



BENEFICIAL OWNER OF INCOME – PRACTICAL ASPECTS



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OPENING REMARKS



AMENDING DOUBLE TAX TREATIES BY MLI - IMPACT ON BENEFICIAL OWNERSHIP CONCEPT

COURT PRACTICE OVERVIEW: REASONS FOR FAILURE AND SECRETS OF TAXPAYERS' SUCCESS

SESSION 1



Experts:

Mikhail Filinov, PwC
Nina Goulis, KPMG
Victor Kalgin, EY

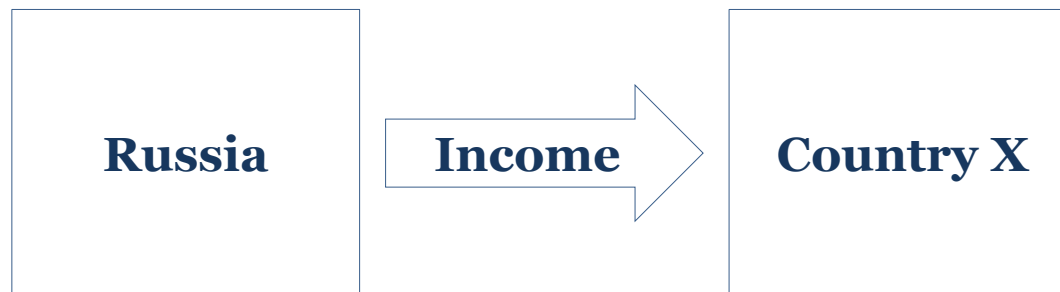


Amending Double Tax Treaties by MLI: impact on beneficial ownership concept

Mikhail Filinov

PwC

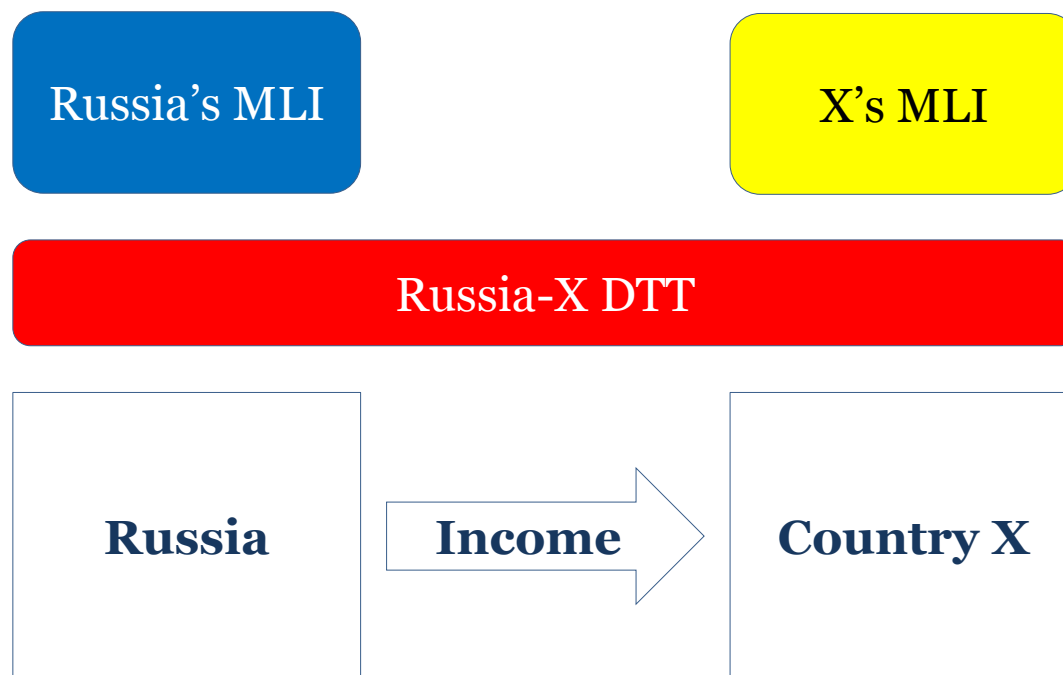
How does it work?



