

CROSS-SECTORAL COMMITTEES



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AMENDING THE AGREEMENTS ON AVOIDANCE OF DOUBLE TAXATION

As part of his speech on March 25, 2020, the President of the Russian Federation proposed amending the agreements on the avoidance of double taxation with “transit” countries through which “significant resources of Russian origin” pass.

These amendments include an increase in the tax rate on dividend income from 5% to 15%, as well as a 15% rate for interest paid to foreign companies located in these countries.

Later, in accordance with the proposals of the Russian Ministry of Finance, agreements with Cyprus, Malta, and Luxembourg were amended. Amendments to the agreement with the



Netherlands were also prepared but were not agreed upon. This resulted in the termination of this agreement starting on January 1, 2022.

With the termination of the agreement, the mechanism for eliminating double taxation between these countries has been removed and the payment of dividends will be taxed in Russia at a rate of 15% along with the Dutch corporate tax. Interest and royalties will be taxed in Russia at a rate of 20% and are also subject to the Dutch corporate tax.

As a result, the investment climate in Russia is suffering greatly because various international corporations have attracted significant direct foreign investments into the Russian economy through the jurisdiction of the Netherlands, as evidenced by the balance of payments data analyzed by the Bank of Russia in recent years.

RECOMMENDATIONS

Amend the Tax Code of the Russian Federation to compensate for the consequences of the tax agreement's termination, including:

- › In terms of dividends and interest, establish reduced rates of withholding tax at the rates of 5% and 15% subject to the fulfillment of conditions similar to those in the amendments to the agreements adopted earlier (Cyprus, Malta, Luxembourg). In addition, codify the right to apply a reduced tax rate on dividends and interest in relation to not only public companies but also to companies that meet two criteria: (1) 50% of the capital of such a company is directly owned by a public company whose shares are listed on a registered stock exchange, and (2) such a company directly holds at least 15% of the capital of the company paying dividends for a 365-day period, including the date of the dividend payment.
- › In terms of royalties, not to withhold tax at the source, subject to the beneficial owner rules stipulated by the Tax Code.

LEGAL UNCERTAINTY AND A FORMAL APPROACH TO APPLYING THE PROVISIONS OF ARTICLE 54.1 OF THE RUSSIAN FEDERATION TAX CODE AND UNJUSTIFIED IMPOSITION OF LIABILITY FOR DELIBERATE NON-PAYMENT OF TAXES

Practice has demonstrated unpredictability in the application of certain provisions of Article 54.1 of the Tax Code of the Russian Federation and the article as a whole (General Anti-Avoidance Rules). In 2021, the Federal Tax Service prepared detailed and generally balanced explanations for the application of those rules, but instances of its formal application by the local tax authorities are still common. In particular, practice demonstrates the unjustified application of the provisions of Paragraph 1 of this article on the distortion of

information, which results in a prohibition on deduction of expenses if taxpayers make even insignificant errors in documents or their financial/tax accounting. The provisions of this paragraph are used instead of or along with Paragraph 2 of the Article in situations where an obligation is performed by another entity (i.e., not an entity-party to an agreement and/or an entity to which a transaction performance obligation is assigned by agreement or by law) regardless of whether the taxpayer should or could know that the obligation would be performed by an entity other than the counterparty. Furthermore, tax agencies do not always account for the fact that economic agents may conduct their activities in any way not prohibited by law, including by engaging third parties (such as subcontractors) to perform their obligations. In practice, this approach results in unjustified refusal to allow expenses/deductions in the event of claims against counterparties of the 2nd and subsequent levels, even if the immediate counterparty is a real economic agent that itself bears liability for the counterparties it engages. There's also the problem of unjustified prosecution of taxpayers on the basis of Paragraph 3 of Article 122 of the Tax Code of the Russian Federation for intentional non-payment of taxes without specifying the evidence and circumstances confirming that a deliberate tax offense was committed.

RECOMMENDATIONS

Strengthening the Federal Tax Service's control over the actions of the local tax authorities in relation to the following issues:

- › correct qualification of offences under Article 54.1 and prevention of a formal approach being taken in applying the article;
- › interpretation of "obligation performance" for the purpose of applying Subclause 2, Clause 2, Article 54.1 according to the provisions of civil legislation and taking into account an assessment of the circumstances of the taxpayer establishing and verifying that its direct counterparty is a real economic agent (from the standpoint of it having functions, risks, and assets);
- › prevention of additional tax accrual for the tax offense committed by counterparties of the 2nd and subsequent levels;
- › prevention of arbitrary imposition of liability for deliberate non-payment of taxes;
- › consideration of circumstances excluding culpability in committing a tax offence if a taxpayer assists in identifying persons involved in tax schemes.

ADVANTAGES

- › Legal determinacy and a uniform approach in applying Article 54.1.

- › Termination of the practice of unjustified imposition of liability for the actions of counterparties of the 2nd and subsequent levels as well as unjustified prosecution for intentional non-payment of taxes.
- › Mitigation of the tax risks associated with business activities and improvement of the business and investment climate.

EXCESSIVE LAW ENFORCEMENT INTERVENTION IN TAX CONTROL AND THE THREAT OF UNJUSTIFIED CRIMINAL PROSECUTION OF DILIGENT TAXPAYING OFFICERS

Criminal law provisions are increasingly being used as an instrument to exert unjustified pressure on businesses, as law enforcement bodies are intervening excessively in tax control activities. This drives unnecessary criminalization of economic relations and repressive criminal crackdowns on businessmen, as well as duplication of law enforcement, control, and supervision functions. This situation is explained, in particular, by the following problems:

- › criminal liability and liability for tax offences are not sufficiently differentiated in practice;
- › the risk of tax offenses being classified as continuing (the consequences of this approach being essentially equivalent to canceling the limitation period with respect to tax crimes);
- › criminal prosecution of the taxpaying officers and other employees for tax abuses committed by counterparties;
- › recognition of tax calculation violations as fraud (Article 159 of the Criminal Code) if a tax refund is granted, thus entailing harsher punishment without a chance to get an exemption from criminal liability by compensating for the damage caused;
- › a rise in the number of criminal cases initiated for tax evasion after the corresponding taxes have been paid in full following tax audits and prior to a criminal case being initiated;
- › imposition of liability for failure to discharge tax agent duties even if no false tax calculation is intentionally submitted by the tax agent;
- › criminal prosecution thresholds set in absolute terms regardless of the scale of the business or the total tax liability;
- › absence of any uniform approach to determining aggregate thresholds and absence of the possibility to effectively challenge the amounts calculated by the investigators.

RECOMMENDATIONS

- › The current law enforcement situation requires urgent solutions, primarily adopted by decree of the Plenum of the Russian Supreme Court. Additional new clarifications need to be provided by the Russian Supreme Court regarding Resolution of the Plenum of the Russian Supreme Court No. 48 dated November 26, 2019 "On the practice of courts applying the legislation on liability for tax crimes," since it did not introduce legal determinacy into the majority of the material issues related to applying criminal law for tax crimes. With respect to matters that cannot be resolved by the Russian Supreme Court's clarifications, criminal law needs to be amended.

ADVANTAGES

- › More effective tackling the tax evasion through more rational use of law enforcement resources.
- › Avoidance of excessive criminalization of economic relations and excessive criminal prosecution of business people.
- › Better guarantees of diligent taxpayers' rights being protected.
- › Reduction of corruption cases.
- › More favourable investment climate.



More information on the Committee page