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TAX PLANNING: NEW BOUNDARIES



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OPENING REMARKS

SESSION 1

NEW ARTICLE 54.1 OF THE TAX CODE: GOOD OR BAD NEWS FOR TAXPAYERS?

RELATIONSHIPS WITH COUNTERPARTIES:

- What taxpayers must do to check counterparties in view of new rules?**
- What has changed in terms of responsibility for bad faith counterparties?**

THE TIME EFFECT:

- Can new rules apply to prior periods?**
- Does the resolution of the supreme arbitration court of 12.10.2006 #53 remain valid?**

THE REACH EFFECT:

- Is it possible to apply new rules to cross border transactions?**
- What is correlation of new rules and mli?**



NEW ARTICLE 54.1 OF THE TAX CODE

Mikhail Orlov

Partner, Head of Tax and legal,
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New legislation (article 54.1 Tax Code)

Federal Law N 163-FZ of 18.07.17 "On amendments to Parts One of the Russian Tax Code"

Re: establishing limits for taxpayers in respect of exercising their rights and performing their obligations

New Article 54.1 of the Tax Code was introduced.

Taxpayers shall not be allowed to reduce the amount of tax due and payable in the following cases:

- misrepresentation of the taxpayer's business operations;
- the main purpose of transactions (operations) is tax avoidance;
- the obligation under the transaction (operation) was not performed by counterparty and/or by person to whom the obligation to perform the transaction (operation) was transferred by the contract or by law.

The following facts shall not be treated as separate grounds that invalidate a taxpayer's reduction of taxes due and payable:

- inaccurate documents;
- the failure of counterparties to pay taxes;
- provision of options via which a transaction can be made in a different way.



Letter of the Federal Tax Service of Russia of 16.08.2017 N CA-4-7/16152@

- It is necessary to provide evidence that proves the audited taxpayer intentionally sought to create the conditions necessary via which it could obtain tax benefits;
- Special attention should be paid to investigating the circumstances that confirm or disprove that the transaction / operation was actually performed by the counterparty;
- The tax authorities cannot determine the rights and obligations of a taxpayer using any calculations;
- This does not cover “Failure to exercise due care”;
- The negative consequences arising for secondary, tertiary and subsequent counteragents that have undertaken illegal actions shall not fall upon taxpayers;
- Proof of the circumstances stipulated by Article 54.1 of the Code is to be provided by the tax authorities when they are conducting tax control measures.



RELATIONSHIPS WITH COUNTERPARTIES: NEW COMPLIANCE FOCUS

Maria Semenova
Mazars

What should taxpayers do to check counterparties in the view of new rules?

The taxpayer should ensure that the counterparty is capable to execute the transaction

Focus	Type of proof	Tracking
Sector player =we know this supplier	<ul style="list-style-type: none"> • License (if applicable) • Membership in the self-regulated organization (if applicable) • Ratings supporting professional reputation (if any) • Referrals supporting experience (if available) • Availability of resources (equipment, machinery, storage spaces, fleet, personnel, etc.) essential for the proper execution 	<ul style="list-style-type: none"> • Copy the source of information (link to the web-site, advertising materials, proposals, referrals) • Financial statements, CVs of key personnel, warehouse leasing contracts, etc.
Justified choice =we need this supplier	<ul style="list-style-type: none"> • Analysis of the commercial conditions attractiveness • Evaluation of contract terms vs the standard market conditions • Summary of the counterparty choice results (including search, monitoring and selection results) supporting the choice of the counterparty 	<ul style="list-style-type: none"> • Internal policy regulating the procedure for the counterparties choice, risk evaluation, tender process • Results of market research and providers (suppliers) screening • Correspondence
Compliant counterparty =health check is performed	<ul style="list-style-type: none"> • Personal availability, identification and proper authorization of signatories • Presence at the registration address, proper information in the state register (EGRUL) 	<ul style="list-style-type: none"> • Collecting standard set of legal documents • Screening of publicly available sources

What has changed in terms of responsibility for "bad faith" counterparties?

