

CROSS-BORDER INTERCOMPANY TRANSACTIONS: RISKS AND SOLUTIONS

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Ararat Park Hyatt



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OPENING REMARKS



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OPENING REMARKS

Session 1

DEVELOPMENT OF THE RECENT PRACTICE OF CROSS-BORDER INTERCOMPANY TRANSACTIONS:

- Mazda case, SUN InBev case, Equant case and other important cases**
- Oriflame case**

INTERNATIONAL PRACTICE: AMAZON CASE, GOOGLE CASE AND OTHER IMPORTANT CASES

EXPERTS' ROUND TABLE "RUSSIAN AND FOREIGN CASES - SIMILARITIES AND DIFFERENCES"

Development of the recent practice of cross-border intercompany: Mazda case, SUN InBev case, Equant case and other important cases

Dzhangar Dzhalchinov

Partner and Head of Russian Tax and
Customs practice, Dentons

Interest



Brunswick Rail (Case No. A40-4757/14)

Thin cap rules are applicable to loans from “sister” foreign companies



Novaya Tabachnaya Companiya (Case No. A40-87775/14)

Double tax treaty with Cyprus prevents the tax authority from blindly applying thin cap rules, the interest rate must be compared with market conditions (arm's length principle)

Services



BAT cases (Case No. A40-60552/12 etc.)

The taxpayer did not submit reports and other materials serving as sufficient documentary evidence of consulting and marketing services allegedly rendered to the taxpayer by its foreign affiliate, the contracts and acts are vague as to the real nature of such services; the value of services was increased by 3,5 times with their volume remaining the same



Cargill (Case No. A68-5375/2013)

Tesa Tape (Case No. A40-142823/13)

The taxpayer submitted detailed contracts, reports, witness statements and other exhaustive evidence of services rendered to the taxpayer by its foreign affiliate

Royalties



Sun InBev (Cases No. A40-104549/13, A40-109010/2014)

Equant (Case No. A40-28065/13)

Oriflame (Case No. A40-138879/14)

The existence of “know-how” as defined by law is not proven, no confidential access to “know-how” is formalized (*Equant*), the license agreement is a “sham” transaction covering cash-pooling and/or cost-sharing mechanisms (*Equant, Oriflame*), a company acted in the name and on behalf of its foreign affiliate (*Oriflame*)



Domodedovo cases (Cases No. A41-30375/2013, A41-30369/13, A41-26946/13)

The existence of “know-how” as defined by law is proven, the know-how was used to create commercial privileges for the company; the procedure for an expert’s examination was not obeyed

Transfer pricing



Hyundai (Case No. A40-50654/13)

Subaru (Case No. A40-89807/14)

Mazda (Case No. A40-4381/13)

The company has created a tax avoidance scheme based on purchase of cars from its foreign affiliate at excessive prices which significantly differed from free market prices. The scheme resulted in illegal transfer of income gained by the company across the frontier.

Conclusions

- Russian tax authorities start to make a much stronger focus on cross-border transactions with the view to combat forms of hidden profit distribution catching up with foreign tax administrations (see BEPS Action Plan)
- Current practice is not outrageously harsh for foreign business (see, for comparison, Ukrainian cases), but it must adapt to new rules of the game
- Factual circumstances and documentary evidence are predominant (*Oriflame, Equant, BAT, BNP Pariba, SUN Inbev etc.*)