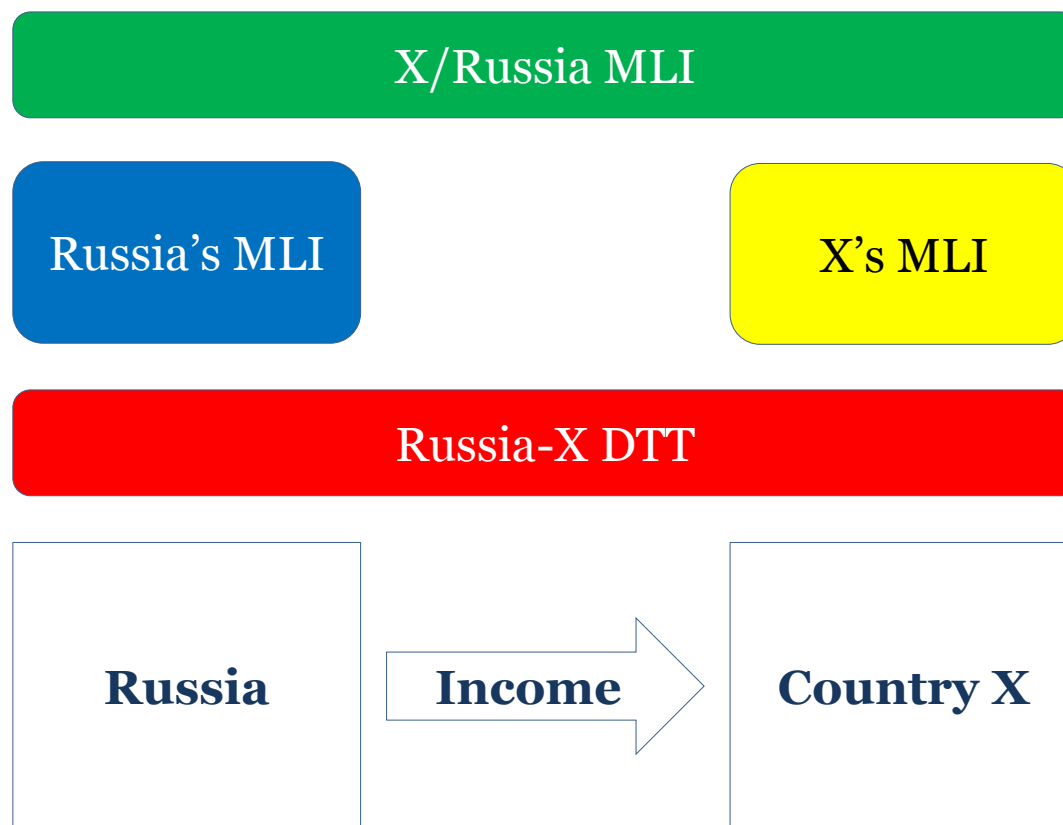
How does it work?



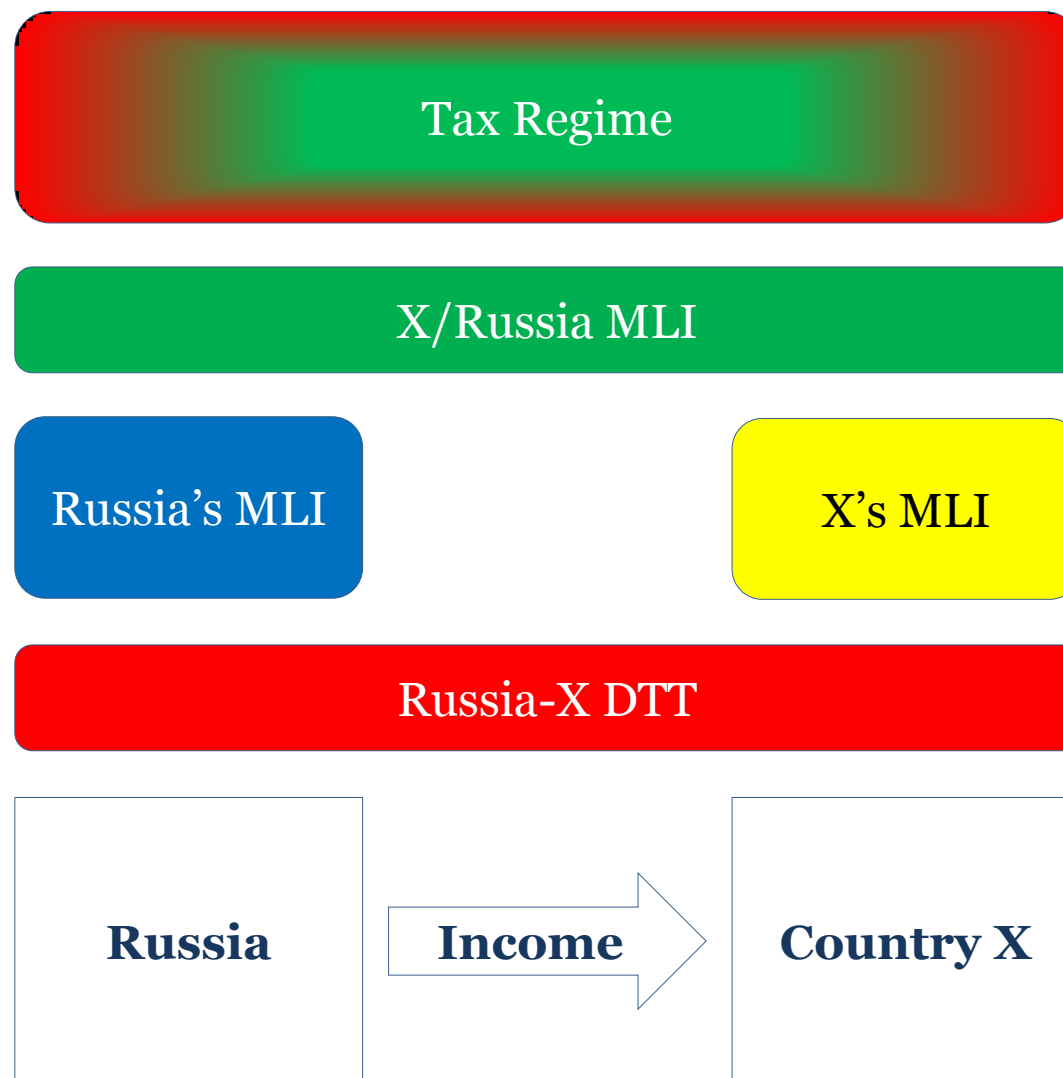
How does it work?



