



ASSOCIATION OF EUROPEAN BUSINESSES
IN THE RUSSIAN FEDERATION

Tax Forum

“Development of the Russian Tax System in 2010: quo vadis?”

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June 30, 2010
Marriott Grand Hotel, Moscow



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“Development of the Russian Tax System in 2010: quo vadis?”

***Mikhail Orlov,
Chairman of Tax Law Expert Council within the Budget and Tax
Committee, State Duma; partner, KPMG***

Main directions of the RF tax policy for 2011-2013

June 30, 2010
Marriott Grand Hotel, Moscow



Draft Laws On Transfer Pricing And Tax Consolidation

Development of the Russian Tax System in 2010:
quo vadis?

Status on Proposed TP Reform



- **Ministry of Finance's Proposed Amendments to the TP Rules**
 - Was approved by the Government and submitted to the parliament on 25 December 2009
 - Was approved by parliament during 1st reading on 19 February 2010
 - 2nd and 3rd readings
 - Initially planned for summer 2010
 - Recent indications are that it will happen in early autumn (September?)
 - Targeted introduction date is still 1 January 2011

Status on Proposed TP Reform



• Recent Developments

- Parliament's budget & tax committee expressed serious concerns about proposed law
- Prepared an “alternative” proposal for amendments to TP rules
- Question: What law will be read during the 2nd reading?
 - The Ministry's proposal?
 - The Budget & Tax committee's alternative proposal?
 - A compromise version?
- Timing of amendments to TP rules – still 1 January 2011?

Status on Proposed TP Reform



	Ministry of Finance	Budget & Tax Committee
Ownership Threshold	20%	50%
Domestic Transactions	Yes	No
Transaction Types	Goods, work, services, IP and Finance	Goods and IP
Functional Analysis / Substance Requirements	Yes	Yes – but effective role unclear
Number of TP Methods	6	4
Market Price	Range	Range + additional 10 -20% deviation
TP Documentation	Yes	Only primary documents
TP Reporting	Yes	Yes
TP Penalties	40%	No

Status on Proposed Tax Consolidation Law



• Recent Developments

- Was approved by the Government and submitted to the parliament on 18 June 2010
- Was sent to The Budget & Tax committee in order to prepare it for the 1st reading
- Question: When will 1st, 2nd and 3rd reading take place?
 - Probably in autumn together with Draft TP Law
- Issue: The thresholds to create a consolidated group is too high
 - Currently, only very few groups could qualify
 - The thresholds are still debated by business community

AEB Position Paper (1 of 3)

- Related parties:
 - recognize parties as related via court only on grounds prescribed by legislative acts
- Controlled transactions:
 - only cross-border transactions between related parties
 - clarify how thresholds are to be calculated (RUR 1bln and 100m)
- Align TP methods with OECD Transfer Pricing Guidelines
 - remove secondary processing method
 - remove limitations for the use of certain TP methods in specific transactions
 - allow year-end true ups / true downs for TP adjustment purposes
- Information sources:
 - only information that equally available to both taxpayer and the tax authorities may be used

AEB Position Paper (2 of 3)

- TP reporting and documentation:
 - exclude TP reporting requirement
 - no TP documentation for third party transactions and transactions involving a tax agent
- Penalty provisions:
 - ascertain that TP documentation guarantees a penalty protection
 - replace 40% TP penalty with 20% standard penalty
- TP audits
 - allow simultaneous TP audits for all parties of a transaction

AEB Position Paper (3 of 3)

- APA:
 - should be available for all taxpayers (not only large taxpayers)
- Transition rules:
 - define “transaction” (contract? invoice? delivery?)
 - clarify how rules will apply to transactions entered before the new law
- Cost sharing / cost contributions arrangements
 - consider allowing under new rules consistent with OECD Transfer Pricing Guidelines

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PricewaterhouseCoopers



Recent Developments in Fighting Tax Abuse in Russia

Development of the Russian Tax System in 2010:
quo vadis?

Recent Developments in Fighting Tax Abuse in Russia



Calculation method for tax assessment

(sub-clause 7, clause 1, article 31 of the Russian Tax Code)

Ruling of the Constitutional Court dated 5 July 2005

- Passenger Transportation Company – 12

Resolution of the Supreme Arbitration Court of Russia dated 22 June 2010

Recent Developments in Fighting Tax Abuse in Russia



Liability of taxpayer for unidentified suppliers

- Kestroy 1

Resolution of the Supreme Arbitration Court of Russia dated 11 November 2008

- Bulves vs Bulgaria

Judgment of the European Court of Human Rights dated 22 January 2009

- Case of Railway Switch Plant

Resolution of the Supreme Arbitration Court of Russia dated 20 April 2010

Recent Developments in Fighting Tax Abuse in Russia



Development of the concept of unjustified tax benefit : new issues

- What is an unjustified tax benefit?

Resolutions of the Supreme Arbitration Court of Russia dated 28 October 2008 and 10 March 2009 on the Russneft case

- What is a tax reconstruction?

- Is it lawful to charge penalties?