DEVELOPMENT OF THE RECENT PRACTICE OF CROSS-BORDER INTERCOMPANY TRANSACTIONS: Oriflame case

Natalia Faizrakhmanova

Senior Associate, Pepeliaev Group

**Current Practice is an Expression of a
Negligent Attitude towards the Law**

**The Oriflame Case is a Weapon of Mass
Destruction**

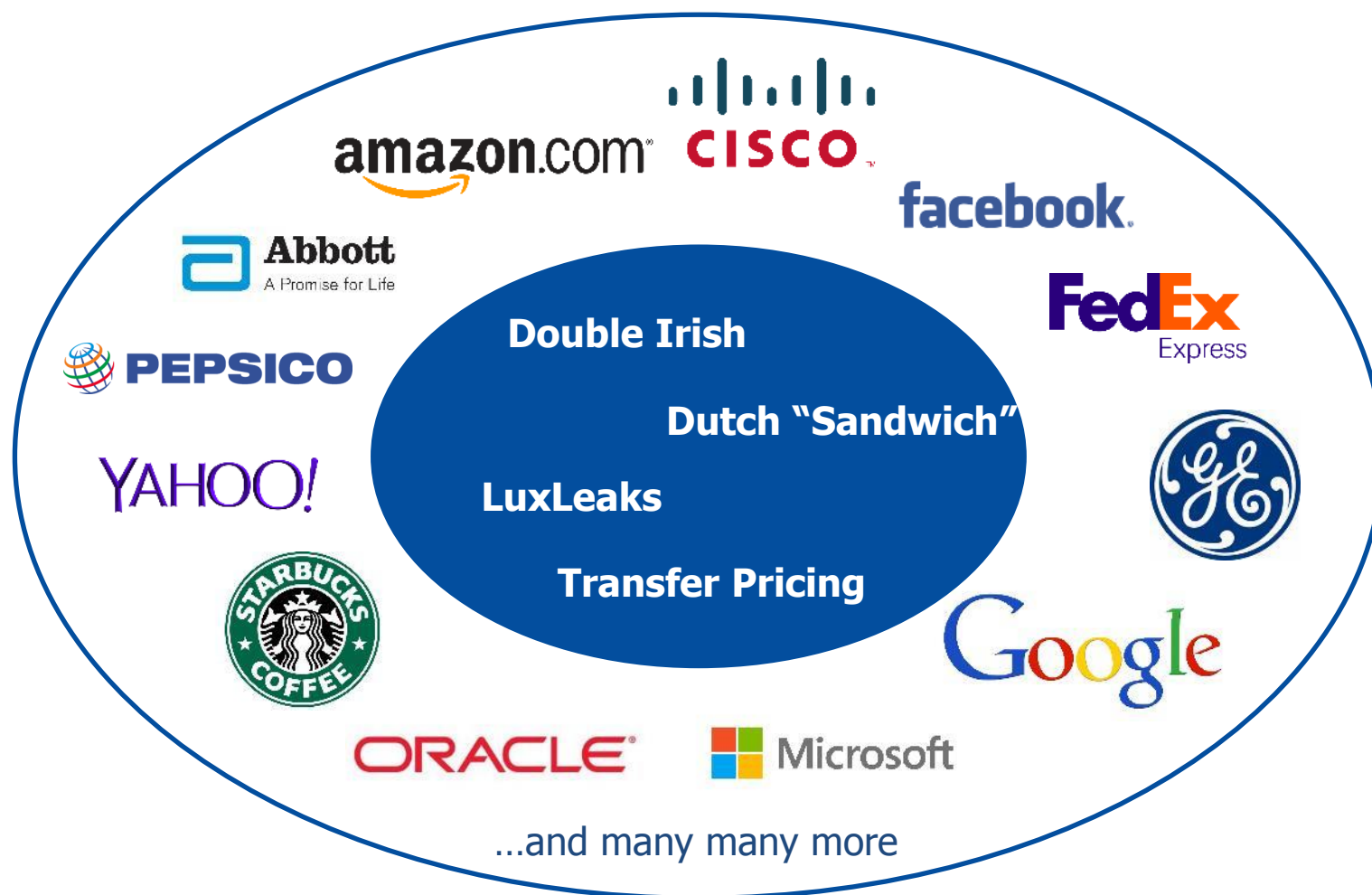
What should taxpayers do?

International practice: Amazon case, Google case and other important cases. The right amount of tax? Lessons learned from international cases

Angelos Benos

Partner, Deloitte&Touche CIS

Common Structures – Well-Known Cases



What now? Authorities and the public are taking actions.