The tax authorities started to focus more on **REALITY** than on **FORMALITY**

Primary focus areas:

transaction should be a real one

transaction should have an economic rational (not merely be aimed at tax saving)

it should not be possible to achieve the business goal without engaging the counterparty

In case the transaction is real, less attention is paid to:

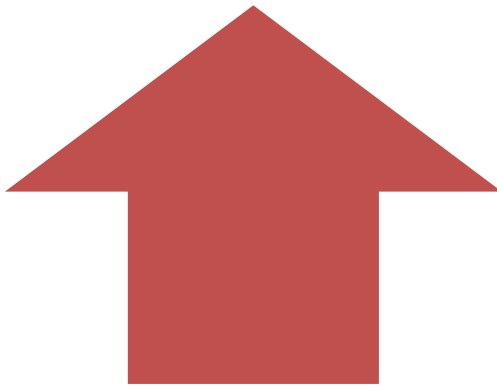
minor omissions in primary documents, results of handwriting expertise relating to primary documents

supplier's management testimony during interrogations

whether the second and subsequent level suppliers are "good faith" (if unrelated?)

failure of the counterparty to pay tax (if taxpayer

demonstrated due care when selecting the counterparty?)



Compliance tip of the day

The taxpayer should exercise due care with regard to delivery/execution tracking



LEGAL POSSIBILITY OF EXECUTION: personalization of contract signing, checking powers of the signatory and execution of the necessary corporate procedures; availability of licenses and permissions



SETTLEMENTS CONFIRMATION: matching payments with the contract terms, documenting offsets, regular reconciliations with suppliers



COLLECTING EVIDENCE OF DELIVERY (EXECUTION): receiving information on dispatch from the third parties (carriers), documenting internal movements of goods (marks on delivery notes, internal consumption records), collecting visuals and records supporting received services (photos, videos, protocols of meetings, etc.)



THE TIME EFFECT: CAN NEW RULES APPLY TO PRIOR PERIODS? DOES THE RESOLUTION OF THE SUPREME ARBITRAGE COURT OF 12.10.2006 N 53 REMAIN VALID?

Raisa Alexakhina

PwC

Article 54.1 time effect

Article 54.1: a taxpayer may reduce its tax base or the amount of tax payable, if both criteria are met at the same time:

- 1) the primary goal of the transaction is not the underpayment or offset of the tax amount;
- 2) the obligation for the transaction has been performed by a party of a contract or by a party that has to execute the transaction under the contract or under the law.

=> Taxpayer's intentions and the substance of the business operations rather than the quality of the primary documents or due diligence in selecting a counterparty are regarded as paramount.

Article 2 of the Federal Law N 163-FZ dated 18.07.2017:

- Art. 54.1 comes into effect starting from 19.08.2017
- Art. 82 (burden of proof) is applicable to ongoing desk and field tax audits, commenced after 19.08.2017 (supported by the Federal Tax Service)
- Art. 5 of the Tax Code (general provisions on temporal scope of tax laws) – new rules cannot put a taxpayer in a disadvantageous position

Application of Article 54.1 to past periods

- YES – applicable during ongoing tax audits, which cover previous periods (Art. 2 of the Federal Law N 163-FZ dated 18.07.2017)

(!) BUT – Both Articles 54.1 and 82 may be applied retrospectively only if put a taxpayer in advantageous position

Otherwise (if disadvantageous) – **no** legal grounds to apply

- In fact, new rules provisions have already been applied in the practice of the tax authorities and courts



What about the Resolution of the Supreme Arbitrage Court of 12.10.2006 N 53?

- Art. 170 of the Arbitrage Procedural Code and Federal Law N 186-FZ dated 28.06.2014 – Supreme Arbitrage Court Resolutions are in effect until abolished by the High Court
 - ⇒ **Resolution N 53 is not currently abolished and, thus, fully applicable to past periods**
 - ⇒ **Resolution N 53 will remain to be the main instrument for the tax authorities, when Art. 54.1 is inapplicable to past periods due to its disadvantageous tax effect**
- Art. 54.1 of the Tax Code does not define as such the concept of the “unjustified tax benefit”
 - ⇒ **If the tax authorities apply the concept of the “unjustified tax benefit”, Resolution N 53 will fully work (while Art. 54.1 will not)**
- Resolution N 53 is also applicable to future periods, but only in conjunction with and with due regard to provisions of Art. 54.1 of the Tax Code



THE REACH EFFECT: IS IT POSSIBLE TO APPLY NEW RULES TO CROSS BORDER TRANSACTIONS? WHAT IS CORRELATION OF NEW RULES AND MLI?

