Agreements of participation in shared construction: relationship of legal, tax and accounting aspects

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Abstract. The article discusses theoretical and practical problems associated with the legal status, accounting and taxation of agreements of participation in shared construction (APSC). Contradictions between the economic content of operations under APSC and its legal form revealed. The consequences of the transition to the use of escrow accounts assessed. The expediency of wider application IFRS provisions and requirements in the accounting of operations under APSC substantiated. It’s proved that wider application of IFRS will allow increasing the reliability of information, avoiding data manipulation and improving the comparability of different companies’ reporting. The results of the study may be useful to heads, managers and accountants of construction organizations, as well as researchers involved in the issues of financing construction.

1. Introduction
Construction is one of the backbone industries of any economy. In the Russian Federation, housing construction plays a dominant role in the construction industry. According to the Federal State Statistics Service, 93% of the buildings commissioned in 2018 are residential. Due to the need to raise funds for a long and expensive construction process, residential premises in multi-compartment buildings (MCB) are mostly sold at the construction stage.

Representing the developer's activities connected with the financial participation of the future housing owners, in the accounting reports should be the key to minimizing conflicts with tax authorities and other control bodies, provide due transparency of activities and the formation of representative indicators allowing interested parties obtaining correct idea of the results achieved and the effectiveness of the developer, and provide an adequate basis for internal managerial decisions.

The objectives of this study are to identify the problems of representing in accounting the relationships under the agreements of participation in shared construction (APSC), to assess them from the standpoint of compliance with modern accounting principles, and to suggest possible solutions.

2. Main Provisions and Result
The sale of unfinished housing in the primary market is formalized by APSC in accordance with Federal Law of December 30, 2004 No. 214-FZ “On Participation in Shared Construction of Multi-Compartment Buildings and Other Real Estate Projects and on Amendments to Some Legislative Acts of the Russian Federation” (hereinafter - Law No. 214-FZ). Currently, the problems of the APSC’s legal nature and accounting are not finally resolved, despite changes in the legislation.
According to the APSC, the developer undertakes to build the MCB on his own and (or) with the involvement of other entities, within the time stated by the agreement, and after obtaining permission for commissioning, transfer the facility of shared construction to the shared construction participant (hereinafter - participant), and participant should pay the price stated in the agreement and accept the property if commissioning permission is obtained (Law No. 214-FZ, art. 4). To carry out work, the developer can engage a third-party organization under the construction contract, acting as the customer directly, or through the authorized technical customer, or carry out construction on his own, performing the functions of the customer and general contractor. In this case, the mode of performing construction (contractual or economic) is not a key condition of the APSC [1-3].

The Civil Code of the Russian Federation makes no provisions for APSC as a separate type of civil law contract, so the questions raise about its legal nature. The authors of [4-6] note its complex nature, and, emphasizing that the APSC does not contain all the essential terms of other agreements, draw analogies and identify differences with the following types of agreements [5]:

- Investment contract are governed by Federal Law of February 25, 1999 No. 39-FZ “On Investment Activities in the Russian Federation in the Form of Capital Investments”, which does not apply to APSC, but is devoted to investments in business projects aimed for profit, while the most participants purchase housing for personal consumption, rather than for economic benefits from entrepreneurial activity [4-6].

- Unlike a particular partnership (joint activity) agreement (Civil Code of the Russian Federation, art. 1041), the APSC assumes no single agreement with all participants, no common commercial goals of participants and developer, no general management, no combining the developer's property and the participants' contributions into common shared property and no profit distribution carried out [4, 5].

- Unlike an agency agreement (Civil Code of the Russian Federation, art. 1005) according to APSC construction begins before the placement of contracts, in relations with third parties the developer acts in its own name, creates, changes or terminates its rights and obligations, not the rights and obligations of participants, bears all risks during construction, is not obliged to submit to participants a report on its actions, its income includes not only of the developer's remuneration, but also savings on the cost of construction, and the loss may occur if the costs exceed the contract price [4].

- Unlike a construction contract (Civil Code of the Russian Federation, art. 740) according to APSC the project is not being built on the instructions of participants, the MCB project is being developed by the developer, construction begins before the placement of APSC [5; 7].