Clause 93, Resolution of the European Court of Justice dated 21 February 2006 on Halifax and clause 11 of Resolution No. 53 of the Supreme Arbitration Court of Russia

Recent Developments in Fighting Tax Abuse in Russia



Law on tax abuse needs to be adopted

- Resolution No. 53 of the Supreme Arbitration Court of Russia dated 12 October 2006 established new rules
- The provisions of the Russian Tax Code on changing the tax qualification of transactions through due judicial process do not work
Resolution of the Supreme Arbitration Court dated 1 June 2010
- Presidential Message for 2010–2012 (dated 25 May 2009)

Recent Developments in Fighting Tax Abuse in Russia



Message of the Russian President for 2010–2012

“The practice of using tax evasion schemes continues to jeopardise the stability of federal budget revenues.

In this context it would be reasonable to implement the following set of measures.

First, to reinforce through legislation the tools for countering abuse of Russian legislation on taxes and levies aimed at tax minimisation, by using the practical experience accumulated by Russian arbitration courts”.

Recent Developments in Fighting Tax Abuse in Russia



The adoption of a tax abuse law is most needed by taxpayers

- Concepts of tax benefit and tax abuse
- Grounds for a tax investigation
- Tax investigation procedure
- Implications of the acknowledgment of a tax abuse
- Concept of abuse for tax control purposes (incompliance of the auditors' actions with the goals of tax administration)

Resolution of the Supreme Arbitration Court dated 18 March 2009

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Pepeliaev Group



Customs Union – tax implications

30 June 2010

What is the Customs Union?



- Free circulation of goods within the member states of the Customs Union (with some exceptions)
- Unified procedures of customs clearance of goods imported from 3rd countries, unified customs tariffs
- Customs clearance of goods under the “residence” principle, i.e. in the country where the importer is registered
- Unified rules of Indirect tax payments in case of mutual trade

What Changes Customs Union Brings for Russian Business?

- Procedure of customs payments upon importation
- Procedure of confirmation of 0% VAT rate upon export of goods
- Changes with respect to services / works performed within the CU

What Remains Unsettled?



- Belarus status
- Yet to be enforced:
 - Protocol regarding the information sharing between the parties of the CU, **Status:** signed, not ratified yet
 - Protocol regarding Indirect taxation rules upon importation into exclusive economic zones of the parties of the CU, **Status:** not agreed-upon
 - Local legislation of the parties of the Customs Union - should be brought to compliance with the legislation of the Customs Union not later than 01.07.2010

Export from Russia



- Export of goods means physical movement from one member state to another rather than a customs regime
- Principle of country of origin of goods is not applied
- Changes in the timeframe for submission of documents confirming 0% VAT rate and in documentation package (next slide)

Export from Russia: Documentary Proof



No	Documents	New rules (The Customs Union)	Current rules (Tax Code)*
1	Export contract / lease contract	+ / +	+ / -
2	Cargo Customs Declaration stamped by tax authorities	-	+
3	Bank statement	+	+
4	Transport (shipping) documents	+	+
5	Application from the importer confirming payment of VAT and excise. Shall be proved by the importer's tax authorities	+	-
6	Other documents (if any established by the local legislation)	+	-

Import into Russia



- Import of goods means physical movement from one member state to another rather than a customs regime
- Indirect taxes should be paid by an importer in its home country on monthly basis
- Looks like tax base does not include expenses incurred upon importation of goods (transportation, lading, etc.)
- In case of return of inappropriate goods, imported in the month of booking there is no need to recognize them in the tax return.
- Possibility to offset VAT overpaid upon importation from the CU against local VAT
- Belarus



Works and Services within the Customs Union

- Important definitions, in particular “consulting”, “marketing”, “design” services
- Expanded list of services rendered at “the place of a buyer’s activity” (e.g. audit services, design services, software maintenance)
- Place of supply may also be confirmed by “other documents established by the legislation of a member state”

