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**Business meeting organized by the AEB
Taxation Committee**

**DEVELOPMENT OF THE
RUSSIAN TAX SYSTEM:
RESULTS OF 2018 AND
PERSPECTIVES**



Alina Lavrentieva

Chairperson of the AEB Taxation
Committee, PwC

OPENING REMARKS

SESSION 1



Tax system fine tuning - key amendments to the Russian Tax Code:

- ***Liquidation of companies and exit of shareholders***
- ***Reduction of share capital and return of contributions to property***
- ***Beneficial ownership issues***

Property taxation - can immovable property move?



KEY CHANGES IN TAXATION OF LIQUIDATION/RESTRUCTU RING TRANSACTIONS

Mikhail Orlov

KPMG

Legislative activity in 2018



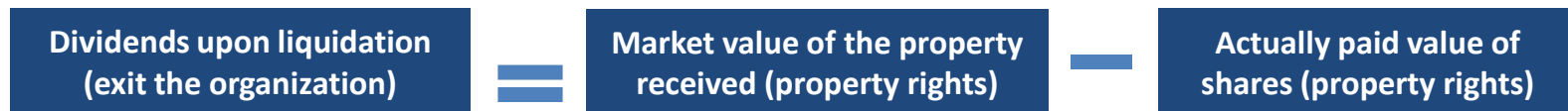
23 Federal Laws amending the Tax Code of the Russian Federation (TC), including:

**Federal Law N 424-FZ
from 27.11.2018**

**Federal Law N 302-FZ
from 03.08.2018**

Qualification of income received upon liquidation

- Income received by a shareholder (participant) leaving the organization or when the organization distributes its property while being liquidated, in part exceeding the contribution to this property, qualifies as dividends. *



- Loss should be recognized as non-operating **expense** (art. 265/280 of the TC)
- Property (property rights) received by a shareholder (participant) is accounted at market value (art. 277 of the TC)
- It is possible to apply the rate of 0% to these dividends if certain conditions are met (art. 284 of the TC)

Revenue from the sale of shares

- Income from the sale of shares in certain cases is subject to income tax at a rate of 0% provided the taxpayer has owned shares for more than 5 years. The requirement to acquire shares after January 2011 is abolished

Return of contribution into assets and share capital decrease

- The funds received by the organization from its subsidiary are not subject to income tax within **the limits of the contribution to the assets** previously received by the subsidiary from such organization, subject to the following conditions (art. 251 of the TC):

Cash contribution(s) to assets

There are documents confirming the amount of contribution and the amount of funds received

- Also, such **income is not subject to Russian withholding tax** (art. 309 of the TC)

Reduction of share capital

- Any reduction of the share capital (regardless of the reasons) is exempt from taxation (art. 251 of the TC)
- Applies to both Russian and foreign companies



BENEFICIAL OWNERSHIP: “LOOK THROUGH” APPROACH SIMPLIFICATION

Anna Modyanova

PwC

Voting!

What is your experience in “look through” approach for withholding tax (WHT) purposes?

Options:

- Successfully applied
- Applied, but it was challenged
- Not applied, other approaches used
- N/A, no payments abroad subject to WHT

What is improved? (1/2)

“Look through” applies to:

- **all** types of Russian sourced income
- **each** separate payment/ group of payments under a contract
- payment to **offshore** companies/ foreign structures without legal personality (e.g. trust)

Simplified confirmation of the beneficial ownership (confirmation letter only) for:

- *Individuals*
- State funds
- *Public companies* (with limitations)
- Government-owned organizations (with limitations)



What is improved? (2/2)

Specified approach to payments on securities under REPO and securities' loans

Dividends distribution:

- Participation of the beneficial owner of dividends in a Russian company required
- Applies to the whole amount of dividends, ignoring ownership stake
- Exemption for dividends in cross-holding structures

Most amendments are effective from 1 January 2018.



Remaining questions

- **DTT condition on direct investment/ minimal stake under a “look-through” approach**
- **What if the legal nature of Russian sourced income is changed in distribution chain?**
- **Should a “defense file” be prepared for an individual/public company?**
- **...**



PROPERTY TAXATION – CAN IMMOVABLE PROPERTY MOVE?