1. Several Court Cases
2. Aggressive Actions (BEPS, CbC, FATCA, etc.)
3. Simple People
4. Tax "Shaming"

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Is it justified?

- **Tax avoidance** involves using whatever **legal** means you choose to reduce your current or future tax liabilities.
- **Tax evasion** means doing **illegal** things to avoid paying taxes. It's the Al Capone path to financial freedom



The Bigger Picture – more taxes will save the world?

A diagram consisting of five colored circles arranged in a pentagonal pattern. The top-left circle is light blue and contains the text 'Employment'. The top-right circle is dark blue and contains the text 'Exports & Services'. The bottom-right circle is green and contains the text 'Shareholders'. The bottom-left circle is dark blue and contains the text 'Foreign Investments'. The center circle is light blue and contains the text 'Customers'.

Employment

Customers

**Exports &
Services**

**Foreign
Investments**

Shareholders

EXPERTS' ROUND TABLE "RUSSIAN AND FOREIGN CASES - SIMILARITIES AND DIFFERENCES"

Moderator: Alina Lavrentieva, Chairperson of the
AEB Taxation Committee, PwC

Experts: Dzhangar Dzhalkhinov, Dentons; Natalia
Faizrakhmanova, Pepeliaev Group; Oleg Akilbaev,
Oriflame; Angelos Benos, Deloitte & Touche;
Evgeny Timofeev, Goltsblat BLP

Session 2

BEPS - QUO VADIS?

NEW LEGISLATIVE INITIATIVES AND THEIR IMPACT ON THE MULTINATIONAL COMPANIES:

- Draft law on thin capitalization
- Draft law on unjustified tax benefit
- Draft law on criminal liability for tax evasion through CFCs and controlled transactions

MUTUAL AGREEMENT PROCEDURES AS AN ALTERNATIVE WAY OF DISPUTE RESOLUTION

EXPERTS' ROUND TABLE "TAX PLANNING AND PROTECTION OF TAXPAYERS' RIGHTS IN THE NEW ENVIRONMENT"



New legislative initiatives

Mikhail Orlov

Head of Tax & Legal, KPMG

On abuse of right (Bill 529775-6)

- Transactions shall not be taken into account for the tax purposes if the main purpose of their accounting is reduction of tax liabilities (amendments to Article 54 of the Russian Tax Code)
- A VAT invoice signed by an unauthorized or unidentified person cannot serve as grounds for the deduction of amounts of tax charged by a seller to a buyer (amendments to Article 169 of the Russian Tax Code)
- Expenses actually incurred shall not be recognized as documented expenses if the documentary evidence provided is signed by an unauthorized or unidentified person (amendments to Article 252 of the Russian Tax Code)

Proposal to review the thin capitalization rules (Bill 724609-6)

Amendments to the definition of parties of controlled indebtedness

- Parties of controlled indebtedness should be related persons based on the criterion of participation of one person in the other
- The term "affiliated persons" of a foreign entity shall be replaced with the term "related persons" (not necessarily based on the participation criterion)

An exception to the controlled indebtedness definition is introduced:

- Debt obligation to an independent bank (incl. a foreign one) shall not be treated as controlled indebtedness

VAT

- A general (universal) procedure for deducting input VAT on transactions to which different tax rates apply (Bill 730216-6)
- The documents listed in Article 165 of the Russian Tax Code are only needed to justify the use of a zero rate, but not to confirm the entitlement to deduction of input VAT

What is being discussed:

- Cancellation of taxation of advances
- Mitigation of access requirements for the claim-based procedure for tax reimbursement

The Draft Law N599584-6 initiated by Members of the Council of Federation

New types of the tax crimes is proposed in the Draft Law (Article 199 Criminal Code)