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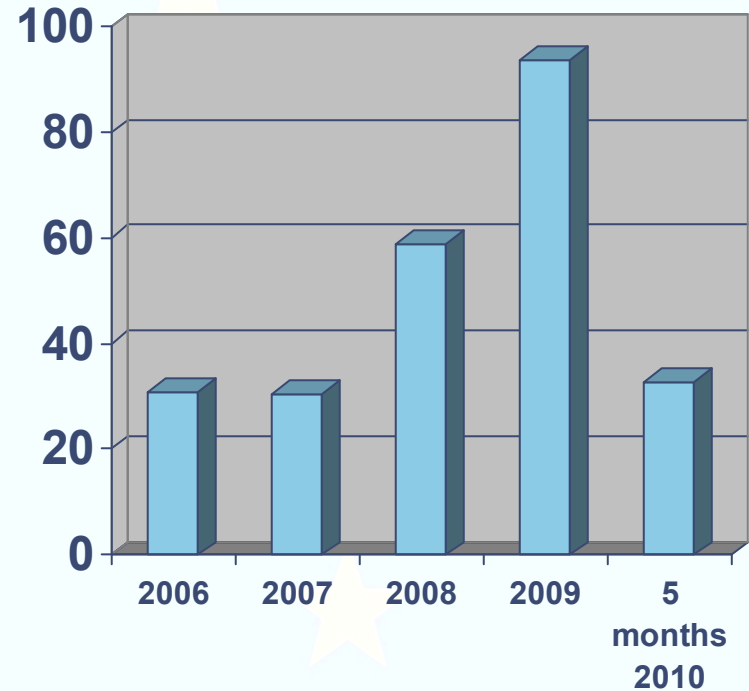
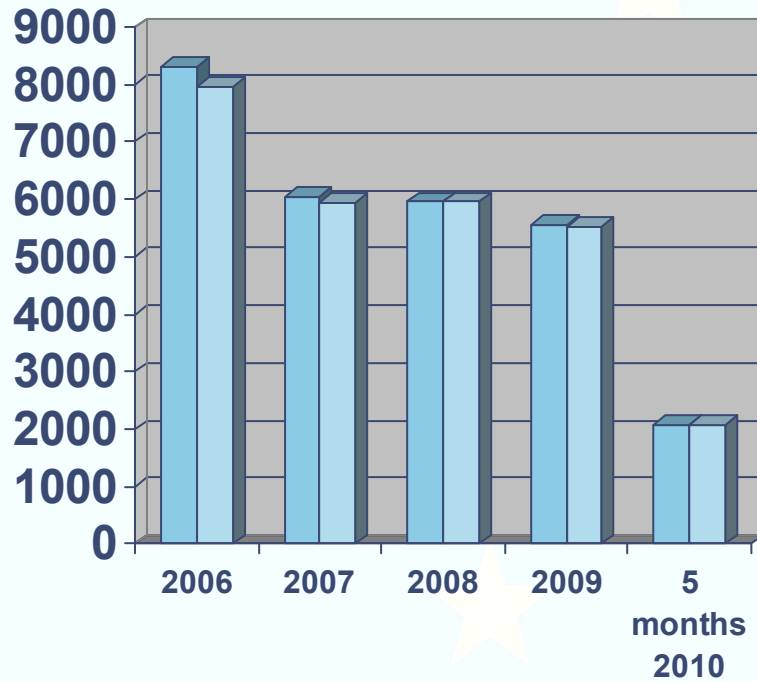
Tax Administration Developments

30 June 2010

Contents

- **Tax audits: interesting statistics**
- **Tax administration developments**
 - filing an adjusted tax return
 - repetitive tax audits
 - other

Tax audits - interesting statistics*

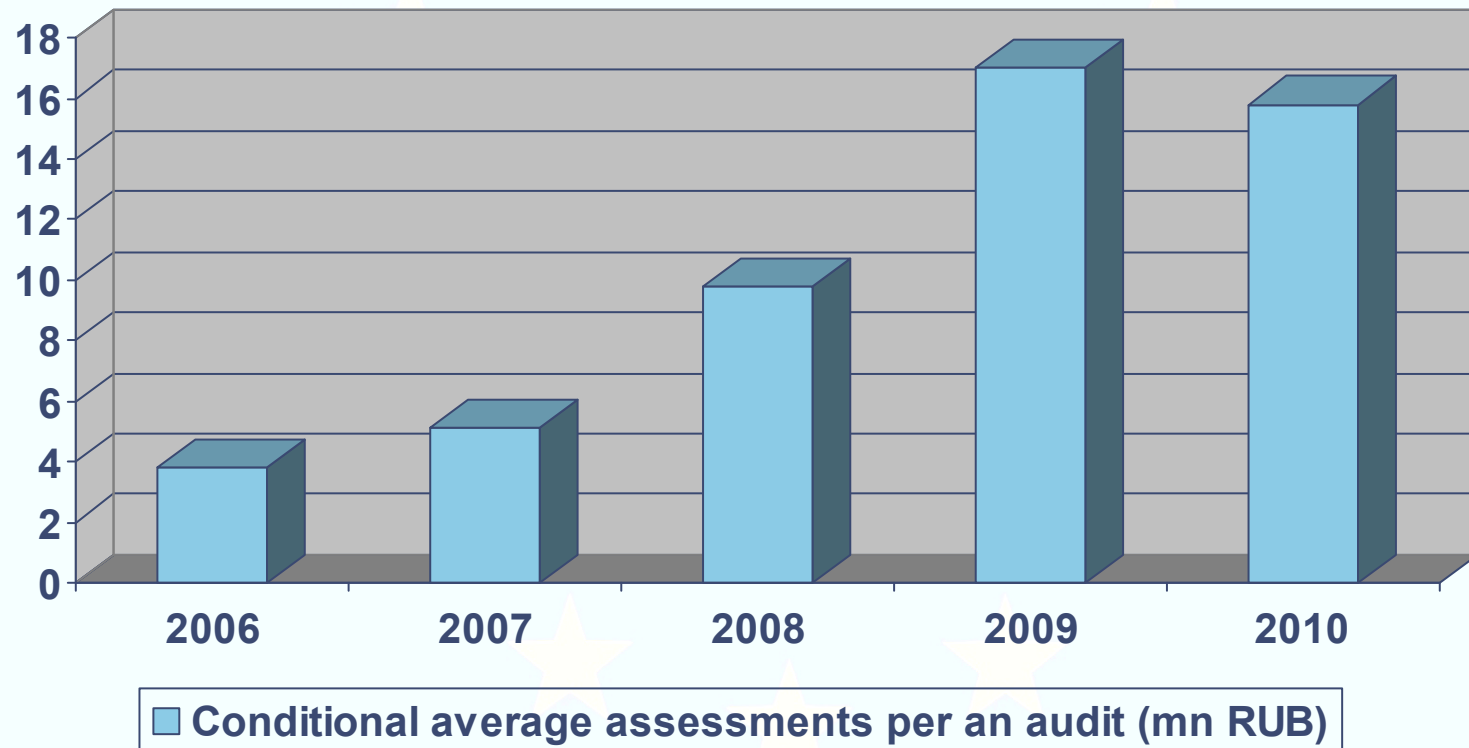


■ Number of field tax audits
 ■ Inc. tax audits which revealed violations

■ Additional assessments based on results of field audits in Moscow (bn RUB)

*Source: Website of Moscow Department of the Russian Federal Tax Service

Tax audits - interesting statistics



Filing an adjusted tax return (1 of 4)

Is tax authority entitled to initiate a repetitive field tax audit based on an adjusted tax return, where the taxpayer has increased a profits tax losses?

