

DEVELOPMENT OF THE RUSSIAN TAX SYSTEM IN 2014 AND PROSPECTS FOR 2015- 2017

Dr. Alina Lavrentieva
Partner, PwC,
Chairperson of the AEB
Taxation Committee

WELCOME REMARKS

Sergey D. Shatalov

Deputy Minister of Finance of the RF

MAIN TRENDS OF THE TAXATION POLICY FOR 2015-2017

Sergey Y. Belyakov

Deputy Minister of economic development of the RF

STATE TAXATION POLICY – VIEW OF MINISTRY OF ECONOMIC DEVELOPMENT'S REPRESENTATIVE

Boris Bruk

Counsel, Dentons

REVISED DRAFT LAW ON CFC AND TAX RESIDENCY RULES – DIALOGUE WITH BUSINESS

Beneficial Ownership Concept Introduced

- Beneficial Owner: (i) a person that simultaneously enjoys possession, use or the right to dispose income or (ii) a person benefiting from use or disposal of income by a third party
- Functional analysis to be performed to determine who beneficial owner is: (i) limited rights test; (ii) agent/ nominee test; (iii) no substantive functions/ risks test; (iv) direct/ indirect payments to another person not entitled to treaty benefits test
- Article 312 (1): tax agent is entitled to request documents confirming beneficial ownership from a recipient of Russian source income
- Proposed wordings of Article 7 and Article 312 (3) are contradictory:
 - what is “economic destiny” (Article 312 (3))?
 - legal approach (Article 7) vs economic approach (Article 312 (3)): which will be predominant?
 - potential “no beneficial owner” cases

CFC Rules Revised : Major Changes

- No “black list”
- Control limited to group of related (affiliated) persons (reference to transfer pricing rules);
- Exemptions introduced:
 - qualifying publicly traded companies;
 - legal entities controlled through qualifying publicly traded companies;
 - entities that do not distribute profits among members/ participants;
 - entities residing in the Eurasian Economic Union;
 - entities residing in jurisdictions (i) facilitating exchange of information with Russia (“white list”) and (ii) imposing the effective income tax rate of at least 15 percent
- Two notifications: (i) CFC (20 March, each year) and (ii) participation in qualifying organizations, even if no CFC (one time, 20 days after beginning of participation)

CFC Rules Revised : Major Changes

- New rules on calculation of CFC profits:
 - income divided into active and passive income (passive income includes dividends, interest, royalties, liquidation proceeds, capital gains from shares/ immovable property, lease income, certain service fees)
 - separate calculation of profits from the activities generating active and passive income
 - separate calculation of CFC profits from other profits (no cross utilization of losses available)
 - unlimited carry over of losses from passive income generating activities
 - transfer pricing adjustments to be taken into account when calculating CFC profits
 - indirect foreign tax credit introduced (foreign income tax paid in respect of CFC profits in CFC residence state is creditable against Russian tax on CFC profits)
- Gratuitous period introduced (at least 1 calendar year): CFC income recognized on 31 December of the calendar year following the year in which CFC recognizes this income for domestic purposes (end of domestic reporting period)
- RUR 3 000 000 exemption threshold introduced

CFC Rules : Further Developments (Media Reports)

- Transitional period:
 - provisional waiver of interest and penalties;
 - the law may first apply to individuals and then will be expanded to Russian resident companies
- Increase of controlling threshold from 10 percent to 50 + percent (could then drop back to 10 percent), otherwise control should be proven by the tax authorities
- Tax amnesty

Tax Residence Rules Revised

- Twofold management and control test introduced:
 - (i) First tier test
 - board of directors (other collective governing body) meetings held in Russia; AND
 - strategic management performed in Russia; AND
 - chief officers work in Russia
 - (ii) Second tier test (if the first tier test is not conclusive, ie accomplished in different states)
 - place of statutory/ management accounting; AND
 - place of management paperwork (issuance of corporate directives, policies etc); AND
 - place of employment of staff and staff management

Vadim Zaripov

Deputy Chairperson of the AEB Taxation Committee

REVISED DRAFT LAW ON CFC AND TAX RESIDENCY RULES – DIALOGUE WITH BUSINESS

Arseny Seidov

Partner, Baker & McKenzie

NEW DRAFT LAW ON ANTI- ABUSE CONCEPT

GAAR: worldwide and local trends

- Rise of GAAR worldwide
 - 1924 – the Netherlands; 1941 – France; 1988 – Canada; 1997 – Italy; 1988 – Singapore; 2010 – the U.S. codify “economic substance doctrine”; 2013 – the UK
 - Global trend to tighten tax rules, tackle treaty abuse and aggressive tax planning
- OECD position: there is no conflict between tax treaty provisions and GAARs:
 - *"GAAR are part of the basic domestic rules set by domestic tax laws for determining which facts give rise to a tax liability; these rules are not addressed in tax treaties and are therefore not affected by them"*
 - *"States do not have to grant the benefits of a double taxation convention where arrangements that constitute an abuse of the provisions of the convention have been entered into"*
- “Russian GAAR”
 - Resolution No. 53 of the Plenum of the Supreme Arbitrazh Court (Oct. 12, 2006)
 - Resolution No. 320-O-P of the Constitutional Court (June 4, 2007), etc.
 - New Draft Law No. 529775-6 introduced by A. Makarov (Deputy Chairman of the Committee on Budget Issues and Taxes) to the State Duma on May 23, 2014