Anna Lessova

LL.M., Of Counsel Beiten Burkhardt



Does art. 54.1 apply to cross border transactions?

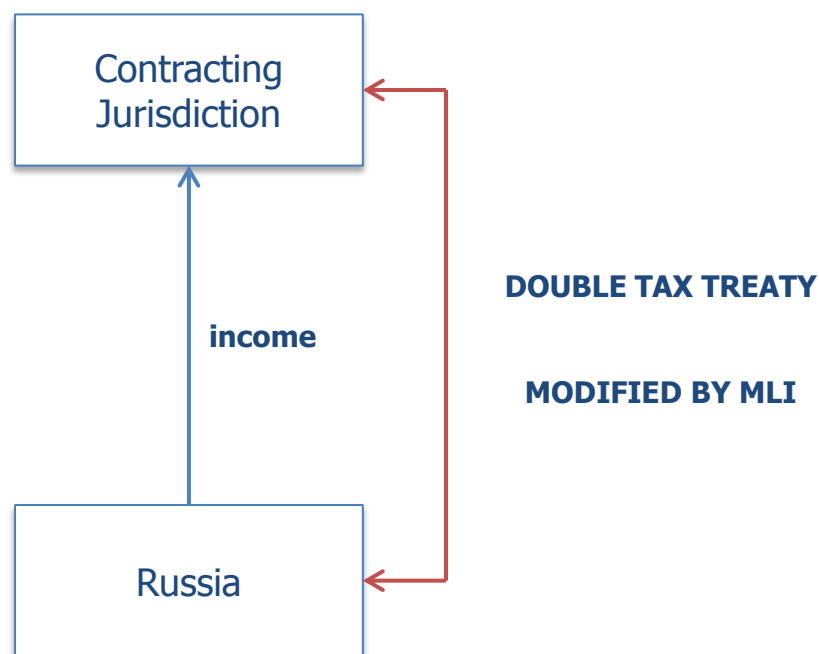
Scope of application:

- Is art. 54.1 a general anti-abuse rule?
- Is art. 54.1 a specific anti-abuse rule governing specific business relations (compare with transfer pricing regulation, articles 246.2, 269, 312 para. 1-1.3 Tax Code, etc.)

According to the Russian Tax Service art. 54.1 paragraph 1 should be viewed as a general anti-abuse rule

No exceptions for cross border transactions and structures

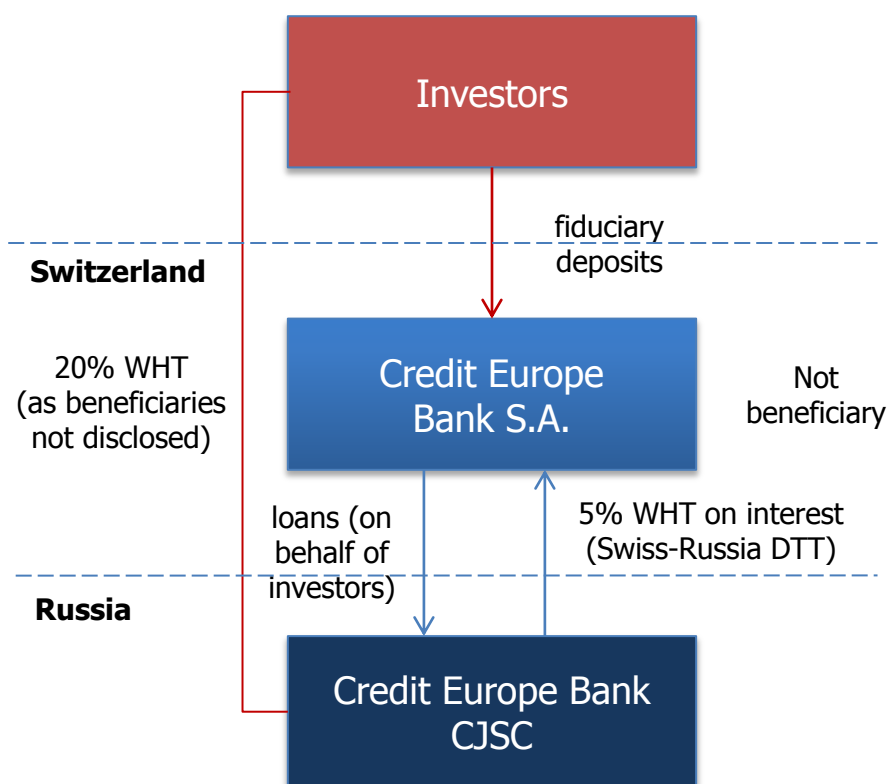
Multilateral Convention – How does it work?