Natalia Faizrakhmanova

Pepeliaev Group

Abolition of the tax on movable property

Expectations

The main objectives of the budgetary, tax and customs, and tariff policies for 2019 and for the planning period of 2020 and 2021:

Investments within the framework of the changed parameters of the tax system are to be encouraged by the abolition of the tax on movable property which is

- **complex and**
- **discourages the accelerated implementation and development of technologies in domestic industry**

Reality

Letters of the Russian Federal Tax Service

No. BS-4-21/4930 dated 16 March 2018

No. BS-4-21/19038@ dated 1 October 2018

No. BS-4-21/20327@ dated 18 October 2018

Case law:

Resolution of the Commercial Court for the Moscow Region dated 23 August 2018 (No. A40-176218/2017), Resolutions of the Commercial Court for the North-Western Circuit dated 4 June 2018 (No. A42-5598/2017) and 18 May 2018 (No. A05-1595/2017), Resolution of the Fourteenth Commercial Court of Appeal dated 13 September 2018 (No. A05-879/2018), etc.

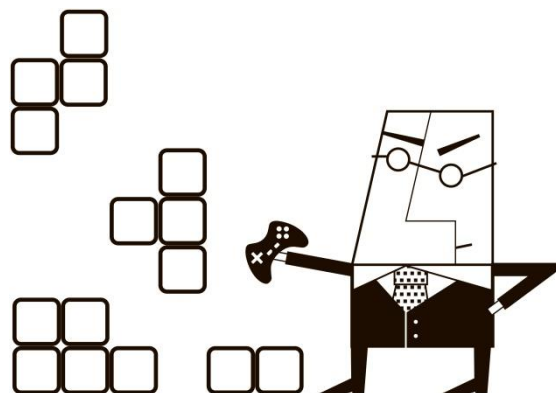
How the terms “fixed asset” and “immovable property” correlate

The determining criterion for accounting purposes is
the useful life.

In the case of different periods of useful life, each part is accounted for
as an independent inventory item



according to accounting rules, an item treated by civil legislation as a
single item may in bookkeeping be accounted for as **several fixed
asset items**.



An immovable property under the Russian Civil Code = uncertainty in calculating tax

Immovable item (article 130 of the Russian Civil Code),
Enterprise (article 132 of the Russian Civil Code),
Indivisible items (article 133 of the Russian Civil Code),
Complex items (article 135 of the Russian Civil Code),
Unified property complex (article 133.1 of the Russian Civil Code)
Principal item and accessory (article 135 of the Russian Civil Code)



Any production equipment which needs to be installed is at risk

! The draft law on amending the Russian Civil Code
• (ID 02/04/02-17/00062515) does not make things
clearer



Key note speech by Head of the Department of International Cooperation and Currency Control of the Federal Tax Service of Russia.

Dmitry Volvach

SESSION 2



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Draft law on ecological fee codification

Art. 54.1 - New rules of an old game

Russian Federation Supreme Court legal positions on taxation matters

Tax disputes - key court decisions

Alternative means of tax dispute resolution: MAP as unutilized potential



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DRAFT LAW ON ECOLOGICAL FEES CODIFICATION

Valeria Khmelevskaya

Brand&Partner

Ecological tax

- New chapter 25.5 „Ecological tax“ from 2020
- Similar to the existing rules, but also several new provisions, *inter alia*:
 - Subsoil users shall be a separate group
 - Group of taxpayers
 - Limited deduction: no more than 70% of the tax amount
- RUB rates pro cubic meter / tonne with annual adjustments based on consumer pricing increase
- Tax registration in each federal subject where the object causing adverse environmental impact is located
- Chamber tax audits: access to premises / area inspection

Utilization fee

- Introduction of the new chapter 25.6 „Utilization fee“ from 2020
- Rules similar to current utilization fee (vehicles) and ecological fee (products to be utilized upon loss of consumer characteristics)
- BUT: utilization by the companies no more considered!
- A new hidden excise duty?



