



Association
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AEB Business Meeting

CRISIS AND TAXES: REALITIES AND PROSPECTS

16 March 2016, Moscow



Dr. Alina Lavrentieva

Chairperson of the AEB Taxation Committee, PwC

WELCOME REMARKS

Andrey Kizimov

Deputy Director of the Department of tax and customs tariff policy, Ministry Finance of the Russian Federation

***Key directions of the Tax Policy
for 2017-2019 - quo vadis?***

Session 1. Legislation

- Thin capitalization - new rules
- CFC, beneficial ownership and tax residency - one more round of amendments
- Transfer pricing at crisis times
- Attempting tax secrecy - draft laws

Experts: Arseny Seidov, Baker & McKenzie, Nina Gulis, KPMG; Svetlana Stroykova, PwC; Andrey Bashkirov, P&G

New Thin Cap Rules – What Has Changed?

Arseny Seidov, Partner
Baker and McKenzie

March 16, 2016

Recent Amendments Related to Interest Deductibility Rules

Russian thin cap rules revised by Federal Law #25-FZ dated Feb 15, 2016 on definition of “Controlled Debt”, with most changes effective as of 2017:

- An unsettled debt of a Russian company can be recognized as controlled debt if it falls in one of the following categories:
 1. debt before a foreign person i.e., a company or an individual (“Foreign Participant”) (i) holding directly or indirectly more than 25% (currently – 20%) shares in such Russian company or (ii) holding more than 50% consecutively in each preceding company in a direct holding chain of such Russian company;
 2. before an affiliated company (as determined under the transfer pricing rules, i.e., including foreign “sister” companies) of such foreign entity;
 3. which is directly guaranteed by or otherwise secured by a company in the previous two categories.
- Foreign “sister” company loans expressly included in the controlled debt definition
- Fixed 3 to 1 debt equity ratio is retained, no correlation with arm’s length principle
- Remaining issues with reclassification of interest paid to Russian lenders into dividends

New Exemptions from the Thin Capitalization Rules

1. Debts to Russian related persons not having a "comparable" debt to the Foreign Participant (i.e., where loans are provided from the lenders' own funds and there is no back-to-back financing where interest income is effectively transferred abroad)
2. Debts to an unrelated bank guaranteed or otherwise secured by a Foreign Participant or a related person if there has been no payment on such guarantee or security (this exemption applies as of January 1, 2016)
3. Debts to foreign SPVs - issuers of Eurobonds that are residents in tax treaty countries

Remaining Opportunities for Interest Deductibility

- Would a formal change in the Tax Code give an argument to exempt “old” foreign “sister” company loans from thin cap rules?
- Are there any chances to support interest deduction based on transfer pricing documentation?
- Any legal value in protocols to double tax treaties on interest deductibility?
- Can a company support interest deduction via Mutual Agreement Procedure (“MAP”)?
 - MAP is not directed by the Russian court practice
 - MAP may put pressure on the Russian tax authorities to accept transfer pricing arguments
 - MAP should be initiated early to avoid a technical conflict with a final court decision
 - MAP may give arguments to avoid double taxation abroad



Beneficial ownership concept & recent amendments to Russian CFC and corporate tax residency rules

Nina Goulis, Partner, Tax
KPMG

Beneficial Owner concept: now in the Russian law



Beneficial owner (BO)

- The entity may use and/or dispose of income at its own discretion;
- The entity for the benefit of which another entity is authorized to legitimately dispose of such income



NOT a beneficial owner

- Has limited authorities in relation to disposal of the respective income;
- Exercises mediation function with respect to the income; and
- Performs no other functions and assumes no risks; directly or indirectly pays income to an entity which would not be entitled to any DTT exemptions if it directly received it

Application of a “look through” approach

This approach is applied if an entity which receives dividends IS **NOT a beneficial owner of income**

- **BO - resident in Russia**: the WHT on distributions is **0% (for companies with qualified membership) and 13% (in other cases)**
- **BO - resident in a foreign state**: WHT **as provided in DTT between the Russian Federation and the respective state**