- ❑ Multilateral Convention (MLI) modifies tax treaties
- ❑ MLI provisions apply “in place of”, “to or modifies”, “in the absence of”, “in place of or in the absence of” the provisions of the double tax treaty, thus creating final tax regime
- ❑ Minimum standard includes anti-abuse part, incl. Principal Purpose Test (PPT)
- ❑ PPT vs domestic general anti-avoidance regulation (in Russia, art. 54.1 paragraph 2 Tax Code)

Case study 1

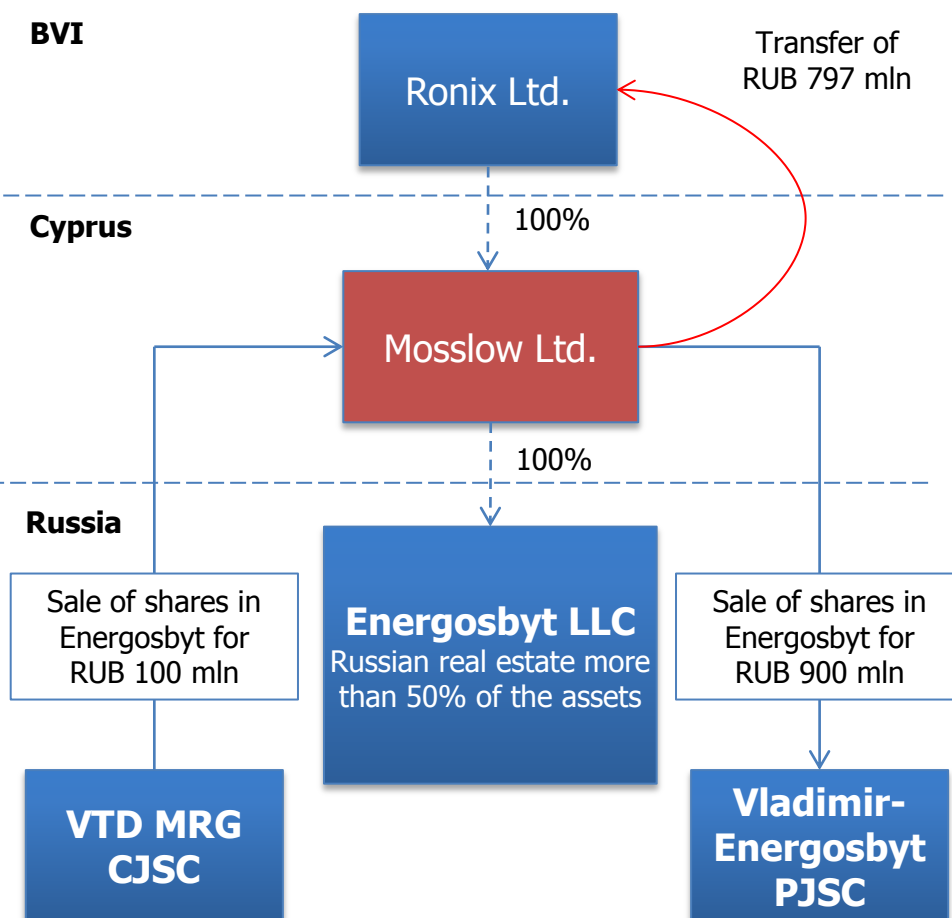
Credit Europa Bank CJSC (case # A40-442/15)



