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

**DEVELOPMENT OF THE
RUSSIAN TAX SYSTEM:
RESULTS OF 2017 AND
PERSPECTIVES**



Dr. Alina Lavrentieva

Chairperson of the AEB Taxation
Committee, PwC

OPENING REMARKS



SESSION 1

MODERATOR:

Dr. Alina Lavrentieva

Chairperson of the AEB Taxation Committee, PwC



WHAT TAX SYSTEM IS NEEDED FOR RUSSIA?

Sergey Shatalov

Vice President, Media Group "Action-MCFER"



Alexey Overchuk

Deputy Head of the Federal Tax Service



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MULTILATERAL CONVENTION TO IMPLEMENT TAX TREATY RELATED MEASURES

Anna Modyanova

PwC



Multilateral Convention: Application

- Instant implementation of certain BEPS measures
- 66 Russian DTTs* and more than 2 000 around the world
- More than 100 member countries
- Changes to the current DTTs in force, new DTTs in accordance with new rules
- «The minimum standard» + optional provisions
- Monitoring of OECD from 2018

* Double Tax Treaty



Limitation on Benefits

- Principal Purpose Test (“PPT”)

VS

Simplified Limitation on Benefits provision (SLoB)

- SLoB – a two-party choice (Russia-India, Russia-Canada)
- DTT Russia-Japan
- «Beneficial ownership» still in force

What Else Will Change?

- Alienation of property-rich shares («365 days rule»)
- Dividend withholding tax («365 days rule»)
- Tightening of PE provisions
- Hybrid mismatches (transparent entities, dual resident entities)
- Regulation of Mutual Agreement Procedure



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NEW LAW ON THREE-TIERED TRANSFER PRICING DOCUMENTATION

Vladimir Elizarov

Deloitte

Three-tiered approach for preparation of Transfer Pricing documentation - Background

On 5 October 2015, the OECD, as part of G20/OECD work on the action plan to address the base erosion and profit shifting (BEPS), released the final draft of Action 13: Transfer Pricing Documentation and Country-by-Country Reporting.

G20/OECD have agreed on very significant changes to the compliance and reporting of global information for risk assessment and transfer pricing purposes. The OECD has adopted a three-tiered approach to documentation, that includes Master File, Local File and Country-by-Country (CbC) report to provide a global financial snapshot of an Multinational Enterprise (MNE).

Country-by-Country report

- Key financial information on all group members on an aggregate country basis with an activity code for each member.

Master file

- Key information about an MNE's global operations including a high-level overview of a company's business operations along with important information on a company's global TP policies with respect to intangibles and financing.

Local file

- Information and support of intercompany transactions that local companies engage in with related parties.

Key provisions of the Russian law

The Russian Law will apply to the MNE Groups that report revenues of not less than **RUB 50 billion**.

A taxpayer belonging to an MNE Group must file with the tax administration:

- Notification of participation in an MNE Group;
- Master File (upon request);
- Local File (upon request);
- CbC report.

The provision of the Russian Law apply to financial years beginning in **2017**, however there is an option for MNEs to voluntarily apply new provisions to financial years starting within 2016.

The local file requirements will apply starting from **1 January 2018**.

Timeframes:

- The first notification of participation in MNE Group must be filed **by 31 August 2018**.
- The Master File can be requested for the first time **not earlier than 31 December 2018**.
- The Local File can be requested for the first time **not earlier than 31 December 2019**.
- The first CbC report must be filed **by 31 December 2018**.

The Russian Law vs OECD and Key Action Items

Similarities/Differences

In addition to standard content, the **Notification** should include information regarding the inclusion (non-inclusion) of the taxpayer to the list of strategic enterprises/companies or about whether the taxpayer is a subsidiary of an enterprise/company included in such a list as well as information regarding the federal executive body authorized by the Government of the Russian Federation to provide the preliminary consent for abovementioned entities.

In general, the Master File, Local File and CbC Report do not require additional information compared to OECD BEPS Action 13 standards. There are certain Local File requirements that may somewhat differ from other countries / between countries.

What to do?