Russian SAC position
Yes, the tax authority is entitled.

Source: Resolution of the Russian SAC Presidium No. 8163/09 of 16 March 2010

Filing an adjusted tax return (2 of 4)

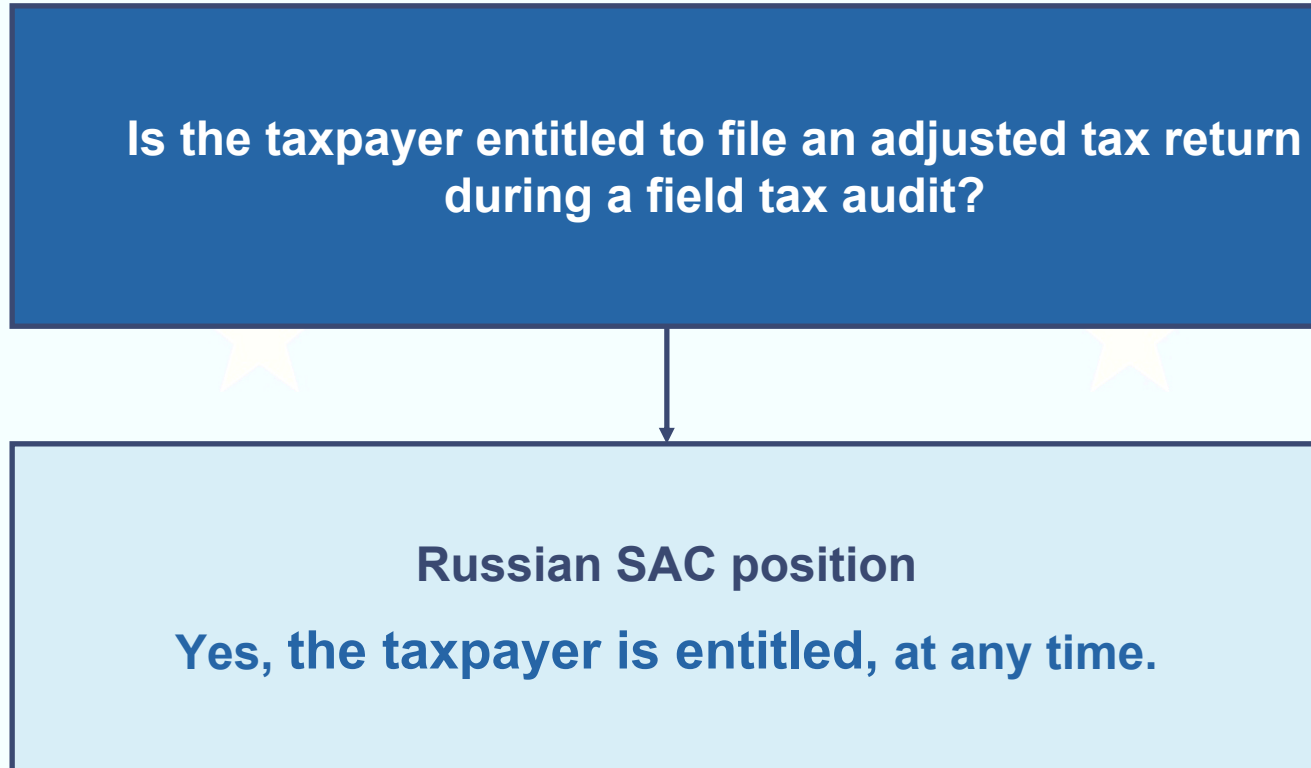
What is the tax authority entitled to check during repetitive tax audit based on the adjusted tax return?

Russian SAC position

**The tax authority can audit only the adjusted data.
The tax authority cannot re-audit any data which the taxpayer has not changed.**

Source: Resolution of the Russian SAC Presidium No. 8163/09 of 16 March 2010

Filing an adjusted tax return (3 of 4)



Source: Resolution of the Russian SAC Presidium No. 8163/09 of 16 March 2010

Filing an adjusted tax return (4 of 4)

What are the consequences of filing an adjusted tax return during a field tax audit?

Russian SAC position

If a tax return is filed after the end of a tax audit, but a relevant decision is not issued, the tax authority, **in view of the scope and nature of adjusted data**, is entitled to:

- (1) take additional tax control measures, or
- (2) issue a decision without auditing the adjusted data and subsequently conduct a repetitive field tax audit.

Source: Resolution of the Russian SAC Presidium No. 8163/09 of 16 March 2010

Repetitive tax audits (1 of 2)

Is the superior tax authority entitled to conduct a repetitive tax audit, if a court decision on the initial tax audit has taken effect?