NEW: from 2017 an obligation will exist to obtain a confirmation on the beneficial ownership status from a recipient of the income

Beneficial Owner concept: trends in court practice

Company	Reference	Type of income
<div>-</div> Cases ruled in favour of the tax authorities		
TD Petelino LLC	Resolution of the 9 th Appellation court dated 4 August 2015 №A40-12815/15	Royalty
Nestle LLC	Ruling of the Supreme Court of Russian Federation dated 29 February 2016 №A40-16883/15	Interest
MDM bank	Resolution of the 9 th Appellation court dated 09 February 2016 № A40-116746/2015	Dividends
<div>+</div> Cases ruled in favor of the taxpayers		
JSC "Saint-Petersburg Telekom"	Resolution of the AC Moscow region dated 15 January 2016 № A40-187121/14	Dividends
CJSC "Votek Mobile"	Ruling of the Supreme Court of Russian Federation dated 21 December 2015 №A14-13723/2013	Dividends
JSC "Moskommertsbank"	Resolution of the AC Moscow region dated 19 May 2015 №A40-100177/13	Interest

Controlled foreign companies (CFC) rules: new in regulation

Rules for computing income

- If one of the following conditions is met, the profits of a CFC can be determined on the basis of the financial statements of CFC (i.e. without re-calculation based on Russian rules):
 - CFC is situated in a treaty country (except for the countries that do not provide information exchange for tax purposes);
 - there is an auditor report with respect to the provided financial statement and such report does not contain negative opinion (or absence of such opinion).

Elimination of double taxation of dividends

- No double taxation of dividends in cases when such dividends are received by the controlling person as a result of the CFC profit distribution and if such profit was already taxed at the level of controlling person.

Extension of the period for tax-free liquidation of CFCs

- The deadline for completion of the liquidation procedure of CFCs is extended until 1/1/2018 (with some additional conditions applicable).