As a result, the Decree of the Plenum of the Supreme Arbitration Court of the Russian Federation of July 11, 2011 No. 54 “On Certain Issues of the Settlement of Disputes Arising from Contracts for Real Estate to be Created or Acquired in Future” classifies the APSC as a variant of the contract of purchase and sale [8].

The legal nature of the contract, the rights and obligations of the parties arising from it, are of paramount importance for its taxation and reflection in accounting. According to the Letter of the Ministry of Finance of August 13, 2013 No. 03-03-06 / 1/32811, the tax consequences of specific transactions depend on its legal basis [9]. The developer's activities carried out by the APSC have certain features of taxation on income tax and VAT [10; 1].

When determining the tax base for income tax, targeted financing in the form of participants’ contributions accumulated in the developer’s accounts (Tax Code of the Russian Federation, art. 251, cl. 14.1) and the developer’s expenses related to the real estate construction project (Tax Code of the Russian Federation, art. 270, cl. 5) are not taken into account. From the moment the parties sign the transfer act or other document on the transfer of the shared construction project, the developer’s obligations are finished (Law No. 214-FZ, art. 12, cl. 1). If at this moment the developer remains the difference between the amount of targeted financing and the amount of construction expenses for the property, which is not refundable to the participants, it is included in non-operating income (Tax Code of the Russian Federation, art. 250, cl. 14). The excess of construction costs over the contract value is
not accepted for taxation of profit (Letter of the Ministry of Finance of Russia of April 20, 2009 No. 03-03-06 / 1/263, Ruling of the Supreme Arbitration Court of the Russian Federation of June 25, 2009 No. VAS-7867/09) [0].

In accordance with Law No. 214-FZ, transferring a share in the right to common property in MCB when selling apartments as well as developer's services (including in the form of participants’ target funds savings) under APSC, excluding production-directed facilities (Tax Code of the Russian Federation, art. 149, cl. 23, 23.1, 23.3), are not subject to VAT.

The analysis of the developer’s taxation under the APSC shows that, from the standpoint of income tax, it is closer to agency contracts, regardless of the construction mode, and from the standpoint of VAT, when fulfilling the function of a contractor, - to contract agreements, without fulfillment, - to agency contracts [11]. The approach of the Decree of the Plenum of the Supreme Arbitration Court of the Russian Federation of July 11, 2011 No. 54, interpreting the APSC as a purchase and sale contract, is supported only in civil, but not in tax litigations.

In accordance with the Tax Code of the Russian Federation, organizations determine the tax base on the data from accounting registers and (or) other documented data on taxable objects (Tax Code of the Russian Federation, art. 54, cl. 1). Proceeding from this, a judicial position stated that the tax consequences are results of transactions reflected in accounting [12]. In the issue, a practice of accounting for operations on APSC, reflecting the features of their taxation rather than the economic nature of operations has formed.

In accordance with the Letter of the Ministry of Finance of Russia of November 6, 2013 No. 07-01-06/47399 the features of accounting APSC are not governed by regulatory acts. According to the Letter of the Ministry of Finance of Russia of May 18, 2006 No. 07-05-03/02, to account the developer's costs the Accounting Regulation for Long-Term Investments, approved by the Letter of the Ministry of Finance of Russia of December 30, 1993 No. 160 should be applied. Construction costs will record on account 08 “Investments in non-current assets” regardless of the economic or contractual mode [13].

If contractual mode of construction is used, the participants’ funds received by the developer for financing construction are recorded as liabilities. The transfer of the completed shared construction facility to the participant under the transfer act extinguishes the obligations to it without affecting the income and expense [14]. As of the date of signing the transfer act, the savings of participants’ target funds are determined, which, together with the remuneration for the developer's services stipulated in APSC, constitutes the income of the developer.

If an economic mode of construction is used and the developer functions as a contractor, participants’ funds are considered as advances taxed with VAT (Letters of the Ministry of Finance of Russia of July 7, 2009. No. 03-07-10/10).

As of the date of signing the transfer act for the shared construction project, revenue is recognized in the amount of the contract price and cost of sales in the amount of construction costs.

