with the territorial labour inspectorates.
- As of 1 February 2011, the provisions regarding the keeping and completion of the work books are abolished, with the record of employees being kept by completion of the general registry of employees and its communication to the territorial labour inspectorate, in electronic format.

The Government Emergency Ordinance entered in force on 3 January 2011.

New rules for deducting R&D expenses

On 15 January 2011, the Russian State Duma passed Bill in the first of three readings. The Bill clarifies the rules for deducting R&D expenses for profits tax purposes.

The most significant changes include:

- The Bill establishes a list of specific R&D expense items;
- It introduces administrative control over expenses that are deducted using the 1.5 multiplier;
- It provides for the right to set up a tax accounting provision for future R&D expenses and sets such provisions;
- It clarifies rules related to intangible assets resulting from R&D.

These changes are discussed in more detail below.

List of R&D expense items

The Bill establishes the following exhaustive list of R&D expenses:

- Depreciation of fixed and intangible assets (except for buildings and facilities) used in R&D, charged during a period defined as the number of full calendar PwC months during which the relevant fixed and intangible assets were used exclusively for R&D purposes;
- Salaries of employees involved in R&D;
- Provided for material expenses directly associated with R&D;
- Other expenses directly associated with R&D that in total do not exceed 75% of the aforementioned salary expenses;
- Cost of work done under work performance contracts for taxpayers that are customers for R&D work;
- Contributions to the Russian Technology Development Fund and other industry and cross-industry funds for R&D financing created under the Federal Law "On Science and Governmental Research-and-Technology Policy" that in total do not exceed 1.5% of the income from sales determined under Russian Tax Code (RTC) Article 249.

Administrative control over expenses that are deducted using the 1.5 multiplier

Taxpayers that incur R&D expenses included on the Russian government list are entitled to gradually include the actual amount of expenses multiplied by 1.5 under other expenses within one year starting from the first day of the month

following the month in which R&D activity (or its separate stages) was completed. If the taxpayer exercises this right, it will need to file a special report with the tax authorities, along with the tax return for the tax period when the R&D was completed.

Such reports should be filed for each research and/or development project (or its separate stage) and must comply with the general requirements established by the national standard format for scientific and technical reports. The tax authorities are entitled to obtain expert opinions on such reports. If the taxpayer fails to file a report, the actual expenses for research (development, or its separate stage) multiplied by 1.5 and included in other expenses shall be reinstated and included in the tax base under non-sale income in tax accounting.

The Explanatory Note to the Bill points out that the introduction of an exhaustive list of expenses and introduction of special R&D reporting (for R&D deducted with 1.5 multiplier) should help minimise tax avoidance.

Provision for future R&D Expenses

The Bill entitles taxpayers to set up a provision for future R&D expenses. A provision for implementing each approved R&D programme may be set up for a period of no more than two years. The size of the established provision shall not exceed the size of planned expenses (budget estimate) for implementing an R&D programme that has been approved by the relevant taxpayer. The Bill provides a formula for calculating the maximum size of provision contributions. Expenses incurred will be written off using the established provision.

If the amount of the established provision is less than the amount of actual expenses, the difference shall be additionally deducted as an expense. The amount of a provision that is not completely used by the taxpayer within two years from the date when it was included in the provision shall be included in the non-sale income of the taxpayer of the current reporting (tax) period. The income shall be increased by interest calculated for the period of the provision based on an interest rate equal to double the Bank of Russia refinancing rate in effect on the date when the provision was set up.

Exclusive rights to intellectual property generated as a result of R&D

The proposed version of the Russian Tax Code Article 262 provides a detailed description of the tax treatment for those cases when a taxpayer is granted exclusive rights to intellectual property.

It is pointed out that R&D expenses that were previously included under other expenses shall not be reinstated included in the initial value of the intangible asset (IA).

The R&D expenses deducted with the 1.5 multiplier shall be included in the initial value of the IA with the same 1.5 multiplier. That said, if the given IA is sold within five years after it was recognised, one third of the R&D expenses included in the IA's initial value with the 1.5 multiplier shall be reinstated and included in the tax base within the non-sale income in tax accounting.

Russia

Other changes

The Bill provides for a range of other changes. Among these, it proposes adding a new article on the Tax Accounting of R&D Expenses.

Before becoming law, the Bill must first pass the second and third readings in the State Duma, after which it goes to President Medvedev for his signature. The Duma may alter the current text of the Bill. If the Bill becomes law, it is likely that the new rules will take effect in 2012. At this stage, it is recommended that taxpayers actively engaged in R&D carefully assess the potential economic impact of the proposed new rules, such as the right to set up R&D provisions, and also look closely at the potential increase in administrative burdens (in case of deduction of R&D expenses with the 1.5 multiplier).