- ❑ interest payments to an intermediary person
- ❑ improper application of the reduced rate for the interest income under Swiss/Russia DTT (before 2012) – 5% withholding tax rate is available **for beneficial owners of the interest income**
- ❑ additional withholding tax at the rate of 20% (as beneficiaries not disclosed)
- ❑ no room for application of art. 54.1 Tax Code
- ❑ application of (specific) beneficial owner provisions of art. 312 paragraph 1 Tax Code and art. 11 DTT

Case study 2

Vladimirenergosbyt PJSC (case # A11-6602/16)



- sale of shares in Energosbyt LLC to a Cypriot Co
- resale to a substantially higher price to Vladimirenergosbyt PJSC
- transfer of funds to BVI Co
- non-taxation of the capital gain received in Cyprus under Cyprus/Russia DTT (before 2017)
- no room for the application of beneficial owner provisions
- art. 54.1 paragraph 2 case**
- art. 7 paragraph 1 MLI – the more stringent test, as the principal purpose test requires the (tax) benefit be **one of the principal purposes** of the transaction



SESSION 2

IDENTIFYING INTENTIONAL TAX UNDERPAYMENT AS NEW TREND: GUIDELINES FROM THE FEDERAL TAX SERVICE AND THE INVESTIGATIVE COMMITTEE

CRIMINAL LIABILITY FOR TAX EVASION: EXPANSION OF SCOPE AND CURRENT PRACTICE

BUSINESS PURPOSE – THE TEST BOUNDARIES: CORRELATION BETWEEN JUSTIFICATION OF TAX BENEFIT AND ASSESSMENT OF MANAGEMENT DECISIONS' RATIONALE

WHEN THE FORM DOES NOT MATCH THE SUBSTANCE: HOW TO DETERMINE THE RIGHT AMOUNT OF THE TAX LIABILITY?



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IDENTIFYING INTENTIONAL TAX UNDERPAYMENT AS NEW TREND: GUIDELINES FROM THE FEDERAL TAX SERVICE AND THE INVESTIGATIVE COMMITTEE

Maria Kostenko
Baker McKenzie

Identifying intentional tax underpayment as a new trend

- **General trend** in conducting tax audits – more focus on witness interrogation, expert investigation, international exchange of information, and closer cooperation with law enforcement bodies
- Joint Letter of Federal Tax Service and Investigative Committee, dated July 13, 2017
 - Guidelines on proving intentional tax underpayment
 - **Why?** - improve collaboration of tax inspectors and criminal investigators in establishing intent to avoid taxes
 - **Goals:**
 - 40% tax penalty under Article 122.3 of Tax Code
 - “improve the criminal law prospects” of a case
 - **What is intent?**

Guidelines on proving intentional tax underpayment – key takeaways

- **Two-step approach** to establish intent:
 - (1) determine responsible persons – director, chief accountant, other authorized officers, other persons that could be organizers, aiders, or abettors
 - (2) gather relevant evidence (witnesses, seizure, eavesdropping)
- **Recommendations** on preparation of tax audit acts:
 - Draft tax audit acts as “typically used in criminal indictments”
 - Replace the terms “non bona fide taxpayer”, “aggressive tax planning” with “intentional tax underpayment”
- **Examples** of circumstances indicating presence of intent:
 - “coherence of actions within a group aimed at tax minimization”
 - “complicated, continuous, and repetitive actions of a taxpayer as part of a tax scheme”
 - “distorted, artificial contractual relations”

Guidelines on proving intentional tax underpayment – controversial issues

- **Unusual function** for tax inspectors, lack of professional expertise
- Obtaining additional evidence outside the established measures of tax control – back to 90s?
- **Lack** of specific substantive guidance on establishing intent – despite of numerous examples of tax avoidance schemes
- Examples on **legal re-qualification** of contractual arrangements – leave much room for interpretation and abuse of taxpayer rights
- New Article 54.1 of the Tax Code requires **prove of intent** (Federal Tax Service Letter, No. CA-4-7/16152@, dated August 16, 2017) – unclear implementation **in absence of clear guidance**
- One-way road - **presumption of guilt?**



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CRIMINAL LIABILITY FOR TAX EVASION: EXPANSION OF SCOPE AND CURRENT PRACTICE