Liability

- Reduced **10% fine** for non-payment until 31.12.2029
- **Starting from 2020:**
 - routine tax administration, incl. accounts blocking, acceptance-free write-off, seizure of documents
 - criminal liability
- **Draft law No. 602508-7**
<http://sozd.duma.gov.ru/bill/602508-7>
- Liability for non-payment
 - Fines: 3*fee amount, but no less than RUB 500k or suspension of activities up to 90 days for legal entities
- Liability for non-reporting
 - Fines or suspension of activities for up to 90 days for legal entities



ART. 54.1 OF THE TAX

CODE:

OLD GAME BY NEW RULES

Evgeny Timofeev

Bryan Cave Leighton Paisner (Russia)

LLP

Three consecutive tests of Art. 54.1

1

No distortion of facts

on business activities and taxable objects

- Of irreality of an operation
- Of operation not matching the declared one

2

Business purpose of an operation

(operation performed not only for tax purposes)

3

The contract is executed by the counterparty

or a person given full rights to do so by agreement or by law

Effect in time

Formal point of view

From 19 August 2017 tax authorities have to justify provisions of **art.**

54.1 of the Tax Code:

- On desk tax audits of declarations filed after this date
- On field tax audits scheduled after this date

Given the provisions of the Tax Code

Art 5 of the Tax Code:

provision of law acts to full extent only when tax base and taxes are calculated:

- From 01.10.2017 for VAT
- From 01.01.2018 for profits tax
- *For previous periods* – only if benefitting particular taxpayer



Practical issues

The moot point is

execution by an appropriate party

Not many audits

all controlled by the Federal Tax Service

**Application of
both Plenum 53**

and Art. 54.1 of the Tax Code

Focus

on proof of intention

It's important

to change approach to planning operations
and selecting counterparties



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LEGAL POSITION OF THE SUPREME COURT OF THE RUSSIAN FEDERATION ON TAX ISSUES

Alexey Nesterenko

EY

Supreme Court's statistics on tax issues

Number of cases – 1 227, including:

▶ Beneficial ownership	5
▶ Tax incentives (inc. 27 on property tax exemption)	48
▶ Requalification	5
▶ VAT – 631 (inc. 401 on unjustified tax benefit)	631
▶ Unjustified tax benefit	485

Beneficial ownership

- ▶ AO "SMARTS";
- ▶ AO "TNS ENERGO ROSTOV-NA-DONU";
- ▶ AO "SUEK-KUZBASS";
- ▶ OOO "AKTIV RUS";
- ▶ AO "KASHIRSKI DVOR-SEVERYANIN".

Property tax exemption

- ▶ OOO "KIT EKATERINBURG";
- ▶ OOO "Prospereti";
- ▶ OOO "GLOBAL INVEST";
- ▶ AO "AZOT".

Requalification

- ▶ OOO "MON'DELEZ RUS";
- ▶ OOO "HALOPOLYMER KIROVO-CHEPETSK";
- ▶ AO "AMNGR";
- ▶ AO "ARKHANGELSKI FANERNY ZAVOD";
- ▶ OOO ""DABROVICH";

Double tax treaty

The concept of Beneficial Ownership

Court ruling

- Ruling of the Supreme Court dated 15.10.2018 No. 310-KG18-15460

Comment

- ▶ Tax authorities considered a foreign holding company as a conduit (transit payments)

Direct investment

Court ruling

- Ruling of the Supreme Court dated 27.06.2018 No. 308-KG18-8068

Comment

- ▶ Payment for shares was made in a non-monetary form (taxpayer used promissory notes that were not fully paid on the date of dividend payment) (formal nature of operations)

Application of a reduced rate of interest to retrain in dividends (Cyprus)

Court ruling

+ Ruling of the Supreme Court dated 06.03.2018 No. 304-KG17-8961
Ruling of the Supreme Court dated 05.04.2018 No. 305-KG17-20231

Comment

- ▶ Tax authorities considered interests paid as dividends
- ▶ Court considered loan as contribution to the capital of a borrower

Qualification of transactions' nature

Hidden distribution

Court ruling

Ruling of the Supreme Court dated 12.07.2018 No. 301-KG18-8935

Comment

- ▶ Tax authorities requalified income received under certain transactions of taxpayer to hidden distribution of profits in favor of parent company