Draft Russian GAAR – key terms and takeaways

- “A taxpayer is considered to be a bona fide taxpayer if he or she duly performs his or her tax obligations ... *unless tax authorities determine that such performance constitutes abuse of rights by the taxpayer*”
- “Abuse of rights is defined as performance of certain actions with the *main objective of failure to perform one’s tax obligations*”
- “Should tax authorities determine in the course of a tax audit a non-performance by a counteragent of his or her contractual obligations, they may disallow the taxpayer to deduct expenses or apply tax deductions arising from a transaction concluded with this counteragent *if in the course of analysis of good standing of the counteragent taking into account the specifics of conducting particular business activities the taxpayer could obtain information indicating the impossibility of performance of obligations by the counteragent...*”
- Possible implications:
 - tax authorities may be inclined to determining abusive tax planning
 - introduction of a new term (*the "main objective"*) will likely cause a new waive of judicial interpretations
 - subjective provisions will likely lead to development of arbitrary approach of the Russian courts and tax authorities

Possible scenarios and impact

- Short-term considerations
 - Revision of court practice not in favor of taxpayers
 - Increase of number of taxpayers' complaints on results of tax audits
- Long-term considerations
 - Potential decrease of FDI in Russia (but no reliable stats worldwide prove this)
 - Subjective application of GAAR may damage legitimate business structuring
- Alternative ways to address Russian GAAR
- Factors to consider in codifying GAAR in Russia
 - Mandatory judicial review of cases where the obligation to pay tax arises from a revision by tax authorities of the legal qualification of a transaction concluded by the taxpayer or of the status and nature of activities of the taxpayer
 - Bearing the burden of proof: taxpayer, tax authority or shared
 - Guidance on the application of new GAAR
 - Appointing an interim advisory group (advisory panel) to oversee the development of guidance on the new GAAR
 - Specific regulations for combatting "fly-by-night" companies
- Feedback from the business and international tax community

Mikhail Orlov

Partner, KPMG

NEW DRAFT LAWS ON HORIZONTAL MONITORING AND CERTIFIED TAX CONSULTING

The draft law "On tax consulting"

- Introduction of new terms "tax consulting", "tax consultant"
- Status of a tax consultant
- State register of tax consultants
- State control over tax consultant's activity

The problems of the draft

- The concept of tax consulting is not clear
- Tax consultants are supposed to be depended from Federal Tax Service
- The court decision is not required for imposing liability on tax consultants'

"Horizontal" tax monitoring

- A special form of tax control
- Participants of horizontal tax monitoring are:
 - ✓ Tax authorities
 - ✓ Major taxpayers
- Tax authorities get an access to taxpayers' accounting documents
- Limitation of the tax authorities' right to perform field tax audits
- New tax procedure:
 - ✓ Motivated tax opinion
 - ✓ Mutual agreement procedure

Evgenia Veter
Partner, EY

***COST SHARING
ARRANGEMENTS – UPDATE
ON THE DRAFT LAW***

Key facts

- Current status:
 - Cost Sharing/ Cost allocation does not exist as a concept in Russian law, although allowed / accepted by the OECD TP Guidelines and individual countries' legislation;
 - Currently, forms a significant risk for Russian tax payers.
- Ministry of Economic Development proposed a draft law which is meant to allow Cost Allocation / Cost Sharing in Russia.
- Significant developments, if the Law is enacted:
 - Allows multinationals to enjoy (under certain conditions) tax deduction of costs allocated to Russia
 - Reduces a risk of double taxation
 - Stimulates Russian HQs to recharge costs to their foreign subsidiaries

Summary of the Draft Law (1 of 2)

- Tax deduction is to be allowed for HQ costs, provided that they:
 - incurred for the benefit of related group entities
 - incurred during the two years preceding the tax deduction
 - incurred and allocated based on the Cost Allocation (Sharing) Agreement
 - are not in the list of non-deductibles as per art. 270 of the Tax Code
 - do not originate from a low tax jurisdiction (black-listed country)
 - do not exceed 30% of the Russian tax payer's sales
- Cost Allocation (Sharing) Agreement should specify:
 - list and nature of expenses to be allocated
 - period in which expenses were incurred
 - list of related parties - recipients of expenses
 - formula for cost allocation
- Formula for cost allocation should provide for:
 - consistent approach for cost allocation within the group
 - allocation keys (may be adjusted depending on specifics of activities of certain participants and economic benefits expected by them)

