

# Taxation of intragroup services: a new position of the Russian Federal Tax Service may be a generalisation of old approaches

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On 6 August 2020, the Federal Tax Service of Russia (FTS) issued a Letter of long-awaited [clarifications](#)\* on the taxation of services rendered to Russian taxpayers by interdependent foreign organisations that are part of the same international group of companies.

Such groups of companies often optimise the costs of performing certain business functions by delegating them to specially designated legal entities within the group, which in turn provide services to other group companies. Most often, the business processes that are usually delegated relate to activities such as marketing, finance and auditing, IT support, and solving administrative issues.

According to Russian practice, the method of providing intragroup services, their documentation and the procedure for determining the cost of such services are often not standard. In such cases, Russian tax authorities question the reality of the provision of intragroup services. Also, as part of tax audits, they challenge the legality of deducting expenses incurred by Russian taxpayers for such services for income tax purposes. The number of tax disputes on intragroup services grows every year, which is also confirmed by the FTS in the clarifications Letter.

Before the Letter, there was no systematic and uniform approach to the assessment of intragroup services in tax and judicial practice. There were only a few explanations by the FTS and the Ministry of Finance of Russia, and these bodies only commented on certain aspects of tax accounting for intragroup services (see letters of the Ministry of Finance of Russia [No. 03-03-06/1/7868 dated 7 February 2020\\*](#), [No. 03-03-06/1/73272 dated 24 September 2019\\*](#)). When a dispute reached the court, the outcome of the case was, as a rule, not in the taxpayer's favour, such as the [Rusjam LLC case\\*](#), where the tax authority won the dispute and re-qualified the payment the Russian company made under a consulting service agreement as payment of dividends.

The Letter is in fact an attempt to systematise the interaction of tax authorities with intragroup services. It is the first step towards the development of a uniform methodology for the tax accounting of such services.

## Key issues of accounting for intragroup services reflected in the Letter

In the Letter of clarifications, the FTS proposes a step-by-step algorithm of actions to be followed by inspectors as part of their analysis of the legality of accounting for intragroup services.

At the same time, the FTS repeatedly emphasises that a formal approach is no longer admissible. Instead, it points out that the tax authority should comprehensively evaluate the documentation provided by the taxpayer and be guided by a wide range of facts, circumstances and information obtained during control activities when substantiating its position. This applies to both the documentary evidence provided by taxpayers, and the facts and circumstances confirming that the costs incurred by them are economically justified.

### Step 1 – Assessing whether the services are real

The FTS draws attention to the fact that when assessing the reality of intragroup services, it is necessary to consider that they can vary in nature and form of provision.

The FTS gives examples of the most common intragroup services, emphasising that the list of services is not exhaustive, and includes regular (ongoing) administrative support, services in the field of finance, legal consulting, HR, internal control and audit, services related to the development of production and sales, and IT services.

In terms of documenting services, the FTS also stresses the fact that there are no generally accepted standards and criteria. Depending on the specifics of the services, the fact of the provision of services can be confirmed through business correspondence and emails, breakdowns of telephone calls, minutes of meetings, service notes and certificates, timesheets, presentations, printouts from the internal electronic systems of the taxpayer, printouts of electronic calendar, computer screenshots, written explanations and assurances of the parties.

Tax authorities are encouraged to pay attention to how interaction between the participants in the relationship is organised. For example, if a service is provided in the form of electronic access to the resources of a service provider, then this presupposes the presence of a single technical service centre to which taxpayers transfer part of their functions or processes.

To confirm the reality of the services, a Russian taxpayer is given an opportunity to submit, in particular, documents drawn up in accordance with business customs applied in the foreign country where the service provider incurred the relevant expenses. In addition, inspectors must give a proper assessment of such documents.

Finally, in order to make sure that the services are real, the FTS recommends checking whether the taxpayer pays several suppliers for identical services; and how much the provided service repeats functions that the taxpayer, due to available labour resources, actually performs independently (i.e. "duplication" of expenses). When assessing whether the service provided is duplicated, tax authorities should analyse the functionality, experience and competencies that the Russian taxpayer receives, and not limit themselves to establishing the fact that the names of departments coincide or there are employees in positions with similar names.

### **Step 2 – Assessing whether the services are economically viable**

The next step in the analysis of intragroup services is to assess the economic viability of acquiring intragroup services. To do this, the FTS recommends:

- assessing the commercial value of the services and its need to strengthen or maintain the commercial position of the taxpayer, including taking into account whether the taxpayer is willing to pay an independent provider on comparable terms for similar services, and how widespread the acquisition of such services is by other organisations in the same industry from independent persons;
- determining whether third parties are ready to purchase such services or sell them by developing themselves technologies or hiring additional personnel;
- ensuring that the expenses declared by the taxpayer are not compensation for expenses for joint-stock activities; and
- checking how the results of the services provided are used in the taxpayer's business activity (but noting the importance of establishing the taxpayer's intention to obtain an economic effect as a result of the contractor's activity; and understanding that a negative financial result from the use of the service received cannot in itself be the only reason for recognising expenses as unjustified).

### **Step 3 – Assessing the procedure for forming the cost of services**

The FTS is trying to draw boundaries for assessing the cost of intragroup services, pointing out the following:

- Prices applied in controlled transactions cannot be controlled by the field and office tax audits of territorial tax authorities. Nevertheless, inspectors need to check the pricing factors, mechanisms and principles of intragroup services.
- Inspectors should make sure that there is a transparent methodology for the formation of the cost of services and the uniformity of its application throughout the international group of companies. They should also check whether the specified costs of the buyer of services relate to the income of the service provider for the purposes of taxation of corporate profits in accordance with the legislation of the foreign state of which the service provider is a tax resident. In this case, the contractor's expenses should not be assessed.

The Letter of clarifications also supports the use of certain pricing methods. For example, the FTS is in favour of the "cost-plus-margin" method. Under this method, the pricing procedure is determined as the sum of the costs incurred by the service provider and the mark-up (margin) customary for a certain field of activity.

### **Comments**

The Letter can be seen as a positive development even though it does not bring anything conceptually new to the approach when analysing the justification of the costs of intragroup services. The FTS has studied the practice of intragroup services and, taking into account the variety of these services, calls on territorial tax authorities to abandon formalism and apply a systematic, consistent and balanced approach when analysing documentary evidence and the economic viability of services. It is hoped that this message will be well received by inspectors on the ground and will develop into good practices in the accounting of expenses for intragroup services.

Several important issues were not reflected in the Letter, such as the possibility of using "allocation keys" to determine the cost of services and re-qualifying payment for services as dividends. Also, in the Letter of clarifications, certain conclusions are ambiguously formulated, like the recommendations for assessing the pricing procedure and the economic viability of services. As a result, the practical application of the FTS's recommendations both by taxpayers and tax authorities will definitely be more complicated.

While we await further official clarifications in the near future, Russian companies that belong to an international group of companies should review their intragroup service arrangements in light of the Letter to see if some adjustments need be made to reduce the risk of services being seen as not economically viable during tax audits.

For more information on this eAlert, please contact CMS Russia experts [Hayk Safaryan](#), [Yulia Smourova](#), [Anna Osmakova](#) or your regular contact at CMS Russia.

*\*In Russian*

#### KEY CONTACTS

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**Hayk Safaryan**

Partner | Tax, Moscow



**Yulia Smourova**

Senior Associate | Tax, Moscow



**Anna Osmakova**

Associate | Tax, Moscow