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Corpora delicti of tax crimes

- Article 199 – **Corporate** tax evasion
- Article 199, 199.4 - Failure to pay **insurance contributions – new!**
- Article 199.1 – Failure to act as **tax agent**
- Article 199.2 – **Concealment** of corporate **property** to be used for tax recovery
- Article **159 – Fraud**, i.e. **theft of funds** through deception or abuse of trust (including **VAT refund**)
- ? Articles 174, 174.1 – Money laundering *
- ? Article 193 – Evading repatriation of currency proceeds *
- ? Article 193.1 – International fund transfers under false documents *

** These articles might be invoked in challenging the substance of transactions with foreign companies*

Fraud vs non-payment of taxes: what's the difference?

- **Direction** of cash flow (from the Treasury)
- May be investigated by the Investigative Committee AND the **Police**
- No (even pro-forma) need to request the tax authority's **opinion**
- No additional reasons for **terminating** criminal proceedings (paying the tax won't help)
- **Remand in custody** is possible
- Longer **sentences**

Recent high-profile criminal cases

- *Cherkizovo* case
- *Delovye Linii* case
- *Adamas* case
- *Armada* case
- *Rosan* case (authorized distributor of BRP (Bombardier))



VS



and many more...



BUSINESS PURPOSE – THE TEST BOUNDARIES: THE CORRELATION BETWEEN THE JUSTIFICATION OF A TAX BENEFIT AND AN ASSESSMENT OF THE RATIONALE OF MANAGEMENT DECISIONS

Ksenya Litvinova
Pepeliaev Group



Tax code

A taxpayer may decrease the tax base and/or the amount of tax due as provided for by the Russian Tax Code with respect to transactions (operations) that have taken place if the main purpose of consummating such transaction (operation) **is not a to avoid (partially avoid) and/or obtain an offset (refund) of taxes.**

If a taxpayer may obtain a similar economic effect from consummating other transactions (operations) that are not prohibited by legislation, this may not be treated as an independent ground for recognising it to be unlawful for a taxpayer to decrease the tax base and/or the amount of the tax due.

articles 54.1(2) and 54.1(3) of the Russian Tax Code



The practice of the commercial courts

«-»

Case No. A50-17405/2016 of OOO Firma Radius-Service

Case No. A11-6203/2016 of OOO Mondelēz Rus

Case No. A40-251161/2015 of OOO Continental Tyres RUS

«+»

Rulings of the Russian Supreme Court dated 27 March 2017 in case No. A40-213762/2014, and dated 26 April 2017 in case No. A40-63455/2015

Risk zones

- transactions regarding an intra-group reorganisation
- financing of business activities
- diversification (\neq division) of business
- procurement of services of related parties/the parent company
- third-party transactions (supply, sub-lease)
- payments made upon the agreement of the parties when employees are dismissed
- payment of bonuses/remuneration of the managing company if the company's activities are loss-making
- others



When the form does not match the substance: how to determine the right amount of the tax liability

Gennady Timonichev
Dentons

In this world nothing can be said to be certain, except death and taxes — Benjamin Franklin

Five stages of grief

Denial

Anger

Bargaining

Depression

Acceptance



Five stages of determination the right amount of the tax liability

1. Denial (reality)



2. Anger (abuse, including “masochist” approach)



3. Bargaining



4. Depression



5. Acceptance



4. BENEFIT



5. AGREEMENT

Subjects to discuss RE the right amount of the tax liability

1. PRICE OF THE TRANSACTIONS :

- computational method (*recommended margin*),
- valuation techniques,
- TP methods and quasi-TP methods (market indicators).

2. FORM OF THE TRANSACTIONS:

- different type of the transaction (hidden dividends, thin cap rules)

3. SUBSTANCE OF THE TRANSACTIONS:

- different functionality (implications of GAAR and SAAR: fly-by-night and conduit companies, thin cap rules, look-through approach).

4. INTRA-GROUP TAX EFFECT OF THE TRANSACTIONS:

- piercing of veil: horizontal (Kingwater-based cases) and vertical (transfer of the tax liability to stakeholders);
- **intra-group tax adjustments vs. “sadistic” approach**



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CLOSING REMARKS



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Q&A