Russian subsidiaries of European MNEs

- Check if the new requirement applies to your group. If yes:
- File the notification in Russia;
- Make sure Master File is available for you. Translate it to Russian;
- Make sure your local documentation meets the local files requirements;
- ***In some cases you may be required to file the CbC report in Russia (!)***

Russian MNEs with European subsidiaries

- Check if the new requirement applies to your group. If yes:
- File the notifications in Russia and other countries;
- Prepare and file the CbC Report;
- Prepare Master File meeting all requirements in all countries of presence. Translate it to other languages, where required;
- Prepare Local File/s, meeting all requirements in the relevant country of presence;
- ***In some cases, you may be required to file the CbC report in other countries (!)***



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NEW BOUNDARIES OF TAX PLANNING

Anton Nikiforov

Pepeliaev Group

Letters of the Russian Federal Tax Service

- No. ED-5-9/547@ dated 23 March 2017
- No. ED-4-2/13650@ dated 13 July 2017
- No. SA-4-7/16152@ dated 16 August 2017
- No. ED-4-9/22123@ dated 31 October 2017

Reality

Who ?

Situation No. 1: it is not known

- Resolution of the Presidium of the Russian Supreme Commercial ('Arbitration') Court No. 2341/12 dated 3 July 2012
- Resolutions of the Presidium of the Russian Supreme Commercial ('Arbitration') Court No. 2833/10 dated 15 July 2010, and No. 3710/13 dated 22 October 2013
- article 45 of the Tax Code
- Resolution of the Seventeenth Commercial ('Arbitration') Court of Appeal dated 24 November 2017 in case No. A50-17166/2017 (TMK-Energo)

Situation No. 2: it is known

- resolution of the Ninth Commercial ('Arbitration') Court of Appeal dated 2 October 2017 in case No. A40-218634/16
- justified tax benefit ?

Protection?

- Ruling of the Russian Supreme Court dated 28 September 2017 in case No. A53-22858/2016
- Ruling of the Russian Supreme Court dated 7 November 2017 in case No. A40-242243/2016

Performance of an obligation

- Resolution No. A26-1429/2015 of the State Commercial ('Arbitration') Court for the North-Western Circuit dated 6 June 2016.

Primary purpose of the transaction



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- ✓ Primary purpose is a non-tax (non-business?) purpose
- ✓ the underlying cause of the choice between the alternatives (ruling of the Russian Supreme Court dated 14 December 2017 in case No. A50-17405/2016 of Firma Radius-Service)

✓ Article 5 of the Tax Code

2. Tax laws that establish liability or a new obligation, or worsen taxpayers' position have no retroactive force.

3. Tax laws that eliminate liability or establish additional guarantees for the protection of taxpayers' rights have retroactive force.

4. Tax laws that eliminate taxpayers' obligations or improve their position may have retroactive force if it is provided expressly by the law.

Resolution of the State Commercial ('Arbitration') Court for the Sverdlovsk Region dated 27 October 2017 in case No. A60-30976/2017 (Detskiy Mir Department Store)

Resolution of the Ninth Commercial ('Arbitration') Court of Appeal dated 9 August 2017 in case No. A40-224912/16-20-2017 (STC-Energy JSC)



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Q&A



SESSION 2

MODERATOR:

Vadim Zaripov

Deputy Chairperson of the AEB Taxation
Committee



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2017: LEGISLATIVE NEWS OF THE PASSING YEAR

Vadim Zaripov

Deputy Chairperson of the AEB Taxation
Committee

NEW LAWS ADOPTED

Movable property taxation – exemption starting 2018:

- may be provided by regions
- the rate cannot exceed 1,1%

(Federal law of 27.11.2017 N^o 335-FZ)

VAT on scrap metals shall be paid by a buyer *(335-FZ)*

0% VAT on re-export of goods processed in Russia

(Federal law of 27.11.2017 N^o 350-FZ)

Right to deny 0% VAT on goods and services under export transactions
(350-FZ)



NEW LAWS ADOPTED

Application to refund the overpaid tax can be filed within 3 years (not within a month) (article 79 of the Tax Code)

New procedure to refund profits tax withheld to foreign organizations
(Federal law of 14.11.2017 N° 322-FZ)

Taxpayer has a right to ask for installments for paying tax assessment as a result of tax audit
(Federal law of 14.11.2017 N° 323-FZ)

Debt forgiveness by shareholders after 1 January 2018
(Federal law of 30.09.2017 N° 286-FZ)

Sub.point 3.4 VS sub.point 11 of point 1 of Article 251 of the Tax Code



UPCOMING NEWS

Audit secrecy – providing access to tax authorities
(Draft law N° 911054-6)

Improving tax administration and VAT
(Draft law N° 249505-7)

Refining tax system... Or rebuilding?