Russian SAC position

Yes, the superior tax authority is entitled. However, the decision on such audit should not contradict with the facts identified by court.

Source: Resolution of the Russian SAC Presidium No. 14585/09 of 16 March 2010

Repetitive tax audits (2 of 2)

Is tax authority entitled to initiate a field tax audit, if a desk audit has been conducted?

**Russian Constitutional Court position
Yes, the tax authority is entitled.**

Source: Ruling of the Russian Constitutional Court No. 441-O-O of 8 April 2010

Good news - is tax authority entitled to:

request documents beyond the tax audit?

request any previously submitted documents?

not to invite the taxpayer for consideration of the results of additional tax control measures?

not to invite the taxpayer for consideration of the results of a desk tax audit, when VAT recovery has been denied by a tax authority's decision?

increase additional tax assessments following the results of consideration of an appeal to a higher tax authority?

No!

Source: Resolution of the Russian SAC Presidium of 17 November 2009 No. 10349/09, Article 93.5 of the Tax Code, Resolution of the Russian SAC Presidium No. 391/09 of 16 July 2009, Resolution of the Russian SAC Presidium No. 5172/09 of 28 July 2009

Thank you!



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Court precedents in the tax law

**Development of the Russian Tax System in 2010:
quo vadis?**

The role of Court practice

In the Russian system of law

Features

- Continental system of law (key source of law – statutory acts, Courts act on the basis of law)
- Court decision is not a source of law (does not contain compulsory legal rules on the basis of which other Court decisions may be taken)

Problems

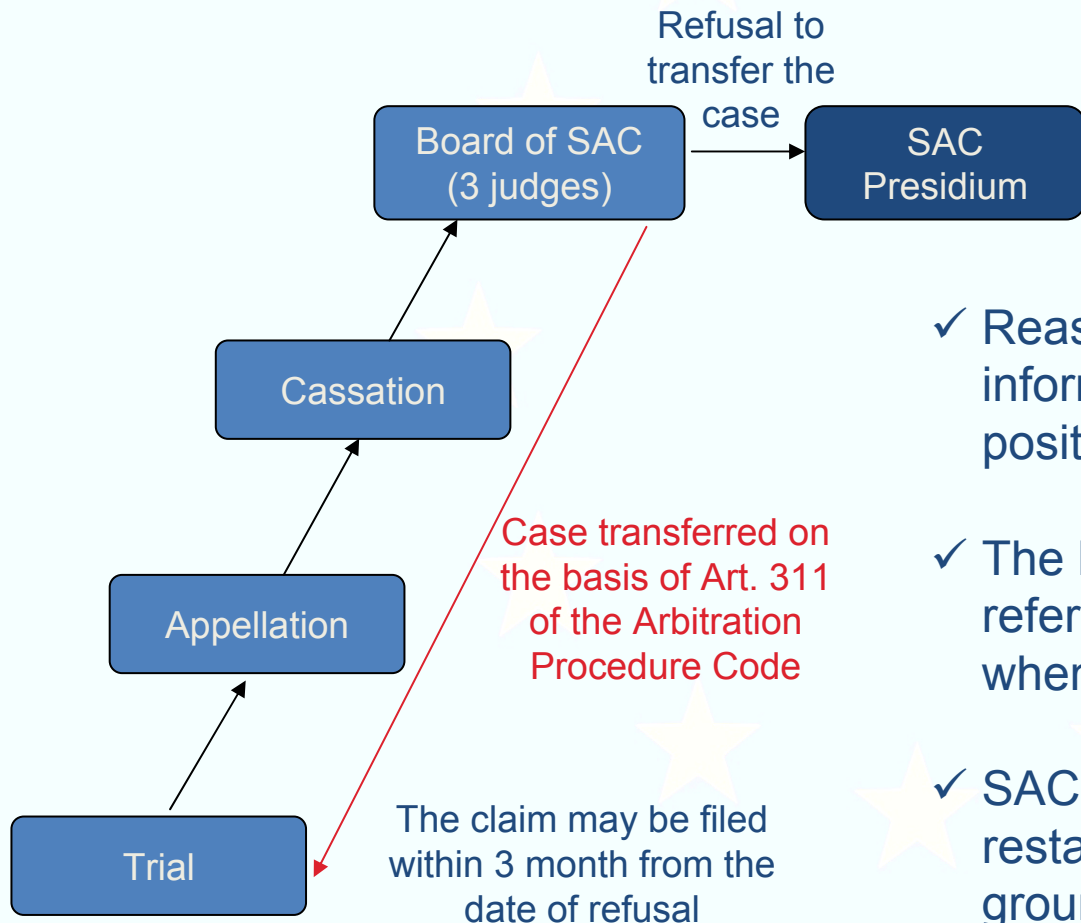
- It is necessary to maintain the uniformity of Court practice in accordance with legal positions of Supreme Courts
- An act of interpretation of law issued by Supreme Courts may serve as a ground for further Court decisions

Possible decision

Introduction of obligatory force of legal positions of Supreme Courts

Decree of the SAC N 14

Dated 14 February 2008



- ✓ Reasons: the lower Courts are not informed or do not apply legal positions of SAC
- ✓ The board of SAC makes a reference to legal positions of SAC when refusing to transfer the case
- ✓ SAC obliges the lower Court to restart the proceedings on the grounds of newly discovered circumstances