Corporate tax residency rules

Participation exemption for self-recognized Russian tax residents

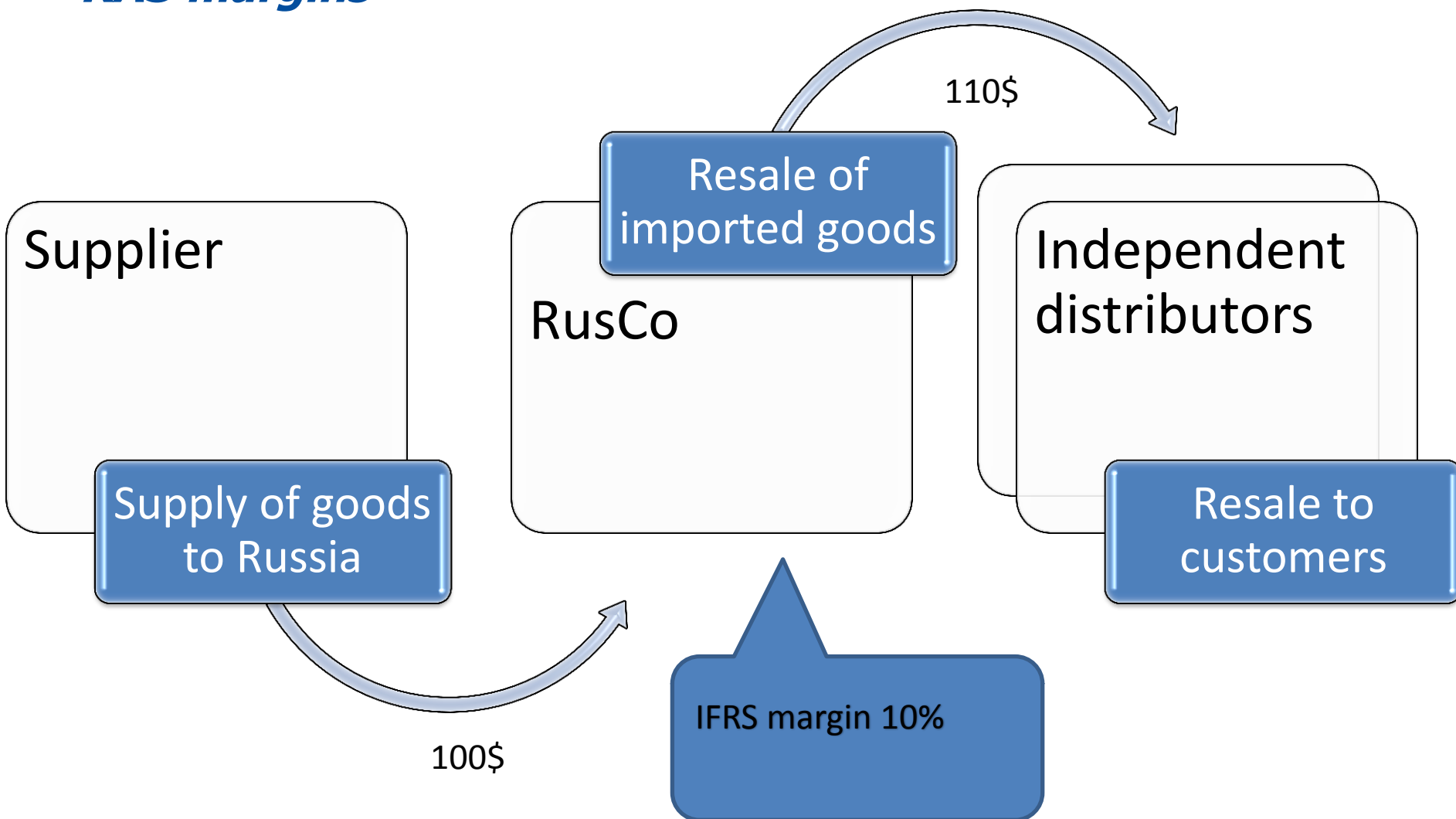
- 0% rate on taxation of dividends is applied only to the companies which self-recognized themselves as Russian tax residents.