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TAX CONCESSIONS UPDATE: NEW IN LEGISLATION AND PRACTICE

Nina Goulis

KPMG

Investment tax deduction – new opportunity?

Criteria	Comments
Qualifying assets	Expenses on purchase and/or completion of FAs with the useful life 3-20 years (3-7 depreciation group)
Substance	<p>Reduction of profits tax by the expenses incurred on qualifying assets</p> <ul style="list-style-type: none"> Regional part: 90% of expenses on FAs. The rest amount of tax cannot be less than 5% (if not amended by the region) Federal part: 10% of expenses on FAs. Can be lowered to 0% <p>Expenses can be carried forward for future periods</p>
Limitations	<ul style="list-style-type: none"> No further depreciation No “depreciation premium” Must be applied to the whole population The approach can be changed once per 3 years Cannot be applied by participants/residents of RIP, SEZ etc. If FA is sold before UL expiration – liability to pay tax plus penalty interest
Rights of the Russian Regions	<ul style="list-style-type: none"> Introduction of ITD Qualifying taxpayers Qualifying assets The size and order of application

SPIC 1.0 vs SPIC 2.0

	SPIC 1.0	SPIC 2.0
Regulation	FZ “On industrial policy”, Governmental Order # 708 (amendments are expected)	New Federal Law “On SPIC” (currently in draft)
Industries	Operated by Minpromtorg (machinery, chemicals, industrial production and processing, forestry, automotive, consumer goods etc.)	Significantly extended (incl. agriculture, processing, extraction of resources, construction, logistics)
Entry conditions	at least RUB 750 mln. (circa 11 mln. EUR) irrespective of the source	at least 1 bln. (circa 15 mln. EUR) of own funds plus additional criteria (e.g. proved successful experience)
Terms	Payback period plus 5 years, but not more than 10 years	Payback period + period when an investor exceeds IRR (??). Cannot be less than 7 years
Operated by	Minpromtorg	TBD by the Government, Governmental “agent”

SPIC 1.0 vs SPIC 2.0

	SPIC 1.0	SPIC 2.0
Guarantees	No specific provisions (except for tax)	Special “grandfathering clause”
Tax guarantees	Yes	+ social contributions + new taxes (social contributions)
Reduction of CPT rate to 0%	Yes. “90%” criteria or separate accounting (under draft law). From the period of the first tax profit out of sale of goods under SPIC until its termination but not later than 2025	Yes. Criteria are similar. From the tax period of entering SPIC until the SPIC expiration



Summary

- Legislation and practice is still developing. Need for a constant update
- New opportunities vs new risks
- Current focus on the correctness of the tax concessions applications (RIP, regional concessions) - conditions, periods etc
- Planning and follow up is a key success factor