Position of SAC

Practical implications



- Substitution of surveillance procedure by revision procedure on the basis of newly-discovered circumstances:
 - ✓ 3-month statute of limitation
 - ✓ Application of Art. 311 of the Arbitration Procedure Code
 - ✓ Definition of new circumstances
 - ✓ Moment of discovery of new circumstances
 - ✓ New circumstances as a ground for revision procedure

Decree of the Constitutional Court N 1-Π (1)

Dated 21 January 2010



- **Validates of the position of SAC set forth in the Decree N 14**
- **Sets out new criteria for revision procedure on the basis of newly-discovered circumstances:**
 - ✓ Legal positions of SAC are not automatically retroactive
 - ✓ Retroactivity must be provided by the acts of interpretation of law
 - ✓ Reference to the relevant SAC legal position is not obligatory
 - ✓ Surveillance procedure is not obligatory
 - ✓ Similarity of the facts

Decree of the Constitutional Court N 1-Π (2)

Dated 21.01.2010



➤ Limitations to retroactivity

- ✓ Provisions impairing the status of persons (criminal, administrative and tax matters) cannot apply retroactively

➤ Procedural terms

- ✓ 3-month statute of limitation (Art. 312 of the APC)

Practical implications



- **Increased risk of revision on the basis of newly-discovered circumstances**
- **Efficient means of taxpayers protection**
- **Amendments to the Arbitration Procedure Code**
- **Significant shift to precedent law**

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Profit Tax and VAT Case Law Development

**Development of the Russian Tax System in 2010:
quo vadis?**



Bad Suppliers: The Ultimate Truth Uncovered...

- ***Muromskiy Streluchniy Zavod* [PSAC #18162/09 – 20.04.2010]**
- ***Lizingovaya Kompaniya Malogo Biznesa* [PSAC #15574/09 - 09.03.2010]:**
 - **Wrong signatures are not the end of the day**
 - **Tax Benefits to be denied if additionally proven:**
 - **Transaction unreal, or**
 - **The taxpayer knew or must have known that the signatures (directors) were false**

Bonuses to Customers: VAT issues

- ***Dirol Cadbury* [PSAC #11175/09 - 22.12.2009]**
 - **Bonuses alongside discounts do affect VAT tax base**
 - **Ministry of Finance and Federal Tax Service ignore this case**
 - **Courts do apply it:**
 - *PK Korona* [SZO #A44-2914/2009];
 - *TEKS* [DO #F03-2636/2009, SAC #VAS-10748/09 - 24.02.2010]

Merchandising Expenses with No Title

- ***Dirol Cadbury* [PSAC #11175/09 - 22.12.2009]**
 - **Deductible: the seller still has commercial interest**
 - **Already applied by courts:**
 - *TD Belogorje* [9AAC #A40-132153/09-96-625]

Interest – the Case of the Century

- **SaNiVa [PSAC #11200/09 - 24.11.2009]**
 - Interest recognized when payable under agreement, not in the period of accrual
 - The RF Minfin and Federal Tax Service: business as usual
 - Courts: the life has changed!
 - *Application to expenses:*
 - *Gidromashservice* [9AAC #A40-107003/09-114-785]
 - *Application to income:*
 - *Niva Ryazani* [Ryazanskaya Oblast #A54-892/2010];
 - *Kazenergo* [Tatarstan #A65-34405/2009-SA1-23]

VAT: Technical Documentation Treated as Goods?

- ***Ufimskoe Motorostroitelnoe Proizvodstvennoe Ob'edinenie***
[PSAC #17933/09 - 11.05.2010]
 - **Technical documentation should be treated as goods (including 0% rate on exports) if:**
 - The supplier has purchased and resold it as goods without IP rights
 - (Meaning sale and purchase of copies?)
 - Determined based on the contract analysis and accounting treatment

VAT: Recovery Procedure and Corrections

- ***Liman* [PSAC #162/10 - 20.04.2010]**
 - **Decision denying VAT recovery can be invalidated on the same procedural grounds (Art. 101) as the decision to penalize**
 - Including failure to summon the taxpayer for the hearing
 - **Irrespective of whether the decision to penalize is appealed against**

VAT: Recovery Procedure and Corrections

- ***Tabak Trade* [PSAC #11822/09 - 19.01.2010]**
 - **Simultaneous positive and negative corrections of VAT returns are not safe:**
 - The tax office may first check those it likes more and claim penalty and interest
 - (Why not get back and claim these penalties and interest back later?)

VAT: Assets Liquidation – VAT Recoverable

- **Granit-Kuznechnoe [PSAC #17969/09 - 20.04.2010]**
 - **VAT incurred on assets liquidation services (like building demolition) is recoverable**
 - If the asset was used in VATable activities and
 - If there is a need to liquidate
 - **(Additional ground for fighting off claims for restatement of VAT on residual value)**

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*Dmitry Nikolaev, Head of the international taxation division
Ministry of Finance of the Russian Federation*

New Russian template of the Double Tax Treaty

June 30, 2010
Marriott Grand Hotel, Moscow



New approaches in application of Double Tax Treaties

Development of the Russian Tax System in 2010:
quo vadis?