Direct investment

Court ruling

Ruling of the Supreme Court dated 07.09.2018 No. 309-KG18-6366

Comment

- ▶ Tax authorities requalified payments in favor of foreign counterparties under the contracts for provision of services to "passive" income for the purposes of withholding tax

Russian tax incentives

The objective of establishing

Court ruling

- Ruling of the Supreme Court dated 03.08.2018 No. 309-KG18-5076,
Ruling of the Supreme Court dated 17.04.2018 No. 30-KG18-501

Comment

- ▶ Tax authorities scrutinize conditions of tax incentive application (whether they comply with the law) and nature of transactions.
- ▶ Following the above principle for consideration of the cases, regarding incentive for energy-efficient non-residential buildings, the Supreme Court noted that the tax legislation does not contain the definition of building efficiency class, as well as does not establish criteria for high class building efficiency
- ▶ The tax incentive as a designated purpose – stimulation of usage of highly efficient modern tools for increasing the energy-efficiency of living accommodations, not for commercial buildings

Court ruling

+ Ruling of the Supreme Court dated 16.10.2018 No. 310-KG18-8658

Comment

- ▶ Following the above principle for consideration of the case regarding incentive for movable property the Supreme Court noted that the purpose of the incentive was the stimulation of investments into new devices – stimulation of renewing of fixed assets without essential losses for budget and the issue of applying/non-applying the incentive should be treated in accordance with the purpose.

Legitimacy of applying incentives (both international and national) would be analyzed due to

- ▶ economic basis of application the incentive (meant by legislator)
- ▶ taxpayer's business purpose



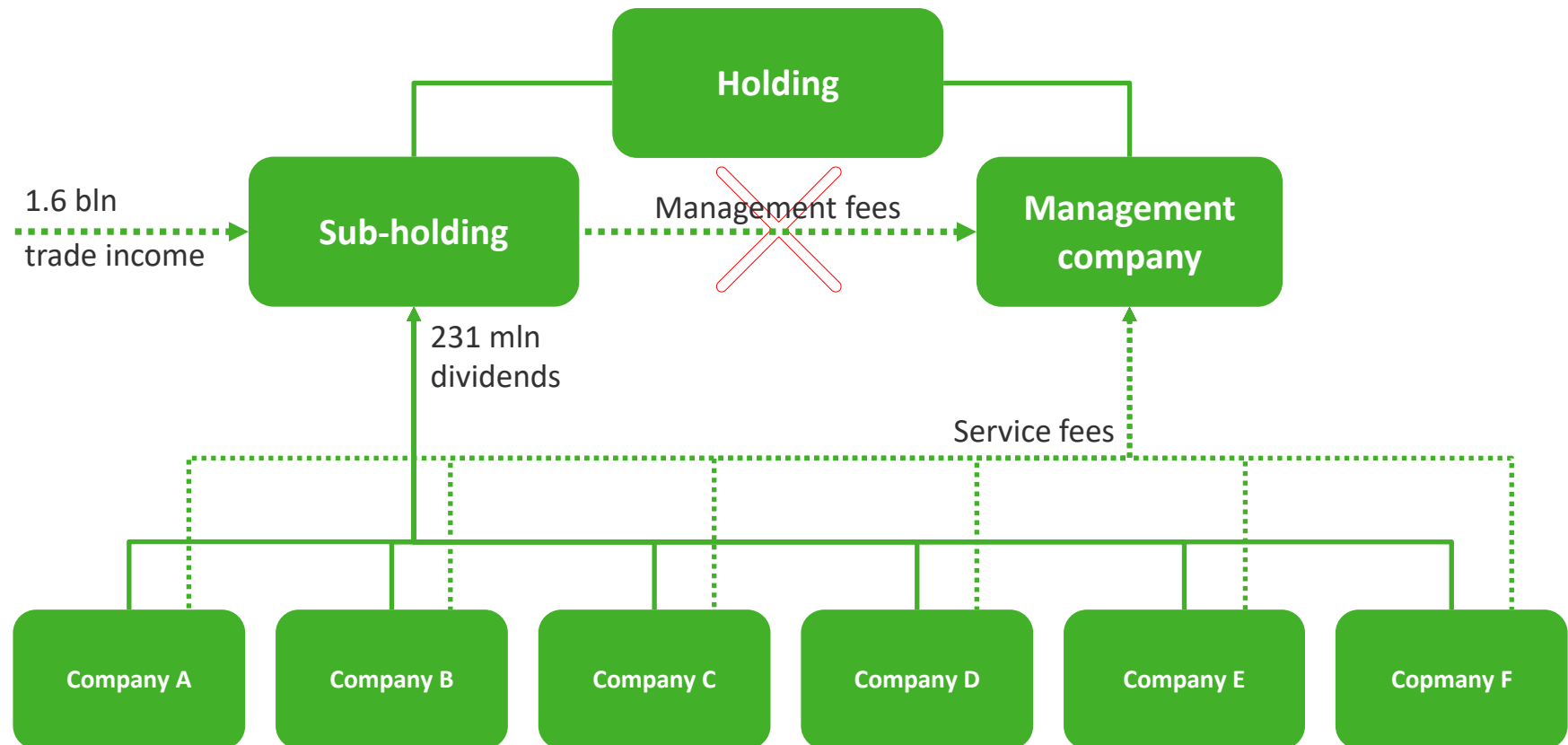
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REMARKABLE TAX CASES