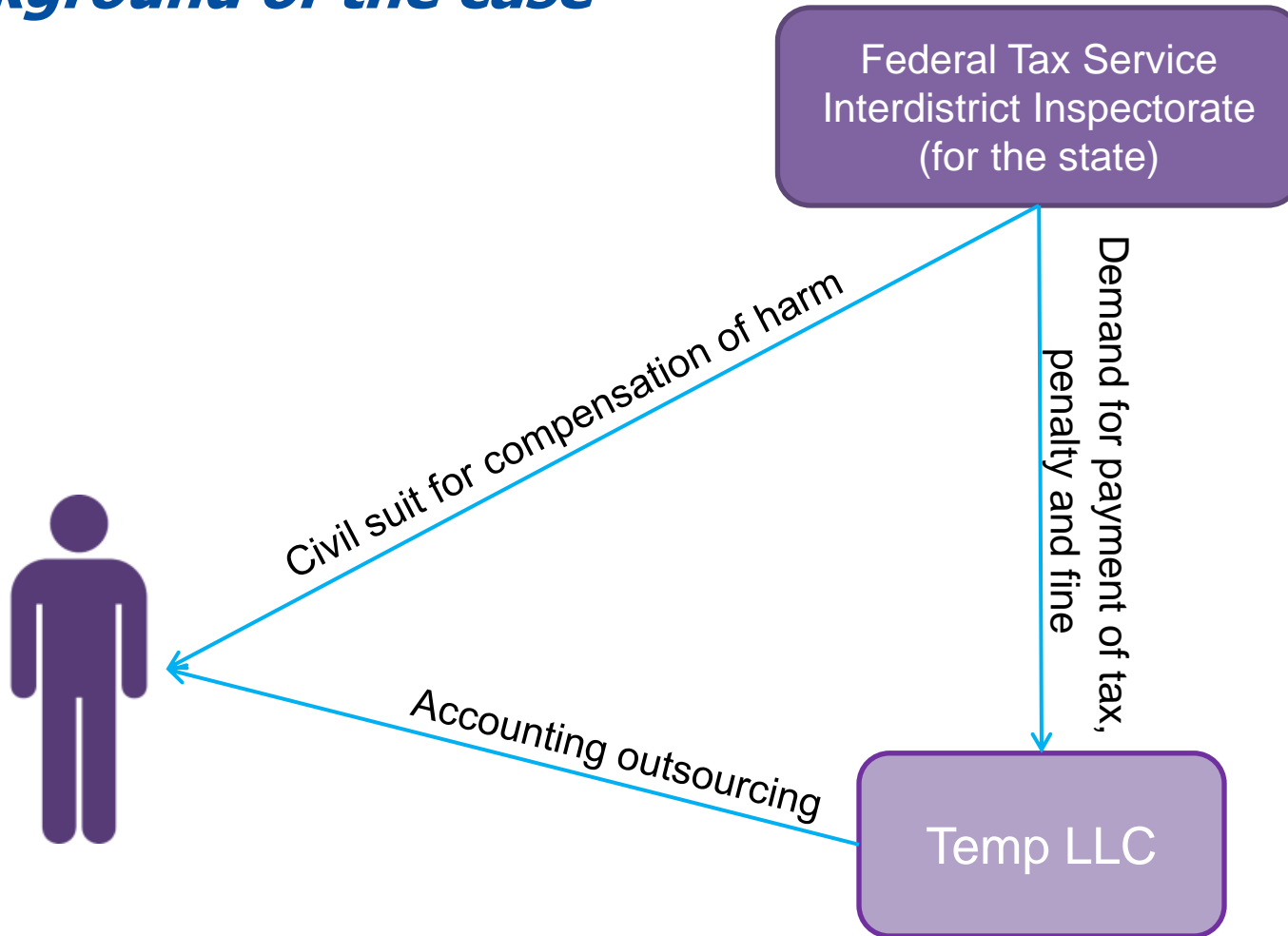
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CONSTITUTIONAL COURT JUDGMENT No. 39-P OF 8 DECEMBER 2017

Igor Shikov

Dentons

Background of the case



Main ideas of the judicial act

- Recovery of compensation for harm is possible on the basis of provisions of the Civil Code
- Harm is limited to the amount of tax arrears + penalty; the fine is not part of compensation
- Compensation for harm cannot be recovered from an individual while there is an organization that is delinquent on taxes or until recovery options have been exhausted (exception: the organization is created to conceal the controlling person's actions)
- A guilty verdict or termination of the criminal case are not *prima facie* proof of guilt
- The approach to determining the amount of compensation is differentiated taking into account the person's financial situation, degree of guilt, etc.

Things to think about

- Public-law entities are equal participants of relations governed **by *civil law*** (tax relations are public-law relations)
- The disputed Article 1064 of the Civil Code establishes liability for causing harm to the property of a legal entity and individual. The article does not mention public-law entities
- How would an individual's suit against the state for compensation for harm be considered? Would the individual have an advantage in gathering evidence?
- Can it now be assumed that tax inspectorates can file civil suits on behalf of the state in other cases?

Legal context

- Amendments to the Tax Code in November 2016, 401-FZ: a third party can perform a tax payment obligation
- Compensation for damage caused by a crime is equated to performance of a tax obligation (Article 45(3)(7) of the amended Tax Code)
- The compensation amount is not considered excess tax paid and is not subject to refund or set-off (Article 13.1, Article 78 of the Tax Code)
- Constitutional Court Ruling No. 396-O of 28 February 2017 in a case for recovery of damages from the founder of an organization and its actual CEO
- General trend: blurring of the lines of financial liability



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TRANSFER PRICING COURT PRACTICE - RECENT DEVELOPMENTS

Ruslan Radzhabov

EY

Transfer Pricing audits in Russia

Protection of the sovereign tax base

- ❑ To prevent base erosion and profit shifting in the cross border transactions

Analysis of the supply chain

- ❑ to challenge the overseas margin by identifying the Russian-related involvement/execution in the trader-related functions and risks

Cooperation with the foreign tax administrations

- ❑ to identify the third party arrangements as a key when reviewing the controlled arrangements

Application of the TP methods

- ❑ CUP as a starting point. TNMM – when assessing Trader's profitability adjustment. But when the adjustment is applicable?