How does it work?



How does it work?



Treaty Abuse

Issues to address

1. No purpose clause – no proof of abuse
2. Treaty abuse
3. Dividend transfer transactions
4. Avoidance of RE-reach taxation
5. PE in a 3rd country – avoidance tool

Suggested approach

1. Define the purpose
2. PPT or LoB
3. 365 days holding period
4. 365 test period
5. 60% of ETR text





Court practice overview and development

Nina Goulis
KPMG

Development of court practice

In favour of the tax authorities

Interest payments:

1. MDM Bank PJSC – A40-116756/2015;
2. Bank Inteza JSC – A40-241362/2015;
3. Credit Europe Bank CJSC – A40-442/2015;

Royalties:

Petelin Trading House LLC – A40-12815/2015;

Coupon income on bonds:

Gazprombank JSC - A40-178650/2015

Khanty-Mansiysky Bank Otkrytie – A40-

Dividends:

1. Severstal -PJSC A40-113217/2016;
2. Krasnobrodsky Yuzhny LLC – A27-20527/2016 (first instance)

Distribution of assets:

1. Kapital LLC - A13-5850/2014
2. Vladimirenergosbyt PJSC – A11-6602/2016 (first instance)

Additional accruals: RUB 1,973 million

In favour of the taxpayer

Interest payments:

1. TOROS LLC – A41-598/2010;
2. Eastern Value Partners Ltd – A40-60755/2012;

Dividends:

1. Votek Mobile CJSC - A14-13723/2013;
2. Saint Petersburg Telecom OJSC – A40-187121/2014.

Additional accruals : RUB 472 million

**1 January
2015**

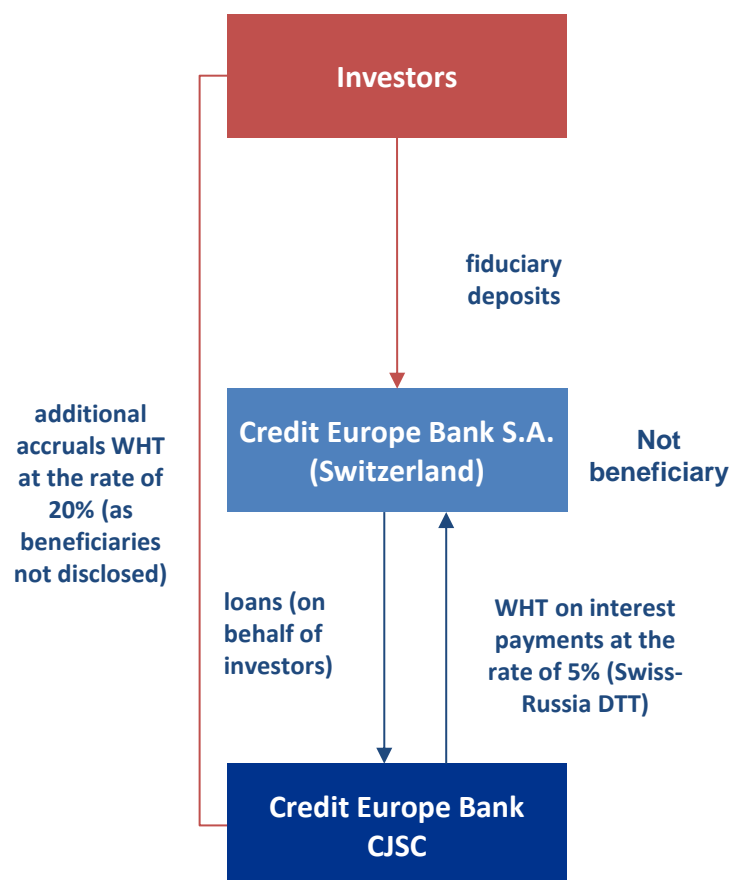
- Ministry of Finance clarifications on BO issues;
- Amendments to article 7 of the RF Tax Code
- Provisions of the DTTs

- A right to ask for the beneficiary owner status
- Extensive development of court practice for previous periods

1 January 2017

Direct obligation for the taxpayers to confirm they are beneficiaries

Withholding of tax at the source of interest payments

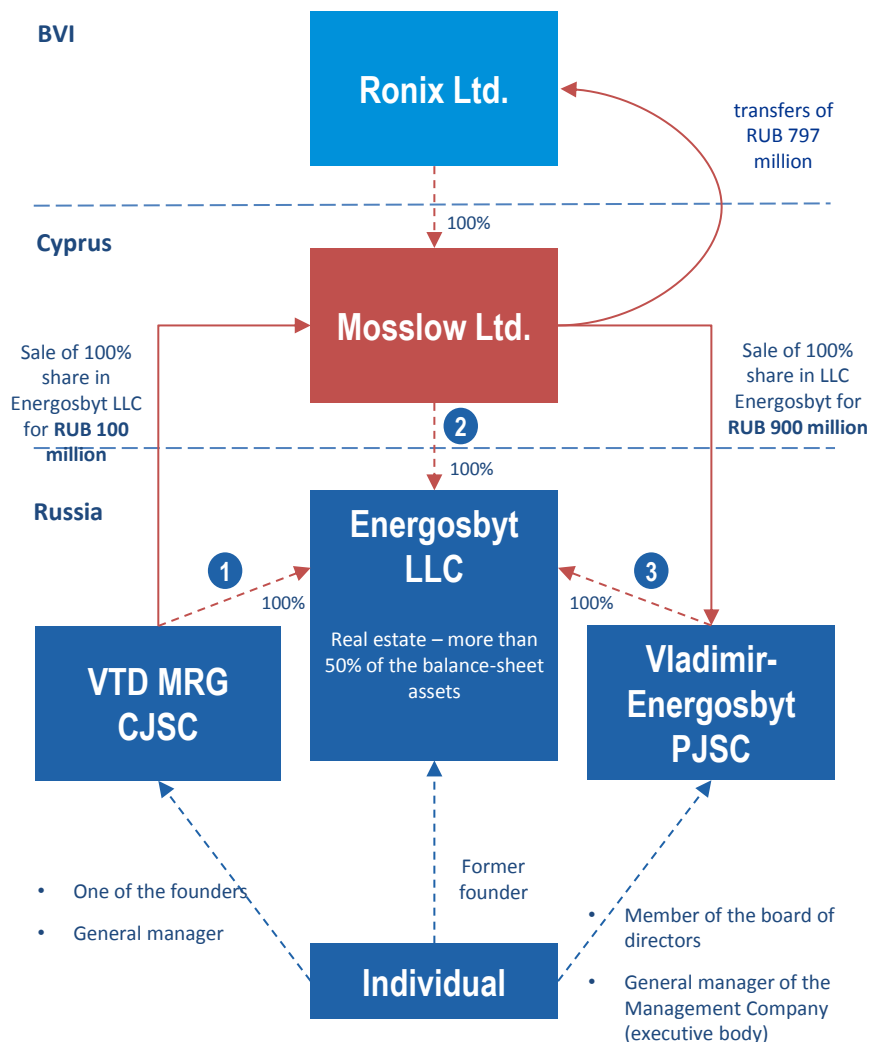


Credit Europe Bank CJSC (case # A40-442/15)