Main official documents

- **Russian Tax Policy for 2011, and the periods of 2012 and 2013 (31 May 2010)**
- **Russian new model Tax Treaty (Government Regulation No. 84 from 24 February 2010)**
- **Draft law on counteracting treaty shopping (2009)**

Russian Model Treaty

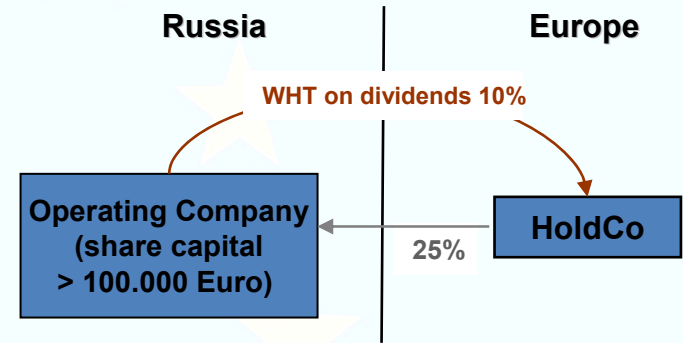
Residency criteria

- **Residency criteria for individuals unchanged**
- **Residency criteria for corporations**
 - Effective place of management
(place of board of directors meetings, place where the management activity is performed, place where executives execute their duties, place where accounting records and archives are maintained)
- **Lack of understanding between competent authorities of the contracting states can lead to limitation of benefits**

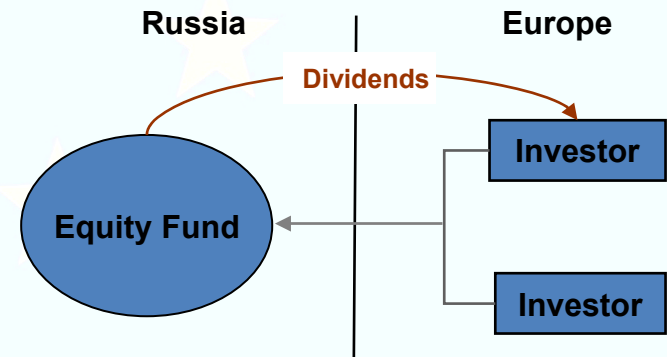
Russian Model Treaty

Dividends

- **Reduced tax rate of 10% applies to participation that is**
 - not less than 100,000 Euro; **and**
 - not less than 25% of the share capital.



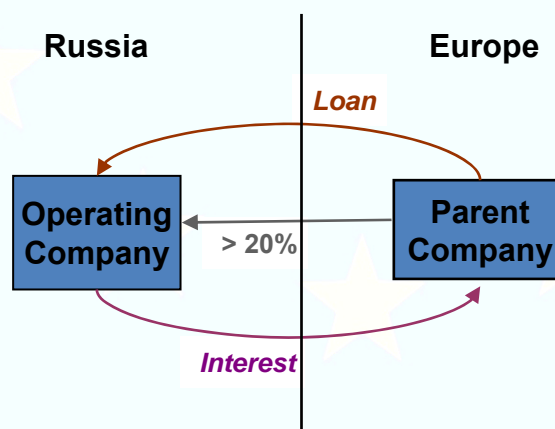
- **Revenue received from mutual equity funds qualifies as dividends**



Russian Model Treaty

Interest income

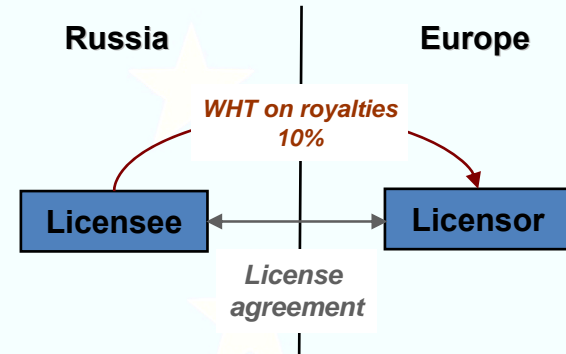
- Interest may be subject to 10% Russian withholding tax
- Thin capitalization rule (Article 269.2 of the Tax Code)
 - Application of national thin cap rule allowed
 - Non-discrimination concept shall not impede application of national thin cap rule
 - Interest re-qualified into dividend shall not be treated as interest under treaty



Russian Model Treaty

Royalties and other income

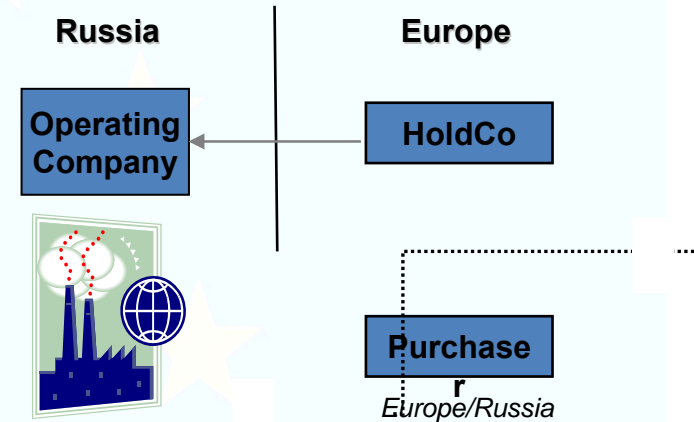
- Royalties may be subject to 10% Russian withholding tax
- Other income (in the sense of Article 21 of the OECD Model Convention) may be subject to Russian withholding tax
 - Income paid in connection with hedge arrangements
 - Services fee? Similar types of income?