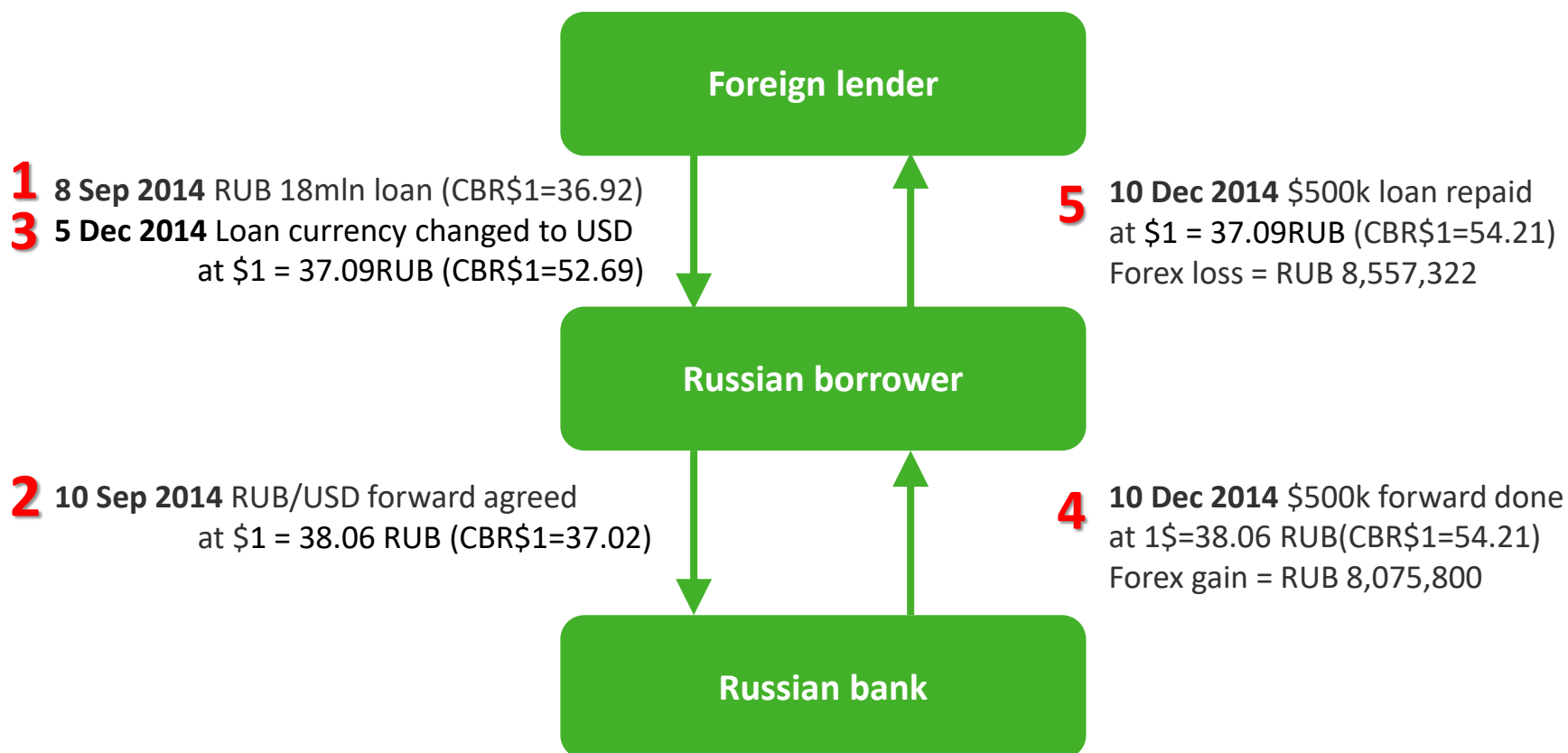
Anton Zykov

Deloitte

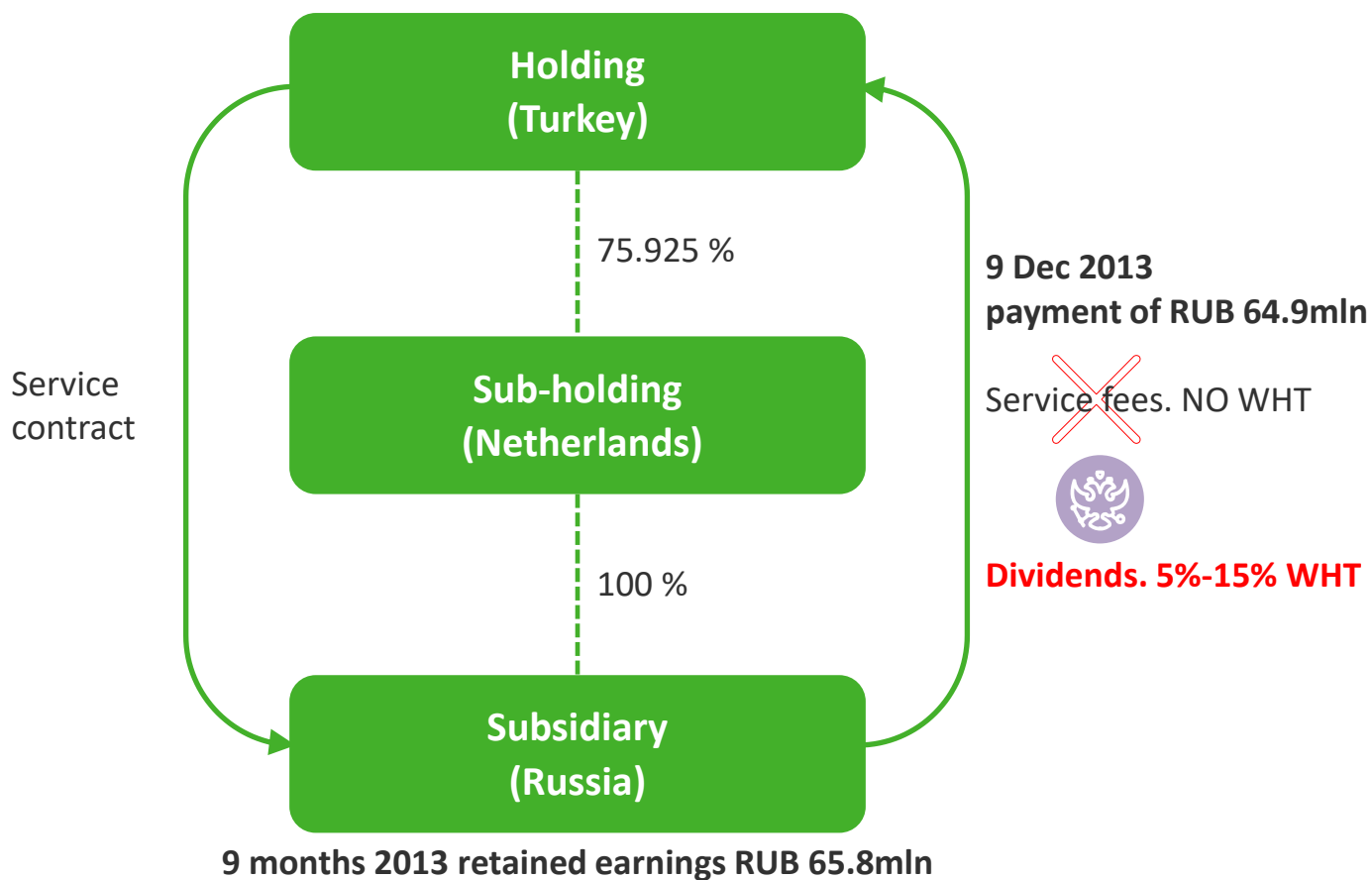
A47-9881/2017: HoldCo loses deductions



A32-46618/2017: Unreasonable forex loss



A11-9880/2016: Service fees-to-dividends





ALTERNATIVE MEANS OF TAX DISPUTE RESOLUTION: MUTUAL AGREEMENT PROCEDURE (MAP) AS UNUTILIZED POTENTIAL

Maria Kostenko

Baker McKenzie



MAP Process

- **MAP** is a special procedure in a tax treaty that allows to **resolve international tax disputes** and eliminate double taxation where domestic procedures are ineffective
- **Deadline for MAP application – 3 years** from the first notification of the action not in accordance with a tax treaty (official notice of tax assessment)