(cassation, January 2017)

- Credit Europe Bank S.A. placed deposits in its name, but on behalf of other legal entities and individuals (*evidence: off-balance accounting of deposits according to IFRS financial statements*)
- The tax authority was unable to establish the owners of the income, as it had no right to request information under the Russia-Swiss DDT effective before 2014
- Credit Europe Bank CJSC knew about the bank secrecy regime in respect of investors, so it recognized the intermediary nature of the activity of Credit Europe Bank S.A. (*evidence: response of Credit Europe Bank S.A. to Credit Europe Bank CJSC*)
- Credit Europe Bank CJSC and Credit Europe Bank S.A. acted in concert (*evidence: common business product on the placement of "confidential" (fiduciary) deposits*)

Distribution of assets in favour of a foreign entity



Vladimirenergosbyt PJSC case (A11-6602/16)

(first instance, January 2017)

Indicia of unsubstantiated benefit:

- The decision to acquire the 100% share was approved by Vladimirenergosbyt PJSC before Mosslow Ltd. had purchased it
- The settlement accounts of Mosslow Ltd and the Individual were opened at the same bank on the same day. The share was purchased on funds borrowed from the Individual (RUB 100 million) returned back immediately after share resale
- The resale transactions were performed over a short period of time (from May to September 2011 inclusively)

Mosslow Ltd is not the beneficiary, as:

- The sole participant is a BVI resident that was the recipient of the income from the resale
- The sale of the share was the one income-generating transaction for Mosslow Ltd. and there were no other income, expenses and assets
- Mosslow Ltd. did not pay any taxes in 2009-2012, and was liquidated in April 2013

The additional accruals for Vladimirenergosbyt PJSC calculated based on the total amount of income (RUB 900 million) in connection with the lack of supporting documentation confirming any expenses incurred by Mosslow Ltd. (the share was acquired on funds borrowed).

Sub-Clause 5, Clause 1 of Article 309 of the RF Tax Code, rate of 20%



How to defend actual right to income?

Victor Kalgin
EY



Tele2

- operating, investment and financing activities
- less than 50% of dividends were distributed
- directors make independent decisions
- confirmation of an actual right to dividends

<http://kad.arbitr.ru/Card/026312b7-cc1c-492f-9f9b-eabf6aa61725> (St Petersburg Telecom OAO)

<http://kad.arbitr.ru/Card/5c14d57a-fa0d-4e57-87d2-79edd7fd7851> (Votek Mobile ZAO)



Japanese Car Manufacturer

- strategic functions
- know-how adaptation to the Russian market
- cash gaps
- letter from Swiss tax authorities

What other factors are important?

Taxes paid

Conversion
of cash
flows

Decision
-making
process

Expenses

Business
rationale

Indemnities

Directors in
common

**Contracts
provisions**

Risks taken

Etc.



CONFIRMATION OF BENEFICIAL OWNERSHIP AND DEFENSE FILE - PRACTICAL STEPS

SESSION 2



- **Defining beneficial owner in relation to the various types of income: dividends, interest, royalties**
- **Can economic intermediaries (financial companies of the group, the licensees in sublicensing relationship, etc.) be beneficial owners of income?**
- **Notification of the beneficial owner of income and defense file**
- **Tax agent responsibility and the options of using indemnity tools**
- **Beneficial owner of the income – basic mistakes of foreign companies in Russia**



Experts:

**Rustem Akhmetshin, Pepeliaev
Group;
Kirill Vikulov, Baker & McKenzie;
Alla Zverkova, Goltsblat BLP;
Maria Semenova, Mazars**