Russian Model Treaty

Capital gain

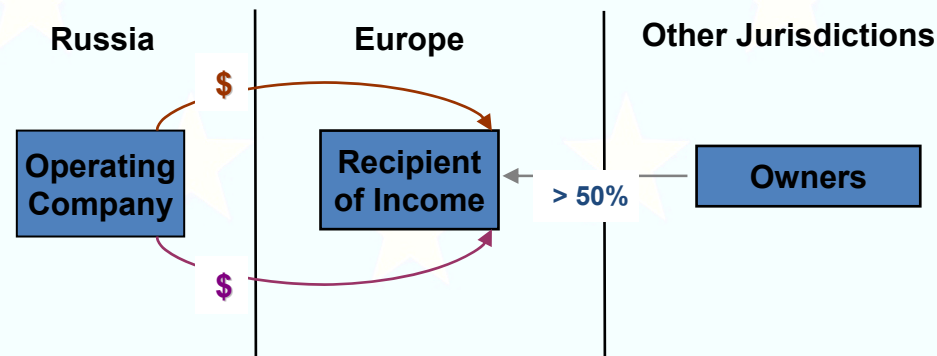
- Sale of shares in a Russian company where more than 50% of such company's total assets consist of Russian real estate property should be subject to Russian corporate profit tax
- Sale of other assets can be taxed in Russia (Article 13.5 of the model treaty)



Russian Model Treaty

Limitation of benefits

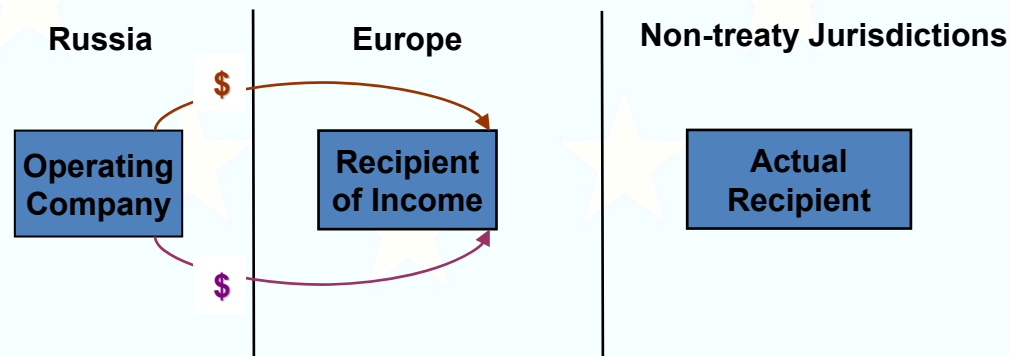
- Abusive use of treaty benefits (at the tax authorities' discretion)
- Treaty benefits appear to be the only or the main economic reason for using off-shore structures (with respect to interest, dividend and royalty income)
- Third country beneficiaries
 - More than 50% of a foreign company receiving Russian sourced income directly or indirectly belongs to persons that are not resident in the jurisdiction of such foreign company



Draft law on counteracting treaty shopping

Beneficial owner concept

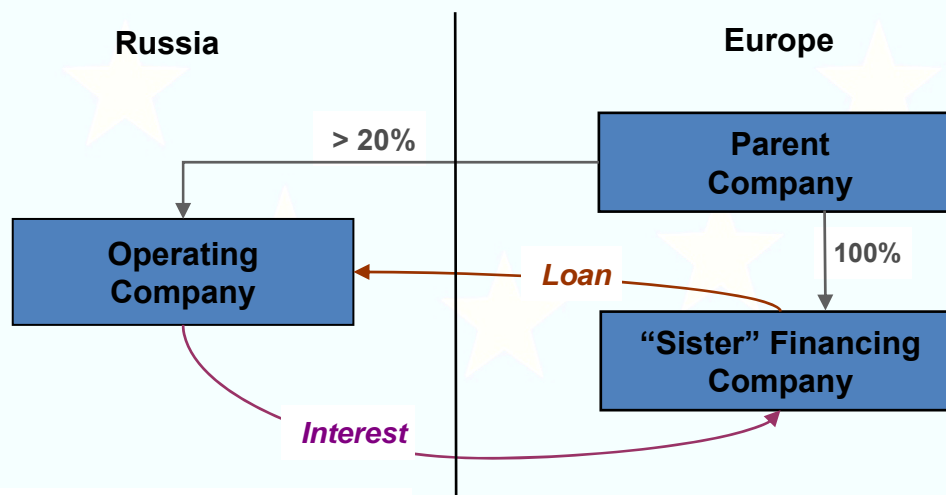
- Proposed amendments to Part I of the Russian Tax Code (Article 7)
 - Non-application of treaty benefits to (any) income paid by a Russian company to foreign tax residents if the actual recipient of the income is not resident of the state that has agreed a double tax treaty with Russia
- Status of the draft



Recent practice developments

Thin cap rule

- Minfin's Letter # 03-08-05 from 27 November 2009 on loan provided by Dutch affiliated company
- Minfin's Letter # 03-08-05 from 14 April 2010 on loan provided by German affiliated company
- *Hydromashservice* case (Гидромашсервис)
9th Court of Appeal Moscow from 9 April 2010



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Thank you for your attention!