Oil Company Dulisma court case

Decision on the case # A40-123426 / 2016 JSC “Oil Company Dulisma”

- ❑ Commodity – ESPO oil
- ❑ Contractual party – Concept Oil Services Limited (Hong Kong)
- ❑ Resources of information – PLATTS agency
- ❑ TP method – CUP as calculated the price of oil DUBAI, plus a premium.
- ❑ No TP documentation
- ❑ Results – 177 mln RUB (in favour of FTS of Russia)

Conclusion

- ❑ CUP the most likely would be applicable to the commodity transaction
- ❑ The transfer pricing control is applicable to the “third party” company situated in the offshore jurisdiction
- ❑ Identification of the unjustified tax benefit is not required when undertaking the TP audits

PAO Uralkali court case

A40-29025/17-75-227 PAO Uralkali court case

- ❑ Commodity – potash fertilisers
- ❑ Contractual party – Uralkali Trading SA (Switzerland)
- ❑ Resources of information – Argus agency
- ❑ TP method – CUP (FTS of Russia) vs TNMM (Taxpayer)
- ❑ Results – 980 mln RUB (in favour of FTS of Russia)

Conclusion

- ❑ CUP remains the priority method
- ❑ Testimonials regarding BEPS are not required
- ❑ No Trader's profitability adjustment – who is to justify the applicability?
- ❑ Broad interpretation of art. 105.5 of the Tax Code
- ❑ Value chain analysis is underestimated