Transfer pricing – impact of economic downturn

Svetlana Stroykova
PwC

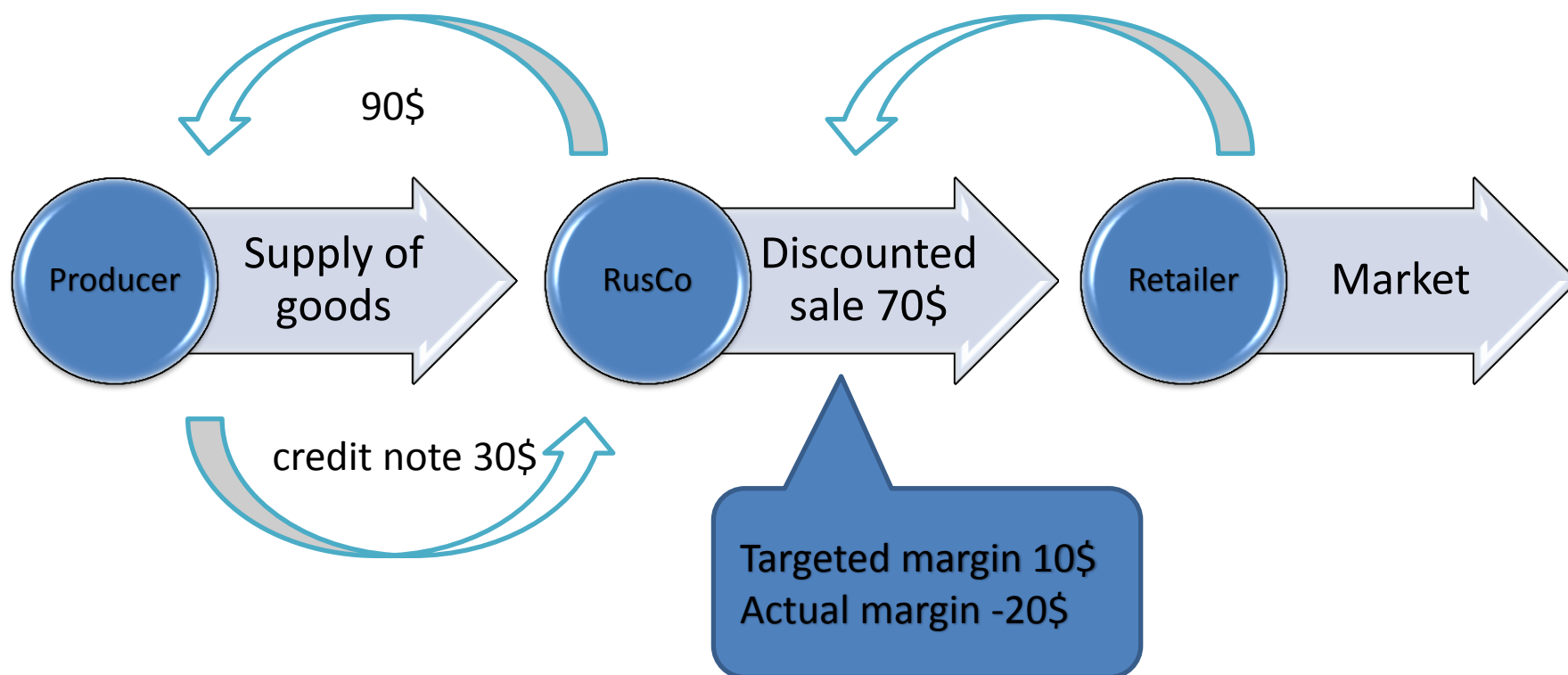
Transfer pricing – impact of economic downturn (1)

RAS margins



Transfer pricing – impact of economic downturn (2)

Discounted sales



Transfer pricing – impact of economic downturn (3)

Documenting – margin test

2015 vs 2012-
2014

Revenues, expenses under RAS

Revaluation of foreign currency loans



Attempting Tax Secrecy

Andrey Bashkirov
Procter and Gamble

Draft changes to art. 102 ***«Tax Secrecy (tax confidentiality)»***

Tax secrecy *inter alia* should not include:

- Average salary per LE
- Information on tax violations.

Draft changes to art. 82

"Main principles of tax control"

- Auditor-client privilege is waived
- Auditing firms are obliged to provide client-related info to tax authorities

SESSION 2. Practice

- Changing the financing structure in times of crisis - taxation aspects
 - Loss-making companies, loss-making commissions and simply losses
 - Top managers liability in front of the the state and the company for tax debts
 - New old criminal cases procedure in action.
- The practice of criminal liability for tax offenses**

Experts: Anna Zvereva, Dentons; Alexey Malenkin, EY; Yulia Litovtseva, Pepeliaev Group; Alexander Erasov, Goltsblat BLP

Changing the structure of financing in times of crisis: tax aspects

Anna Zvereva

Dentons

Increase in debt service costs



A falling ruble results in an increase in the ruble valuation of foreign currency debts



Higher debt and rising negative FOREX differences result in continuous erosion of borrowers' net asset value



Higher debt and lower equity aggravate thin capitalization problems

Converting debt into equity: Scenarios

1. Share capital increase (debt to equity SWAP)
2. Debt forgiveness
3. Setoff of the debt against a “contribution to assets” - ?



loan principal and interest



assignment of debt to the parent company

Converting debt into equity: Problems

- ❖ Setoff (forgiveness) of loan interest: taxable in any case?
- ❖ Income withholding tax on the offset interest
- ❖ Setoff of the debt with the parent company, which receives the debt under an assignment agreement
- ❖ “Fate” of interest accrued while *thin cap* rules applied but not paid by the time of setoff



Loss-making transactions

Loss-making companies

Loss-making committees

Alexei Malenkin

Partner, EY

Loss-making transactions/loss-making companies

- Economic reasons/sales at loss
- Incorrect tax treatment of transactions
- Aggressive tax optimization
- Other reasons: corporate reorganization, non-arms-length intercompany transactions

What to do?