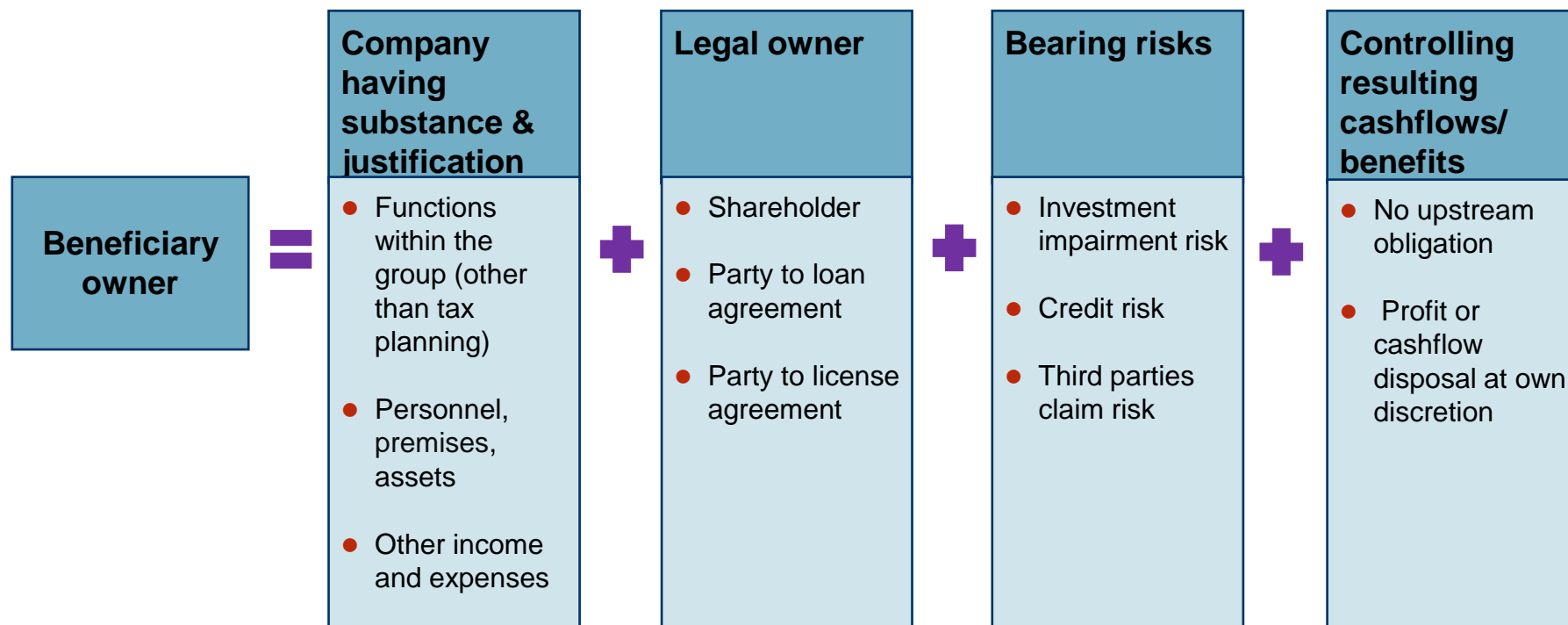


Tips to define the beneficiary owner: dividend, interest and royalties

Maria Semenova

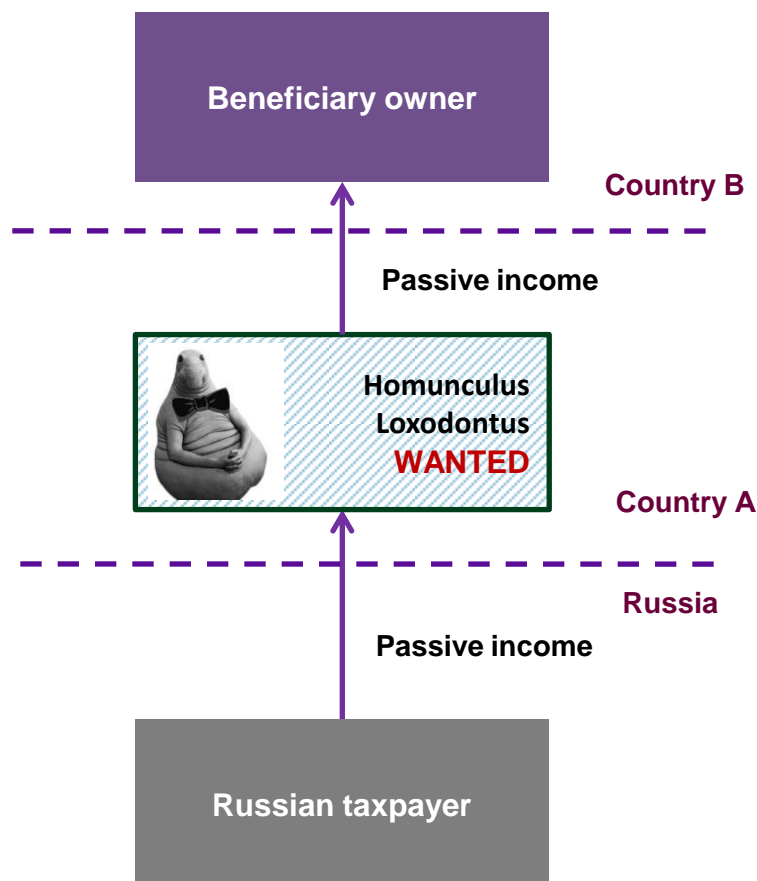
Mazars

Beneficiary ownership formula



IMPORTANT: Russian legislation does not give a conceptual definition of the beneficial owner

How to catch "wait-for-it" man?