Tax evasion performed by

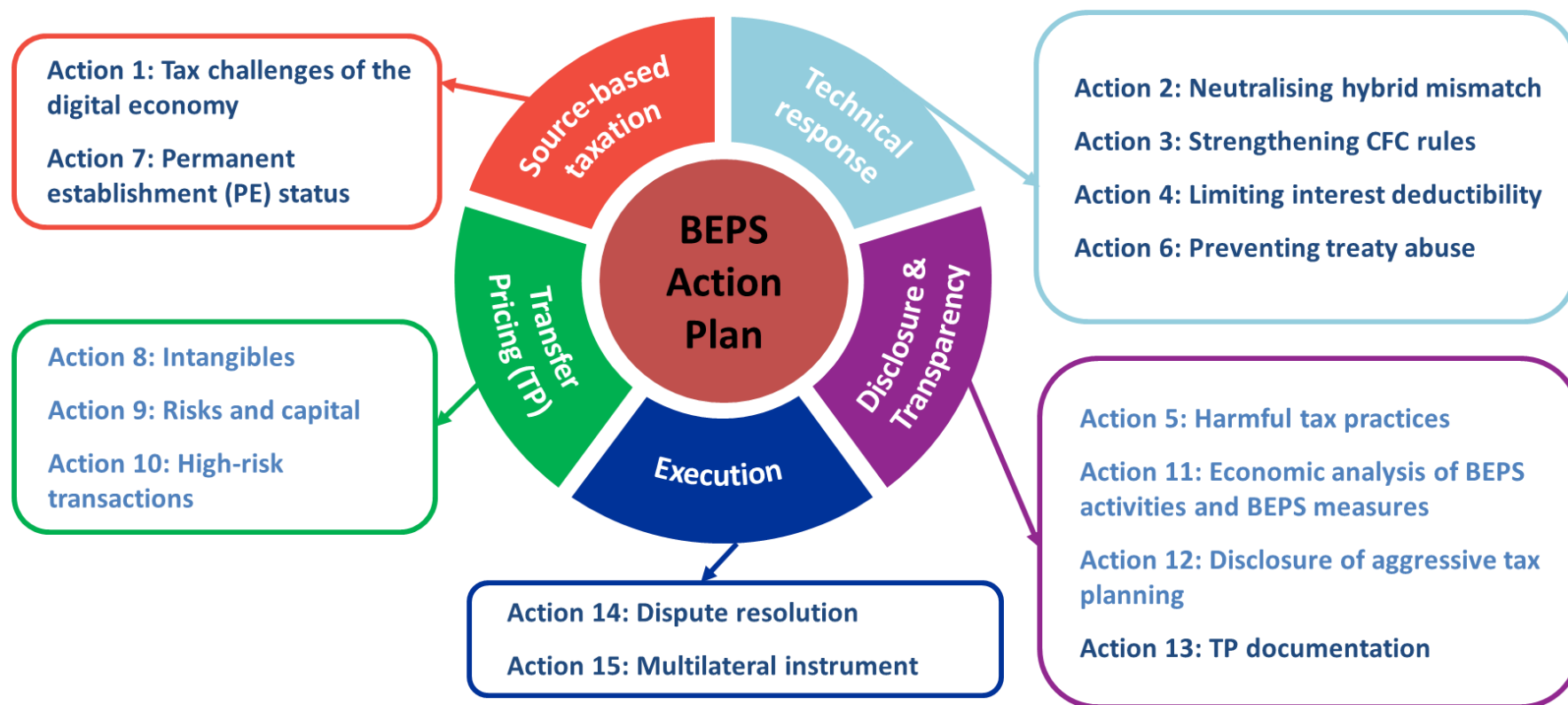
- Organized group
- Using illegally established legal entities
- Non-disclosing or falsification of information related to CFC or controlled transactions

BEPS - quo vadis?