- Correct line of conduct
- Why a company has losses - justification
- Supporting documents: «Defense File»
- NO to «Technical representative»
- Presence of a lawyer or a tax consultant is preferable

Loss – Documents

- **Supporting Documents**
- **Economic justification of expenses** (Ruling of the Arbitration court of the Uralian region dated 23.04.2015 N Φ09-2212/15; Ruling of the Arbitration Court of the North-Caucasus region dated 21.10.2015 N Φ08-7600/2015)
- **Tax losses utilization within tax audit** (Ruling of the Arbitration Court of the Volga region dated 22.05.2015 N Φ06-23332/2015, Ruling of the Arbitration Court of the Moscow region dated 14.10.2014 N Φ05-11780/14)

Financial liability of directors to the state and the company for tax arrears

Yulia Litovtseva
Pepeliaev Group

THE EXTENSION OF PRACTICE WHEN AN ENTITY'S TAX LIABILITIES ARE RECOVERED FROM ITS DIRECTOR

Further to a claim by a shareholder (member) or a legal entity with respect to the harm caused to the entity



The legal entity's losses in the amount of the tax liability may be recovered from its director

(clause 4 of Resolution No. 62 of the Plenum of the Russian Supreme Commercial Court dated 30 July 2013)

Further to an application of a receiver in an entity's bankruptcy case



Secondary liability in the amount of all entity's outstanding obligations

(Ruling No. A40-89736/2013 of the Russian Supreme Court dated 25 January 2016 in the ST LLC case)

Further to a civil lawsuit of a tax authority within or outside a criminal case



Damage in the amount of the tax arrears

(Ruling No. 2-979/2015 of the Russian Supreme Court dated 25 January 2016 in the D.N. Ivkin case and No. 3-UDp14-2 dated 30 July 2014 in the V.S. Zagurskiy case)

THERE ARE NEW METHODS TO RECOVER AN ENTITY'S TAX LIABILITIES FROM ITS DIRECTOR

**Further to a claim
of a tax authority
with no
bankruptcy and no
criminal case
initiated**

(Overview of the case
law established by the
Russian Supreme Court
for quarter IV of 2013)



- ▶ **A failure to fulfil tax obligations over three months and more**
- ▶ **A director's failure to file for bankruptcy or termination of a bankruptcy case**

Appeal Ruling of the Moscow City Court dated 20 October 2015 in case No. 33-22014/2015; Resolution No. 10AP-12171/2015 of the Tenth Commercial Court of Appeal dated 16 October 2015 in case No. A41-37264/15

**Further to a claim
of a tax authority
after a legal entity
has been wound up**



**Winding up the entity when its
obligations are not fulfilled**

Resolution No. F09-9075/15 of the Federal State Commercial Court for the Urals Circuit dated 15 December 2015 in case No. A60-20330/2015

What to do?

In making decisions and consummating transactions, one should take account of the risks of a director bearing personal liability for the company's tax obligations

The goodwill of contracting parties requires more thorough consideration

Standards should be implemented to ensure that transactions (decisions) comply with bankruptcy legislation

Measures should be taken in a timely fashion and the company's owners informed of any signs that the company is insolvent and bankruptcy proceedings may be initiated