- **Grounds for MAP application** - tax has been charged or will probably be charged in disregard of the tax treaty (no need to wait for the final tax assessment)
- Competent authorities are not obliged to reach an agreement and the taxpayer is entitled not to accept the results of a MAP case
- **Practical problem:** overlapping with domestic remedies. MAP is a lengthy procedure taking one-two or more years, and its initiation does not suspend the statute of limitations for applying for domestic remedies

MAP Case Study No. 1

Facts: Russian tax authority rejected deductibility of royalties paid by Russian trading subsidiary to its US parent company – license holder – as not “economically justified”

A third party Russian company lost the tax case on a similar issue

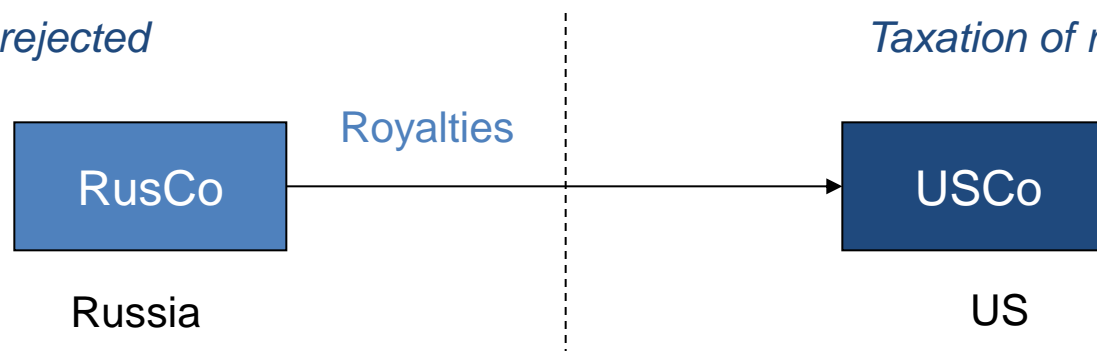
MAP basis: Rejection of an expense deduction at the level of a subsidiary leads to economic double taxation. Taxpayer successfully proved that rejection of a royalty expense resulted in double taxation and should be considered as a treaty case

Requested relief: Deduction of royalty expense in Russia (at source), or tax relief in US (at the place of residence)

Outcome: Tax assessment was revoked by a Russian higher-level tax authority as a result of the appeal review. No formal MAP agreement was concluded