Payment of dividends – new rules

On 31 December 2010, Federal Law No. 409-FZ took effect. Before this there had been some uncertainty about the legal status of announced but unpaid dividends (part of distributed profits) as well as should such amounts be taxed. Moreover, the federal laws “On joint-stock companies” and “On limited liability companies” had not provided for any cut-off deadlines by which shareholders (partners) must claim payouts of announced dividends (distributed profit). As well, in practice, some shareholders (partners) were able to receive dividend payouts (distributed profit) earlier than others.

Now, the Law has clarified the relevant provisions of the federal laws “On joint-stock companies” and “On limited liability companies” that cover dividend (distributed profit) payouts. The new law has also amended the Russian Tax Code (RTC) to exclude unclaimed dividends from taxable income.

New payout timeframes

The Law establishes standard requirements for determining the timeframes of announced dividend (distributed profit) payouts for both joint stock and limited liability companies maximum time frame for paying out announced dividends (distributed profit) is now 60 days from the dividend announcement date.

A shareholder (partner) must claim payment of an announced dividend (part of distributed profit) within three years. Under the general rules, this deadline is final and may not be renewed, except in cases where the shareholder (partner) failed to claim

due to threats of force or violence. While a company’s charter may provide for a longer dividend claim period, it may not exceed five years. Once the established claim period has expired, the shareholder is no longer entitled to collect announced but unpaid dividends (part of profit) and unclaimed amounts can then be restated as part of the company’s retained earnings. Finally, The Law stipulates that a company cannot offer preferential dividend payout terms to individual shareholders of the same category (type) of stock, and as well that payouts of announced dividends for each category of shares must be made simultaneously.

The relevant tax changes

A new paragraph has been added to RTC Article 251 “Non-taxable income”. Now it is explicitly stated that the tax base does not include income in the form of property, property rights or non-property rights, in the amount of their assessed value, that were transferred to a company or partnership to increase net assets (including through the formation of additional paid-in capital and/or funds) by the relevant shareholders or partners. These rules also extend to increases in net assets of a business entity or partnership with a simultaneous decrease or cancellation of the business entity or partnership’s liabilities to the relevant shareholders or partners, if the increase in net assets was made in accordance with Russian law or the business entity or partnership’s incorporation documents, or if the increase occurred at the discretion of a shareholder or partner of the business entity or partnership. These rules also extend to restatement of unclaimed dividends (or part of the distributed profit) in retained earnings. So, there is now an explicit rule that exempts income in a form of unclaimed dividends from taxation. The rule applies to relationships occurring since 1 January 2007.

A transition period

The Law also applies to payouts of announced dividends (part of distributed profit) for which the claim period was still valid as of 31 December 2010. In addition, the new law allows shareholders (partners) who have not claimed announced but unpaid dividends (part of distributed profit) during the past three years (if the dividend claim period had already expired by 31 December 2010) to claim such payouts up until 30 June 2011.

Actions to be taken

- Amend your company’s charter and dividend policy accordingly;
- Review your dividend payout practices, and related legal and tax risks, for the past three years;
- Assess the legal compliance of your current dividend payout practices;
- Develop a new company dividend payout policy; and
- Make sure to follow the new rules when filing your 2010 profits tax return.

Key changes in VAT treatment of services

The Tax Code has changed VAT treatment of certain services.

In comparison to the VAT Law, the Tax Code establishes a number of amendments to the VAT treatment of certain services including changes in the definition of their places of supply.

These changes relate both to cross-border and local supply of services and may have a critical impact on certain industries.

Imported services – place of supply

The Tax Code establishes various rules for determining the place of supply of services. If a particular service is not covered by the special rules, the general rules will apply and the service will be considered to be supplied at the place where the provider is registered.

This means that if services are provided by a non-resident and such services are covered by the general rule for place of supply determination, they will be treated as supplied outside Ukraine and no reverse-charge VAT for Ukrainian customers should arise.

If the special rules apply, a reverse-charge VAT may continue to arise.

Marketing and promotional services

Marketing and promotional services are currently not covered by the special rules of place of supply determination, so they are regulated by the general rules. Therefore, if such services are supplied to a non-resident they should be subject to 20% VAT.

Services of a consulting nature

The list of services not subject to VAT was extended to include consulting, engineering, accounting, legal, audit, actuarial and other similar services of a consulting nature.

Such services will not be subject to VAT irrespective whether they are provided to/by a resident or a non-resident.

We expect the tax authorities to provide further explanations on which services should be of a consulting nature.

Data processing and provision of information

The services on development, supplying and testing of software, data processing and consulting on 'informatization', supplying of information and other services in the area of 'informatization', including services assisted by computer systems, will

also be VAT exempt irrespective of whether they are supplied to/by a resident or a non-resident.

Based on the current wording of the Tax Code, it is likely that the data processing and provision of information services will be VAT exempt only if they are connected to information technology.

Processing of data and provision of information in other areas, including their supply to a non-resident, will be subject to 20% VAT.