The legislation on APSC is continuously being improved, and tax rules remain unchanged, which often causes tax and accounting collisions.

From July 1, 2019, a transition was made from shared financing of construction to project financing, the corresponding amendments to Law No. 214-FZ were introduced by the Federal Law of July 1, 2018 No. 175-FZ. For APSC submitted for state registration after July 1, 2019, participants’ funds should be deposed only to escrow accounts in authorized banks (Federal Law of December 25, 2018 No. 478-FZ, art.8, cl. 16). The old settlement procedure remained valid only for construction projects meeting the criteria of Decree of the Government of the Russian Federation No. 480 of April 22, 2019: APSC concluded for facilities not less than 10% of the total project area with the degree of completion not less than 30% (15 or 6% in some cases).

Funds of participants accepted on escrow accounts in banks are not targeted funds accumulated in the developer's accounts [15]. The developer has no right to exclude them from the tax base for income tax in accordance with the Tax Code of the Russian Federation, art. 251, cl. 1.14 (Letters of the Ministry of Finance of Russia of November 11, 2019 No. 03-11-06 / 2/86786, of December 11,
2019 No. 03-11-06 / 2/96907, of December 13, 2019 No. 03-11-06 / 2 / 97886). Consequently, the income of the developer applying both the general and simplified taxation system (UTS) is the entire amount of proceeds from the sale of shared construction projects (Letter of the Ministry of Finance of Russia of October 8, 2019 No. 03-11-06 / 2/77017) [16; 17]. Due to this the amount of income abruptly increases that may violate the conditions for applying UTS - not more than 150 million rubles per year (Tax Code of the Russian Federation, art. 346.13, cl. 4). The increase in the tax burden due to the transition to a common taxation system is a blow to small, regional developers.

In response to numerous requests, the Ministry of Finance of Russia in January 2020 proposed amendments to the Tax Code of the Russian Federation in order to classify the funds of participants on escrow accounts as targeted financing by analogy with the funds accumulated on the own accounts of the developer. This returns the previous procedure for profit taxation.

Tax collisions mentioned above are largely due to the complex legal nature of the APSC. This once again raises the question of the legality of the established practice of their accounting [11; 18; 19]. In our opinion, the following provisions should be noted:

- The Regulation on Accounting for Long-Term Investments recommended by the Ministry of Finance for use by developers, applies to long-term investments understood as the costs of creating non-current assets not intended for sale, and evidently considers APSC as an investment agreement. The developer carries out the costs of creating MCB it intends to sell in the course of its usual activities. For the developer, this is the work in progress as a part of current assets, but not investment in non-current assets. In accounting, the classification of assets is determined not by their physical form, but by the nature of their use.

- The phrase that the tax base is determined on the basis of accounting registers (Tax Code of the Russian Federation, art. 54, cl. 1) should not be understood literally and hence, accounting shouldn't be based on tax interpretations of transactions, for example, participants’ funds are targeted financing, and only savings constitute income. Accounting and tax accounting are conducted according to various rules, which is confirmed by the presence of temporary differences between them and deferred taxes (PBU 18/02 “Accounting for profit tax of organizations”).

- Targeted financing in accounting usually intends to cover the recipient's own current and capital costs, and not to reimburse the cost of constructing the facility for participants [11]. Obligations to participants should record on settlement accounts and reflect in the balance sheet as part of long or short-term liabilities (Letter of the Ministry of Finance of Russia of May 5, 2014 No. 07-01-12 / 21775).

- The amount of revenue under APSC should not depend on the mode of performing the work (economic or contractual), the source of their financing (own funds, funds of participants or loans) or the method of depositing funds by participants (to the developer’s account or bank escrow account). In all cases, revenue should recognize in the sum of the contract price.

We believe that the current practice of APSC accounting violates the requirement of priority of economic content and business conditions over the legal form of operations (PBU 1/2008 “Accounting policy of an organization”, cl. 6). As the result, financial reporting does not provide a reliable and complete picture of the financial position and performance of the organization (PBU 4/99 “Financial Statements of the Organization”, cl.6): non-current assets are overestimated, current assets, revenue and cost of sales are underestimated. This, in turn, leads to a distortion of liquidity, turnover, profitability, etc.