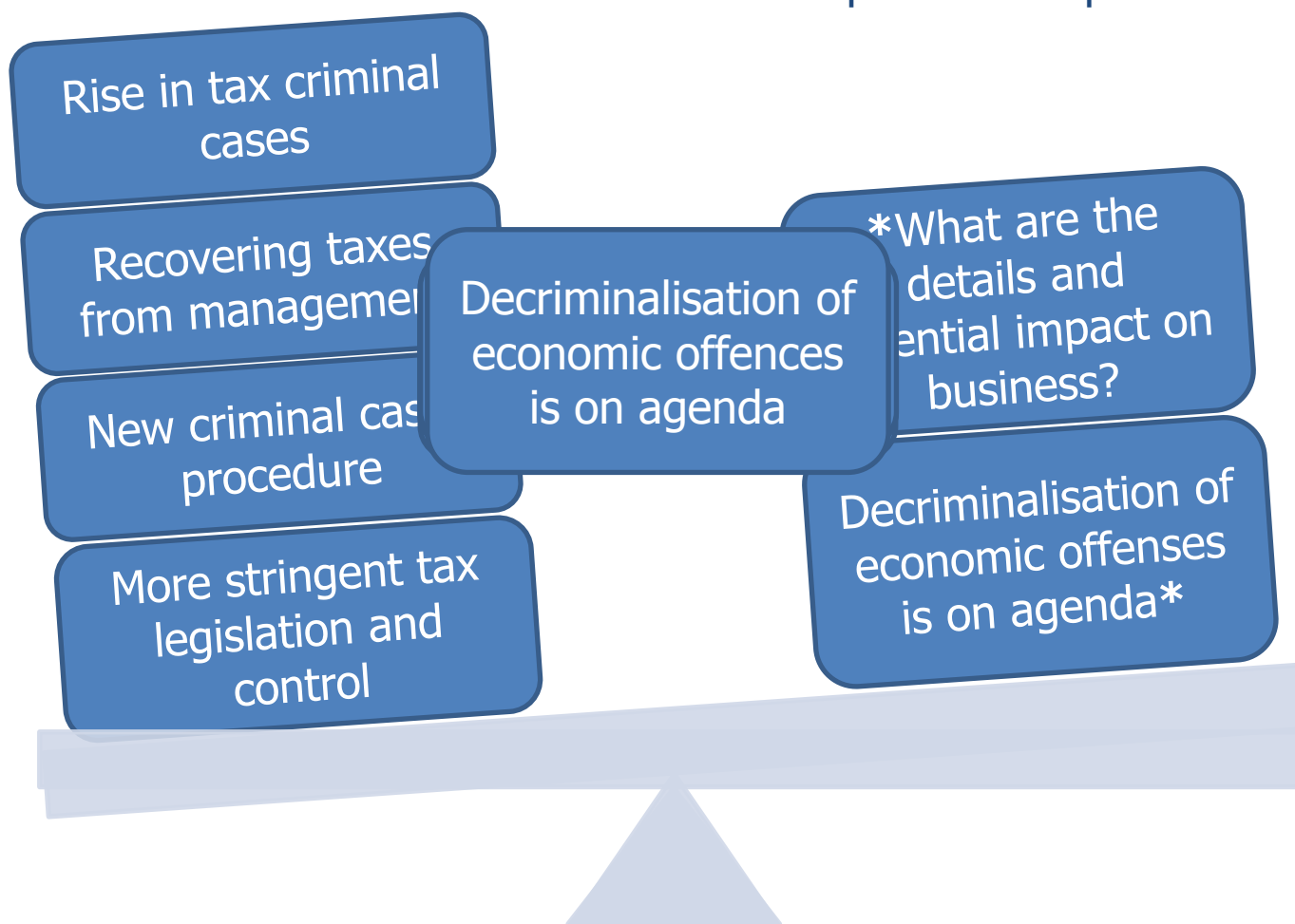


New old criminal cases procedure in action

Alexander Erasov
Goltsblat BLP