Impact of the amendments

If a Ukrainian company supplies services of a promotional/marketing nature, or provides data processing and provision of information services to non-residents (except of an IT nature), they will be obliged to charge 20% VAT.

Such VAT will not be recoverable by a non-resident customer and will represent an additional cost.

Companies engaged in the supply of exempt services (consulting, audit, software development, etc.) will be unable to recover input VAT. Furthermore, they will be required to recognize deemed sale of the assets in respect of which VAT input was previously claimed.

Industries impacted by the amendments

The amendments to the VAT treatment of the aforementioned services may have a significant impact on the following industries:

- Consulting and auditing;
- Marketing/promotional services and market research companies;
- Clinical trials;
- Other companies engaged in the supply of various services to non-residents.

Mandatory registration of agricultural export contracts

The Ukrainian Government has recently adopted a Resolution that provides for mandatory conclusion and registration of export contracts on the sale of specific agricultural products with the Agrarian Exchange or certified exchanges authorized by the Agrarian Exchange.

The following products are included: flint and soft wheat, meslin, corn, barley, winter and spring rye, etc.

Customs clearance of the exported agricultural products shall be conducted only based on the export contracts which have been registered.

The Resolution does not apply to export contracts which were concluded and registered prior to 1 February 2011.

Ukraine

Key changes impacting the alternative energy industry

Prior to the introduction of the 2011 Tax Code, numerous incentives were potentially available for the

alternative energy industry; however, there was no certainty regarding their sustainability.

The 2011 Tax Code confirms the majority of the incentives previously in place and provides further ones as well.

This is a clear illustration that the government intends to support the development of the alternative energy sector. However, there are a number of uncertainties that still need to be resolved.

Corporate profits tax (CPT)

- The Tax Code has confirmed the previously available CPT exemption for the income received from the sale of equipment, raw materials, machinery, etc. used in the production of alternative (renewable) energy. The Tax Code sets a limitation on the exemption, and so not more than 80% of such income will be exempt from CPT. It will only apply to sales on the customs territory of Ukraine (i.e. not to exporting). The Cabinet of Ministers of Ukraine has already established a list of goods that is subject to this exemption. It has also provided the rules for utilization of exempt funds (generally, such amounts should be used to increase the manufacturing capacities of an enterprise).
- The previously adopted CPT incentive regarding taxation of income received from the realization of energy-saving projects remains unchanged. Pursuant to that, 50% of income derived from the implementation of energy-saving projects by enterprises that are included into a specific state register, is exempt from CPT. The Cabinet of Ministers of Ukraine has set the requirement to maintain separate accounting of profits and losses incurred from the realization of such projects. Interestingly, there is no current restriction concerning the utilization of exempt amounts.
- In addition to the above, the Tax Code has introduced a special tax regime for bio-fuel producers. According to the new rules, up to 1 January 2020, income of bio-fuel

producers received from the sale of such bio-fuel is exempt from CPT. There are no provisions stipulating the requirement to utilize the exempt income.

Value-added tax (VAT)

- The Tax Code has preserved the tax incentive regarding VAT treatment of the import of equipment, raw materials, machinery, etc. used in the production of alternative (renewable) energy. Thus, the import of such goods to Ukraine is exempt from VAT if they are used by a taxpayer for its own production and there are no identical goods manufactured in Ukraine. The extensive list of the goods falling into this VAT exemption has been stipulated by the Cabinet of Ministers of Ukraine.
- The Tax Code established several new VAT incentives for the alternative energy sector. In particular, up to 1 January 2019, the aforementioned VAT exemption has been extended to the supply of relevant machinery and equipment within Ukraine.
- Additionally, up to 1 January 2019, the Tax Code specifically provides VAT exemption for the import of equipment and machinery used in the production of bio-fuel and vehicles using bio-fuel. These exemptions only apply if there are no identical goods manufactured in Ukraine.

Beneficial ownership test from 1 January 2011

From 1 January 2011 the Tax Code specifies that the non-resident recipient of income sourced in Ukraine must also be considered the beneficial owner of such income in order to benefit from reduced tax rates under relevant tax treaties.

According to the 2011 Tax Code, agents, nominee holders and other intermediaries in respect of received income cannot be beneficial owners of income sourced in Ukraine, and, therefore, are not entitled to favourable treaty provisions.

The beneficial ownership rules have been subject to uncertain interpretations in many jurisdictions, and it is likely to take time for the Ukrainian authorities and courts to determine their views.

If a tax treaty includes the beneficial ownership provision, there is a clear risk that the tax office will apply an aggressive approach to the arrangements. All arrangements with non-residents, particularly of a back-to-back nature, should be re-examined in light of the Tax Code.

Currently, the effective tax treaties for Ukraine with Cyprus, Spain and Mongolia do not have the beneficial ownership provisions.

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