RECLASSIFICATION OF INTRAGROUP LOANS INTO EQUITY FINANCING: RECENT TRENDS

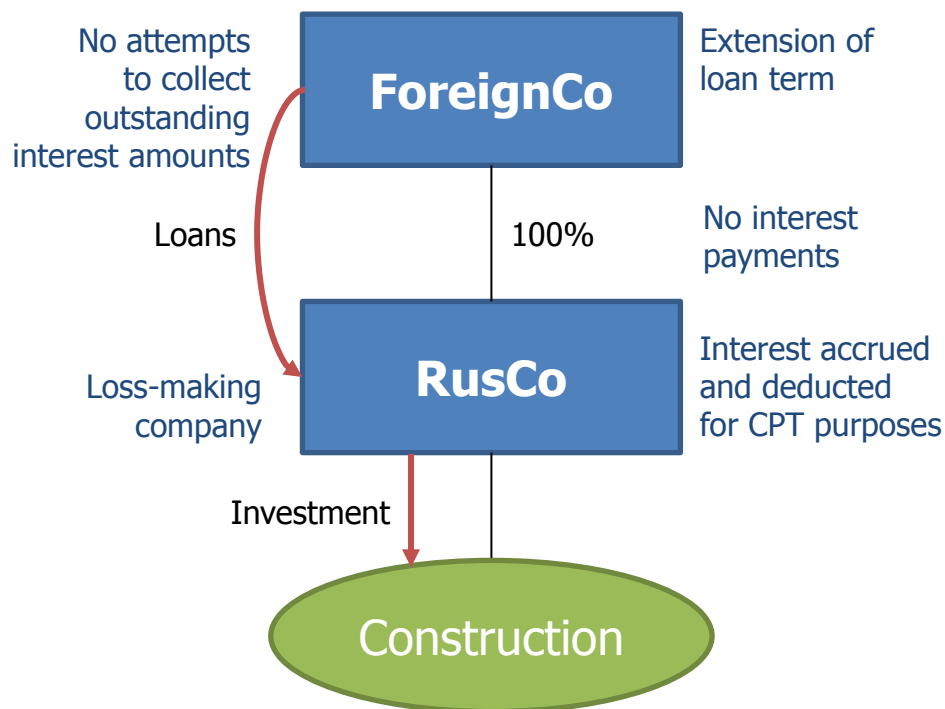
Maria Kostenko

Baker McKenzie

Approach of the Russian Tax Authorities

- Assessment of the financial position of the borrower;
- Analysis of provisions of the loan agreement/respective facts and circumstances:
 - Intent of the parties to repay the loan;
 - Term of the loan / extension of the term of the loan;
 - Increase of the loan principal;
 - Increase / decrease of the applicable interest rate;
 - Subsequent conversion of loan into equity by the lender; etc.
- Analysis of borrower's accounts to identify how the borrower used the provided funds;
- Analysis of the legal nature of the loan agreement under the governing law → expert opinion on the matter of foreign law;
- Ignoring provisions of Article 265(1)(2) of the Russian Tax Code that allow to deduct interest on debt obligations of any kind (including current and/or investment loans);
- Ignoring Russian thin capitalization rules set under Article 269 of the Russian Tax Code that should apply to all types of interest irrespective of their nature → reclassification of the whole interest amount into dividends;
- Disallowance of foreign exchange differences.

Approach of the Russian Courts (1/2)



Position of the Russian tax authorities:

ForeignCo provided equity financing to RusCo

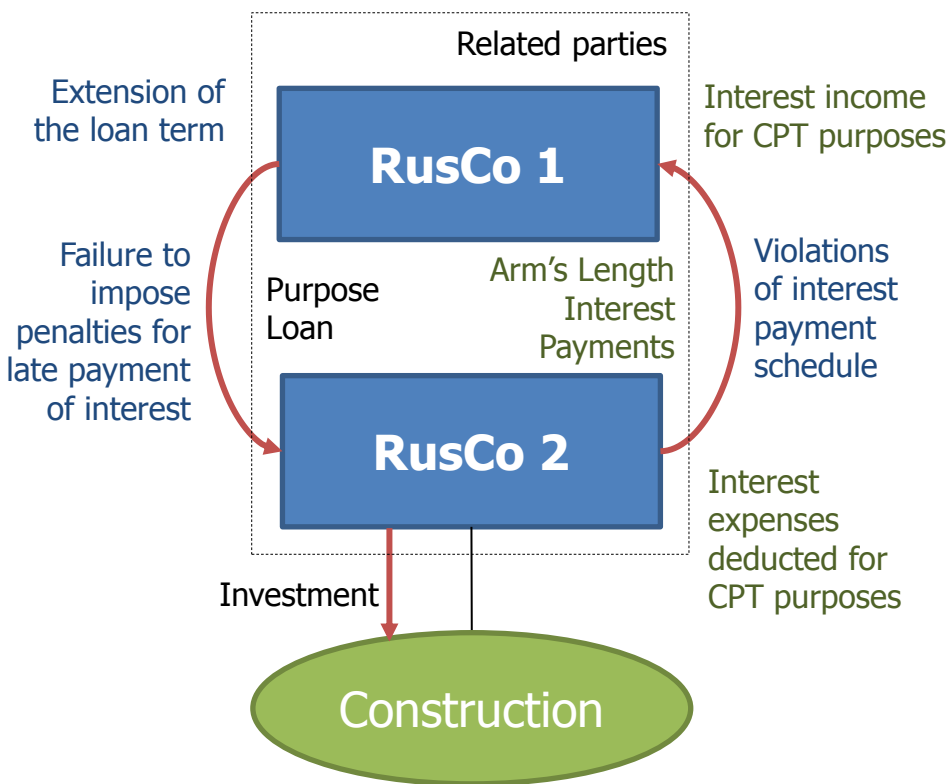
Position of the Russian court:

in favor of the tax authorities



- Loans were provided by an affiliated company for a construction project;
- Loans constitute investments of ForeignCo;
- RusCo was loss-making;
- RusCo failed to prove having recourses to repay loan principal as well as respective interest;
- Interest was accrued and deducted for CPT purposes without repayment;
- ForeignCo did not make any attempts to collect outstanding interest amounts;
- Loan term was continuously extended.

Approach of the Russian Courts (2/2)



Position of the Russian tax authorities:

RusCo 1 provided equity financing to RusCo 2

Position of the Russian court:

in favor of the taxpayer



- Provision of the loan was economically justified;
- Intention of the parties to repay the loan principal was confirmed;
- Interest rate on the loan is arm's length;
- Accrued interest was paid to RusCo 1;
- Payment of the loan principal is not due during the time of tax audit;
- Extension of the term of the loan was justified (request from third-party creditors – banks);
- Purpose of the arrangement was provision of reimbursable financing (i.e., loan) rather than joint acquisition of assets (i.e., investment arrangement).