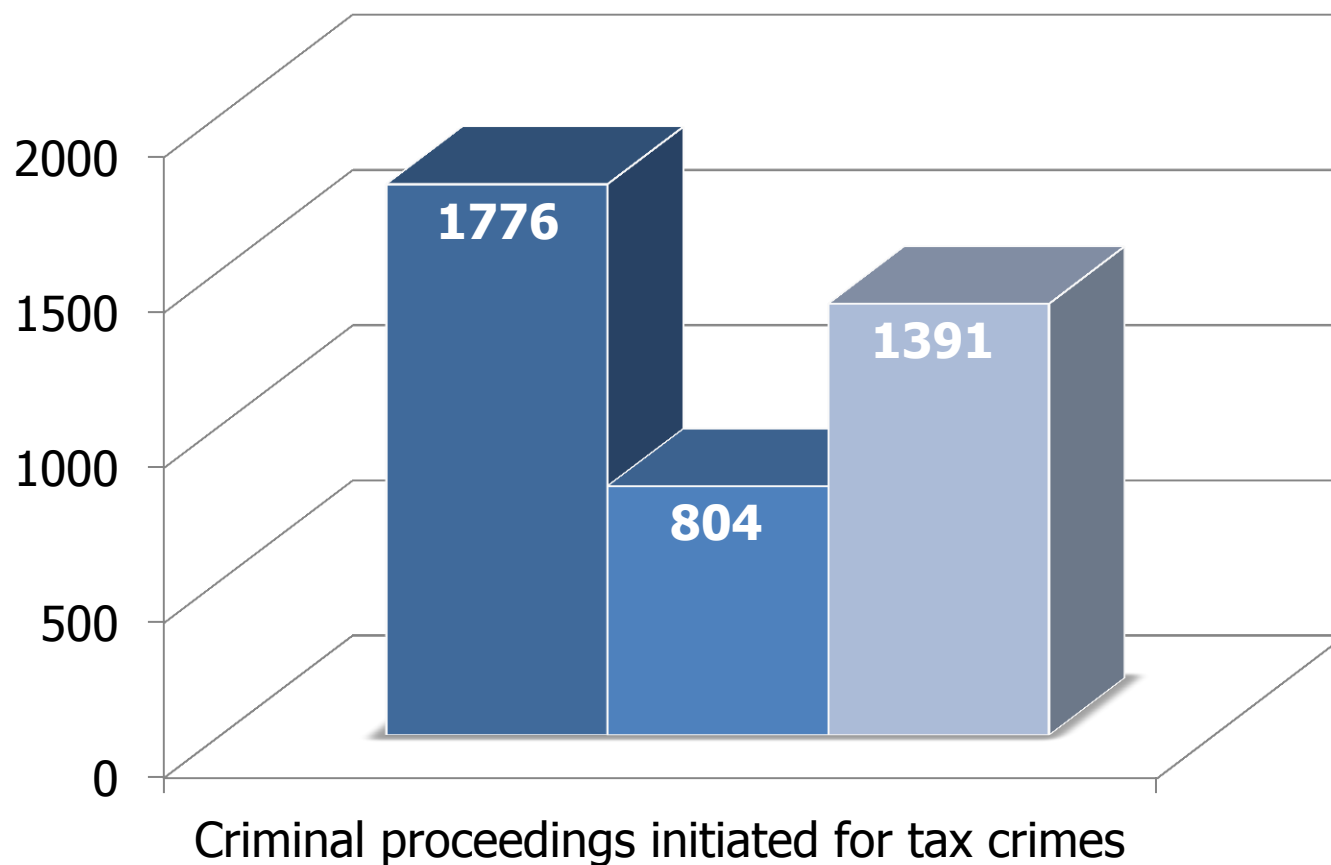
TAX OFFENSES – CRIMINALISATION OR DECRIMINALISATION?

*What are the details and potential impact on business?