Summary of the Draft Law (2 of 2)

- Mark up on costs is allowed if:
 - the amount of the mark up is arm's length (i.e. for services, subject to TP documentation)
- Reporting requirements:
 - report from the HQ which is in line with the Russian bookkeeping requirements
 - report to include the total amount of HQ costs, a mark up, allocation formula / keys specific to each category of expenses
 - report to be certified by an independent auditor
 - TP documentation is a must for a mark up amount
- Independent auditor to confirm:
 - the amount of HQ costs to be allocated
 - a share of a tax payer's costs in the total amount of HQ costs and whether it is calculated in line with the agreement
 - consistency in application of the allocation formula for all participants of the agreement
 - absence of non-deductibles in the amount to be allocated.

Open Questions

- CSA/CCA or SSA??
 - CSA/CCA – joint funding of costs
 - SSA – services for a group of entities
- Shareholder / stewardship costs?
- 30% limitation:
 - Start up companies?
 - Potential double taxation
- Reporting / audit requirements:
 - To what extent these will be practical to comply with?
- VAT treatment?

Thank you

Evgenia Veter

Partner, Head of Transfer Pricing Services in the CIS
EY

tel: + 7 910 445 6779

evgenia.veter@ru.ey.com

Anton Nikiforov

Partner, Pepeliaev Group

***VAT MATTERS: VAT ON
BONUSES, INVENTORY
LOSSES, VAT CONTROL
MATTERS***

Resolution of the Plenum of the Russian Supreme Commercial Court "On certain issues which commercial courts encounter when considering cases connected with collecting value-added tax" (clause 12)

Gifts

Primary product and a supplement

Price of the primary product

Tax assessed on the primary transaction

Transferring advertising materials

The elements of a product





Association
of European
Businesses

Resolution of the Plenum of the Russian Supreme Commercial Court "On certain issues which commercial courts encounter when considering cases connected with collecting value-added tax" (clause 10)

Spoilage, misappropriation, etc.

Retirement (writing off) of property

Burden of proof

Presumption



Resolution of the Plenum of the Russian Supreme Commercial Court "On certain issues which commercial courts encounter when considering cases connected with collecting value-added tax"

Tax Control

Desk audit (clause 14)

(Including VAT in the price (clause 17))

VAT being refunded (clause 21)

Timeframe when a tax deduction applies (clause 27)



Yana Proskurina

Partner, PwC

COURT PRACTICE ON TAXATION MATTERS

Interest deduction – what's new?

Loans from “sister” companies

(+!) Teleset (FAC NWD, Case No. A21-3697/2013)

(-) United Bakers (FAC-NWD, Case No. A52-4072/2012); Severstal (FAC-MD, Case No. A40-88761/2012); Domodedovo (FAC-MD, Case No. A40-16818/13); Brunswick Rail (MAC, Case No. A40-4757/14); Olekminskiy Rudnik (FAC-FED, Case No. F03-7391/2013)

Leasing company

(-) Brunswick Rail (MAC, Case No. A40-4757/14)

Interest paid to a Russian company – is paragraph 4, Article 269 applicable?

(-) Arktikgaz (FAC WSD, Case No. A81-2782/2013), but no interest and penalty

Deduction period – SaNiVa case

(-) Several unfavourable rulings in the Ninth Appellate Court (Cases No. A40-123832/13, A40-4787/14, and A40-135396/13)

Royalties – hot topics

Know-how - substance?

(-) SunInBev, FAC-MD, Case No. A40-104549/13

(+) Domodedovo Group, FAC-MD, Case No. A40-16818/2013 and others

Royalty payments – economic justification?

(+) Cersanit – FAC-MD, Case No. A40-39231/13

(-) Schwank – FAC-WSD, Case No. A70-3295/2013

Free-of-charge trademark usage

(+!) Knauf (FAC-NWD, Case No. A56-30538/2013) (similar FAC-NWD cases - Liviz, Alkor and Co); Iveco (FAC UD, Case No. A76-4926/2013); Orimi Trade, Nevskie Porogi, Karavan (FAC-NWD)

Pre-contract registration expenses

(-!) Hannes Snellman (FAC-MD, Case No. A40-88532/13)

Who are the experts?

Transfer pricing cases

Suzuki– HSE (Lipsits), Case No. A40-111951/12

Mazda - MBC (Shedlovski), HSE (Lipsits), Case No. A40-4381/13

Hyundai – NIOTs, Case No. A40-50654/13

Toliattiazot – VNIKI, FBU RFTCE, Case No. A40-6292/13

Gazprom Export, - VNIKI, Finansoviy Consultant, Case No. A40-90092/12

Other cases

BAT – Incom (Eskov), Case No. A40-78665/12 and others

SanInBev - SSO SMAO, Case No. A40-104549/13

Domodedovo Group – MBC (Shedlovski), Case No. A40-16818/2013 and others

Q&A