List of Recent Court Cases on Reclassification of Intragroup Loans into Equity Financing

- Investproject Case (A40-18786/13)** ❌
- Aquanica Case (A43-31418/2014)** ✅
- Famur Case (A27-24263/2016)** ✅
- Promyshlennik Case (A27-25828/2016)** ✅
- Khemmen - Dalnyi Vostok Case (A16-343/2016)** ❌
- Rusneft-Bryansk Case (A09-2657/2016)** ❌
- Shakhta Belovskaya Case (A27-25463/2016)** ✅
- Sibur-PETF Case (A66-7018/2016)** ✅



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THE SUPREME COURT'S POSITIONS ON FOREIGN INVESTORS TAX ISSUES

Tatiana Kirgetova

Gide Loyrette Nouel

The Supreme Court's positions on foreign investors tax issues

An overview of court practice in respect of disputes related to the defense of foreign investors has been adopted by the *Presidium of the Supreme Court of the Russian Federation dated 12 July 2017* (the "Overview").

The Supreme Court's most important positions on tax issues outlined in the Overview, include:

- The fact that a foreign shareholder had ceased to be a shareholder of a Russian legal entity by the time dividends were paid to the shareholder, by itself should not be an obstacle to applying a reduced tax rate to dividends under the applicable double tax treaty;
- Contributions of assets should be considered as an investment for the purposes of applying a reduced tax rate for dividends under a double tax treaty (i.e. "*investments*" should not be limited to increases of share capital);



The Supreme Court's positions on foreign investors tax issues

The Supreme Court's most important positions on tax issues outlined in the Overview, include **(continued)**:

- If the original foreign shareholder has joined another foreign legal entity (tax resident in the same country) which received dividends from a Russian legal entity (the "*Successor*"), then a reduced withholding income tax rate can be applied to the payment of dividends to the Successor legal entity, provided that the conditions for the applying the reduced tax rate are met by the original shareholder;
- A delay in receiving a tax residency certificate by a tax agent should not, by itself, prohibit the application of a reduced withholding income tax rate under a respective double tax treaty;
- Other important positions of the Supreme Court on tax issues outlined in the Overview.



KEY COURT DECISIONS OF THE SECOND HALF OF 2017

Alexander Erasov

Gołtsblat BLP

TOP 10 TAX CASES



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10

Rusdzham Steklotara Holding

(Vladimir Region No. A11-9880/2016 dated 17.11.2017)

- *Consulting fee paid to a foreign affiliated company treated as hidden dividend distribution and willful non-payment of taxes*

9

Lebedyanskiy

(Lipetsk Region No. A36-4222/2017 dated 27.08.2017)

- *Attack on group operating structure*

8

Amotek Co., Ltd

(NW District No. Ф07-7991/2017 dated 27.08.2017)

- *Liquidating payments to a Korean company are subject to profit tax at a rate of 20% (the DTT was ignored!)*



Vinokonyachny zavod "Alliance-1892"

(Supreme Court No. 305-KГ17-4111 dated 03.10.2017)

- *Customs VAT may be deducted in full amount even in case tax authorities challenged import prices*



TD RIF vs. Agribusiness

(Supreme Court No. 308-ЭC17-13430 dated 28.09.2017)

- *VAT may be recovered from a mala fide contractor*



Transneft-Terminal vs. Port Union Oil Export Limited

(Supreme Court No. 308-ЭC17-9467 dated 23.12.2017)

- *Seller has no right to claim VAT from the buyer unless agreed to the contrary*



Aquamarin

(Supreme Court No. 305-KГ17-5672 dated 31.10.2017)

- *FTS is entitled to overturn department decisions on its own initiative*



Continental Tires Rus

(Supreme Court No. 305-ЭC17-9969 dated 09.08.2017)

- *Economic efficiency of expenses may be challenged from the perspective of unjustified tax benefit*



Akhmadeeva et al

(Constitutional Court No. 39-П dated 08.12.2017)

- *Corporate tax debts may be collected from individuals*



Fleet of Novorossiysk Commercial Seaport

(Constitutional Court No. 34-П dated 28.11.2017)

- *Court practice unfavourable to taxpayers has no retroactive effect !!!*



Vadim Zaripov

Deputy Chairperson of the AEB Taxation Committee, Pepeliaev Group

CLOSING REMARKS



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Q&A