In addition, as in the case of tax accounting, the question arises about the moment of revenue recognition under the APSC: at transfer of the facility under the transfer act or during its construction. Experts say that they could not get certain answers to these questions either in the Ministry of Finance or in the tax authorities.

The standard governing the accounting of APSC is not normatively stated. According to PBU 1/2008 “Accounting policies of the organization”, cl. 7 in the absence of regulatory accounting methods for specific issues, the organization develops them independently based on IFRS. This is
what the Ministry of Finance of Russia recommends to do with regard to the accounting of the APSC in the Letter of November 6, 2013 No. 07-01-06 / 47399.

It should be noted that the practice of selling real estate before the completion is widespread in many countries, and also causes difficulties in determining the moment of revenue recognition. Prior to the adoption of the IFRS 15 “Revenue from contracts with customers”, IFRIC 15 “Agreements on the construction of real estate” was in power [11]. In accordance with it, if the buyer can only have a limited impact on the project, and the developer provides services along with providing construction materials, the contract represents the sale of goods. Revenue will recognized at the end of construction (IAS 18 “Revenue”, cl. 14).

IFRS 15 (mandatory application from January 1, 2018 and voluntary application in the Russian Federation from the date of official publication February 2, 2015) which replaced these documents introduced a new five-step revenue recognition model. The key issue determining the possibility of revenue recognition under the APSC over time was the correspondence to the requirements of IFRS 15, cl. 35(c): the entity does not create an asset with its own alternative use and has an enforceable right to payment for performance completed to date.

Legal protection of the right to pay for work performed on the APSC arose from January 1, 2017. According to art. 9, cl. 1.2 of the Law No. 214-FZ introduced by the Federal Law of July 3, 2016 No. 304-FZ, from this date the participant has no right to terminate the contract out of court if the developer fulfills properly its obligations under the APSC. Judicial practice has shown that this prohibition applies to APSC contracted before January 1, 2017. Thus, revenue under the APSC will recognize over the term of the contract based on the degree of completion.

Analysis of IFRS-reporting of the largest Russian developers showed, that 60% of them applied IFRS 15 ahead of schedule starting from 2017 or 2016. Prior to that, they recognized revenue from the APSC at the time of commissioning MCB. Under the new standard, all companies recognize revenue from APSC over time, 90% of companies calculate the degree of completion based on the costs incurred.

According to PBU 1/2008, cl. 7, organizations that disclose consolidated IFRS statements and their subsidiaries can apply Russian accounting standards taking into account IFRS requirements and other organizations have the right to form their accounting policies on regulatory unresolved issues based on IFRS also.

Thus, we believe that all Russian developers can recognize revenue from APSC in accounting during the term of the contract. Similar conclusions made by the Accounting Development Fund “National Non-Governmental Accounting Regulator “Accounting Methodological Center” in draft Recommendation R-X/2019-OK Construction “Accounting of agreements of participation in shared construction within Developer”. Some authors, for example [11; 20], proposing to use IFRS conclude that revenue under APSC should be recognized when transferring project and this in fact was so before IFRS 15 came into force and changes in art. 9 of the Law No. 214-FZ were made.

3. Conclusions and Discussion
The relationship between the economic content and the legal form of activity, in our opinion, is a peculiar example depicting the principle of unity and struggle of opposites. On the one hand, reflected in the financial statements, the economic substance of the transaction (its impact on the financial position and financial results of the organization) takes precedence over its legal form (type of contract and its legal qualification). On the other hand, the content of the operation will determined by the rights and obligations of the organization arising from the contract terms themselves and from the legislation governing this form of contract. According to the 2018 Conceptual Framework for Financial Reporting constituting the basics of IFRS, the main reporting elements (assets and liabilities) are namely the rights and obligations of the organization.

Presentation of data in accordance with their economic content allows increasing the reliability of information, avoiding data manipulation by choosing various ways of structuring transactions and
improving comparability of reporting for different companies, including those operating in different jurisdictions.

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