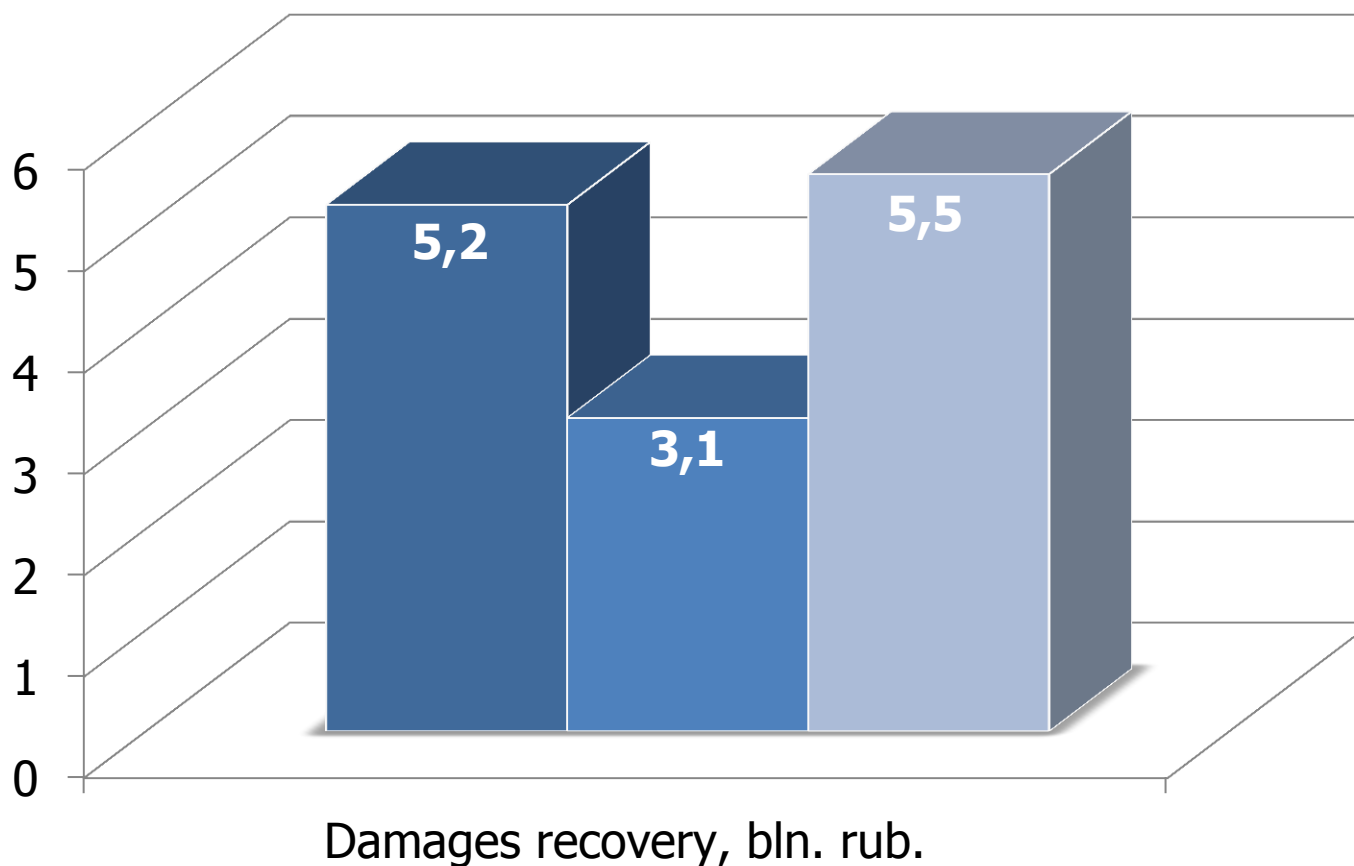
WHAT ABOUT THE STATISTICS?

■ 2011 ■ 5 months of 2014 ■ 5 months of 2015



WHAT ABOUT THE STATISTICS?

■ 2011 ■ 5 months of 2014 ■ 5 months of 2015



RECENT HIGH-PROFILE CRIMINAL CASES

- *Sunrise Tour case*
- *Purgaz case*
- *SU-155 cases*
- *Bazis case*
- *ChelPipe case*

and many more...



VS





Vadim Zaripov

Deputy Chairperson of the AEB Taxation Committee, Pepeliaev Group

CLOSING REMARKS

Q&A