It has limited responsibilities to dispose income, acts as an intermediary/agent, bears no risk, executes no functions, transmits income to a third party....

Dividend

Resolution of the 9th Arbitration Appellation Court of 07.02.2017 on Case No. A40-113217/16 ("Severstal" PAO)

Interest

Resolution of the Arbitration Court of Moscow District of 04.10.2016 on Case No. A40-241361/2015 ("Inteza Bank" AO)

Royalties

Decision of the RF Federal Tax Service of 09.02.2016 No. CA-4-9/1907@ in response to the appeal of "X" OOO

And the last, but not the least

Decision of the Arbitration Court of the Vladimir District of 17.01.2017 on Case No. A11-6602/2016 ("Vladimirenergosbyt" PAO)

Defense strategy building blocks

	Elements	FAR	Dividend	Interest	Royalties
Financial	Statement of Financial Position	Assets	<ul style="list-style-type: none"> • Shares reflected as financial investment 	<ul style="list-style-type: none"> • Capital sufficiency • Loan reflected as an asset 	<ul style="list-style-type: none"> • IP rights reflected as intangible assets
	Statement of Comprehensive Income	Functions	<ul style="list-style-type: none"> • Remuneration to the Board and NEDs • Strategy development costs 	<ul style="list-style-type: none"> • Costs to monitor the borrower • External financing costs 	<ul style="list-style-type: none"> • Expenses relating to IP registration/improvement/maintenance/protection
Non-financial	Board Minutes	Functions/Risks	<ul style="list-style-type: none"> • Independent development of subsidiary's overall strategy, including re-investment of dividend 	<ul style="list-style-type: none"> • Independent elaboration of borrowing and investment strategies 	<ul style="list-style-type: none"> • Independent elaboration of IP development and protection strategies
	Employees Chart	Functions	<ul style="list-style-type: none"> • Directors with authority for strategic decisions 	<ul style="list-style-type: none"> • Financial professionals (risk managers) with appropriate authorities 	<ul style="list-style-type: none"> • IP developers • IP lawyers
	Internal Regulations	Functions/Risks	<ul style="list-style-type: none"> • Corporate governance policies 	<ul style="list-style-type: none"> • Risk management policies 	<ul style="list-style-type: none"> • Regulations on IP protection

IMPORTANT: Russian legislation does not establish the beneficial owner features depending on the type of income



Intermediaries (group treasury companies, intercompany licensors): could they be treated as beneficial owners of income?

Alla Zverkova
Goltsblat BLP

The main feature of a beneficial owner of income: The right to use and enjoy

- “The right to use and enjoy the income”: Russian Tax Code, Minfin and OECD
- Whether the recipient of income (e.g. interest or royalties) has this right or not may be determined by reviewing:
 - The powers of the company’s directors as regards the income (memorandum and articles of association)
 - Whether there are contractual or fiduciary obligations to pass on the payment received to another person
 - Whether there are facts and circumstances indicating the existence of express or implied arrangements as regards the management of the recipient company and transferring of income
- Application of the above criteria to intermediaries – how to prove beneficial ownership?

Other (secondary) features of a beneficial owner: Absence of transit of income

- No channeling of the income received to a resident of a jurisdiction that does not have a Double Taxation Treaty with Russia
- Conduits:
 - Fiduciaries, agents, nominees (Minfin, OECD)
 - The obligation to pass on the income must relate to the payment received and would not include contractual or legal obligations unrelated to the payment received (OECD).
- Questions:
 - Is a group treasury company having both loan payables and receivables a conduit if the payables do not mirror the receivables?
 - Can a group treasury company financed through capital contribution (i.e. receives interest but pays dividend) be treated as a conduit?
 - Can a group treasury company that uses the received interest income to finance new loans provided to the group companies be treated as a conduit?
- How to prove the absence of transit of income?

Other (secondary) features of a beneficial owner: Functions, risks and substance

- When determining the beneficial owner of the income the functions performed and risks assumed are taken into account.
- Functions of an intermediary should be sufficient and correlate with the company's profile
- An intermediary should bear the risks that are usually borne by an owner of income in a transaction between unrelated parties (e.g. credit risk, FX risk, market risk, liquidity risk)
- Substance is not directly mentioned in Art. 7 of the Russian Tax Code; but it is unlikely that a company without any substance may perform sufficient functions
- Which level of substance would be sufficient depends on the types of activities carried out by a company and functions performed
- How to prove substance?