Tax deduction is rejected

Taxation of royalties



MAP Case Study No. 2

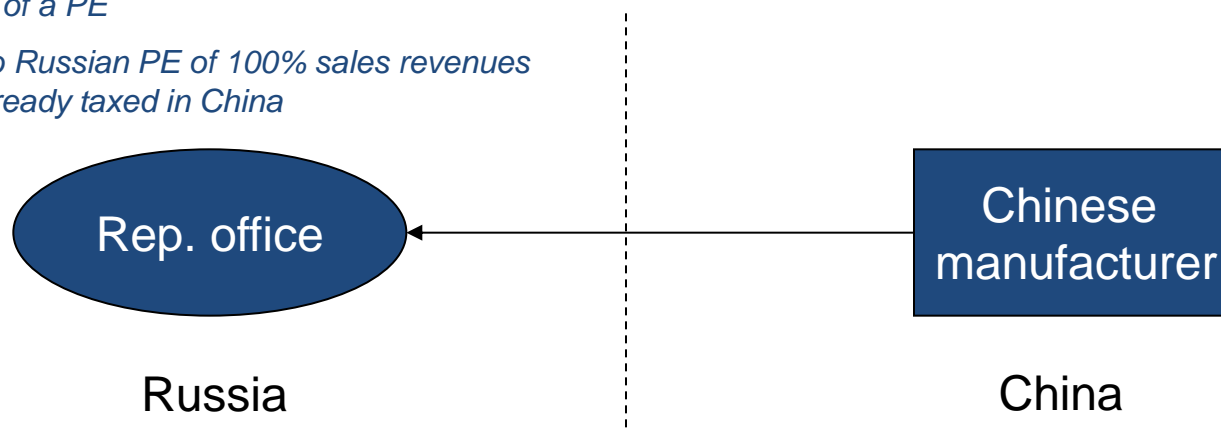
Facts: Russian tax authority recognized a PE of a Chinese manufacturer in Russia. All sales revenue was attributed to PE in violation of Art. 7 of the China-Russia Tax Treaty

MAP basis: Existence of PE - questionable. Attribution of all sales revenues to Russian PE contradicts Art. 7 of the China-Russia Tax Treaty

Requested relief: In case PE will be recognized, profits must be allocated to PE based on functions, assets, and risks in accordance with Art. 7 of the China-Russia Tax Treaty

Outcome: The tax assessment was fully revoked by the Russian tax authorities. No formal MAP agreement was concluded. The taxpayer withdrew the case from court

- *Recognition of a PE*
- *Attribution to Russian PE of 100% sales revenues that were already taxed in China*



MAP Case Study No. 3

Facts: Russian tax authority rejected deductibility of interest paid by a Russian subsidiary to a EU company based on Russian thin capitalization rules

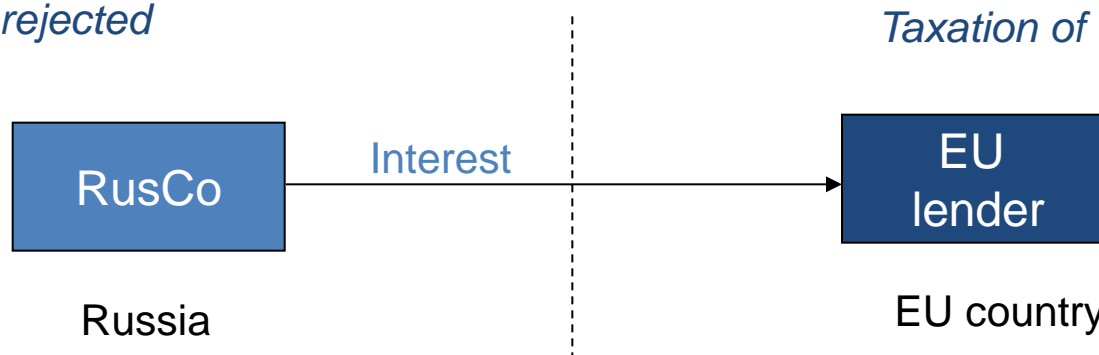
MAP basis: Rejection of an interest expense deduction at the level of the Russian subsidiary leads to economic double taxation. Taxpayer successfully proved that rejection of the interest expense resulted in double taxation and should be considered as a treaty case

Requested relief: Deduction of interest expense in Russia (at source), or tax relief in EU country (at the place of tax residence)

Outcome: Tax relief in EU country was granted by the EU country tax authority. No formal MAP agreement was concluded

Tax deduction is rejected

Taxation of interest





Vadim Zaripov

Deputy Chairperson of the AEB

Taxation Committee, Pepeliaev Group

CLOSING REMARKS