Beneficial Ownership Confirmation and “Defense” File

Scope of Tax Agent’s Liability and Use of Tax Indemnities

Kirill Vikulov
Baker McKenzie

Verification of the beneficial ownership ("BO") status as tax agent's obligation

- Scope of the obligations of the tax agent:
 1. Timely provide beneficial ownership confirmation ("free form") before payment.
 2. Verify the BO status:
 - on (i) intragroup transactions and (ii) transactions with 3d parties;
 - passive income subject to Russian withholding tax;
 - technically, the verification is required for each payment stream.

Option 1: No WHT as tax agent receives sufficient BO evidence

Option 2: WHT is applied in case of insufficient BO evidence

- right to tax refund

Option 3: No WHT as tax agent:

- receives BO Confirmation (no defense file)
- relies on the tax indemnity

Short/Long Confirmation Form vs Defense File

- BO Confirmation (free form) to be provided by the foreign recipient:
 - **Goal:** confirm the right to (1) receive income and (2) dispose of income at its own discretion for tax treaty purposes;
 - Consider LOB clause under the respective tax treaty.
 - **Form:** (1) short confirmation vs. (2) long all-inclusive form:
- Will the Russian tax authorities request even more information?
- Substituting the BO Confirmation with the Defense File:
 - Information on functions and risks connected to receipt of income;
 - Financial information confirming absence of passing income offshore;
 - Inclusion of payments in taxable income (no treaty shopping).
- Absence of the universal list of documents to be included in the Defense File (to be determined on a case-by-case basis).

Tax indemnity – legal nature and mechanics

- Critical issue for transactions with unrelated parties – tax indemnity on the withholding tax.
- Wording is important:
 - not an instrument to shift liability, not a penalty for breach of contract;
 - reimbursement of losses equal to the amount of tax liability (with regard to time, value of money concept and associated taxes).
- Scope and calculation:
 - minimum amount: tax imposed, penalties and late payment interest;
 - gross-up in the amount of corporate profits tax of the tax agent with regard to tax indemnity execution.
- Obligation of the counterparty to inform about new/changed circumstances that affect the BO status.



The beneficial ownership of income: the main mistakes foreigners make in Russia (inconsistency in approaches and what to do about it)

Rustem Ahmetshin
Pepeliaev Group

International approaches to the beneficial ownership of income

Simply put, the beneficial ownership of income means that the beneficial owner has the right to dispose of such income freely and to use it at its own discretion.

Therefore

- the main criterion is that a beneficial owner (its management bodies) has the corresponding *powers* based on the constituent and other documents
- a beneficial owner *is assumed* to have beneficial ownership of income (on the assumption that it has the legal capacity of a legal entity as an entity operating on the market)
- the assumption *is not refuted* by it being affiliated to another entity, not paying taxes or transiting the income (save for certain exceptions) and other circumstances which do not directly relate to the powers to dispose of the income

Russian approach (based on an analysis of practice)

The following facts attest to the *lack* of beneficial ownership of income:

- Participation in the transfer of income of low tax and offshore jurisdictions
- The main line of business is stated to be of a holding, financial or investment nature
- An (almost) complete lack of assets, operations and personnel
- 'Controlled status' meaning the *apparent* inability of the management to make independent decisions and the participation of other group companies in management
- The transit of income, a short period of time for all transactions
- The non-payment of taxes, especially with respect to the income

Preventing errors arising from inconsistencies in the two approaches

- The confirmation of beneficial ownership in terms of substance should take account of *Russian* factors, rather than of foreign practices only
- A formal legal approach cannot be applied here; an analysis of the *actual circumstances* is required on a case-by-case basis
- Tax authorities and courts often *presume* that a taxpayer is a *bad faith taxpayer* and a *tax abuse* has been committed
- The above bodies are guided by *external* signs of the alleged abuse. They do not analyse or have a genuine understanding of the concept of the beneficial ownership of income, or know and study the Commentaries (to the OECD Model Convention) and other international instruments
- A position should be defended based on proving that *no tax abuse took place* and *no tax goal* was pursued in founding and operating the company or in the tax-free transit of income



Vadim Zaripov

Deputy Chairperson of the AEB Taxation Committee, Pepeliaev Group

CLOSING REMARKS



Q&A