Alexei Nesterenko

Partner, Russia Tax Controversy Leader, Ernst & Young

Snapshot of OECD's BEPS action plans



Action name	BEPS initiative	Russian Legislation	Risks in Russia
Digital economy (Action 1)	<ul style="list-style-type: none"> ▶ Not possible to “ring-fence” the digital economy ▶ Require other BEPS Action Plans especially Action 7 (PE) <ul style="list-style-type: none"> ▶ Virtual PE standard ▶ Withholding tax on digital transactions ▶ VAT registration 	Russian legislation does not include such features	<ul style="list-style-type: none"> - Online retail - Internet advertising - Cloud computing - Internet app store - Intangible assets - Royalties - Special taxpayers
Neutralising hybrid mismatch (Action 2)	<ul style="list-style-type: none"> ▶ OECD Model tax Convention changes ▶ Domestic law review ▶ Guidance on co-ordination 	Russian legislation does not include features, but worldwide court practice expected be used	<ul style="list-style-type: none"> - Hybrid financial instruments - Hybrid transfers - Imported mismatch structures
Strengthening CFC rules (Action 3)	<ul style="list-style-type: none"> ▶ MNCs may defer home country taxation of profits by “parking” them offshore ▶ CFC rules aimed to counter tax deferral schemes, forcing profits to be taxed immediately in the current tax year ▶ Prevent shifting of profits to low tax jurisdictions 	Deoffshorisation Law	<ul style="list-style-type: none"> - Threshold requirements - Definition of control - Definition of CFC income - Computing income - Attributing income

Action name	BEPS initiative	RF Legislation	Risks in Russia
Interest deduction and other financial payments (Action 4)	<p>The level of debt or interest expense</p> <p>An entity's gross or net position</p> <ul style="list-style-type: none"> ▶ Limitation with reference to the position of an entity's group ▶ Limitation with reference to a fixed ratio ▶ Targeted rules ▶ Non-deductible interest expense 	ThinCap rules	More strict rules could be implemented in Russian tax legislation
Harmful tax practice (Action 5)	<ul style="list-style-type: none"> ▶ Review of member country preferential regimes <p>Focus on substantial activity requirement in determining whether a preferential regime is potentially harmful</p> <p>Need for increased transparency through exchange on rulings</p> <ul style="list-style-type: none"> ▶ Participation to non-OECD member countries ▶ Revisions or additions to the existing framework 	Russian legislation does not include features, but wide court practice will be used	Russian court practice would take into account harmful tax competition
Treaty benefits in inappropriate circumstances (Action 6)	<p>More stringent conditions to ensure legitimate entitlement to treaty benefits</p> <ul style="list-style-type: none"> ▶ Emphasize objective of tax treaties ▶ Introduce limitation of benefits provisions or general anti-abuse rule 	Beneficial owner concept application could be applied in very strict manner	<ul style="list-style-type: none"> - Beneficial owners - Dividend transfer transactions - Transactions intended to avoid dividend characterisation - Splitting-up of contracts

Action		RF legislation	Risks
Preventing the artificial avoidance of PE status (Action 7)	<p>Prevent artificial avoidance of PE status and to attribute fair share of profits to PE</p> <ul style="list-style-type: none"> ▶ Develop changes to PE definition taking into consideration existing operating models Lower PE threshold ▶ Narrowing scope of PE exemptions 	Current Russian court practice based on internal tax legislation could be applied in very strict manner	Russian PE activity/ non-PE activity
Intangibles (Action 8) Risk & capital (Action 9) High-risk transactions (Action 10)	<p>Align transfer pricing outcomes with value creation activities</p> <ul style="list-style-type: none"> ▶ Develop changes to TP guidelines ▶ Develop rules to prevent BEPS ▶ Moving intangibles between group members ▶ Transferring risks among or allocating excessive capital to group members ▶ Scrutinize transactions which would very rarely occur between unrelated parties 	Tax code & wide court practice will be used	Intercompany transactions under risk
Mandatory Disclosure Rules (Action 12)	Coordination with Actions 5, 13	No legitimate instrument in legislation	<ul style="list-style-type: none"> - Person for disclosure - Threshold conditions - Hallmarks
Guidelines for country-by-country reporting (Action 13)	A comprehensive package containing the different elements will be developed by April 2015	Implementation is necessary	<ul style="list-style-type: none"> - Timing of preparation - Who should file - The use of information - The framework for G- to G exchange mechanism

Unilateral actions on BEPS

Activity is happening already in many countries, including in connection with:

- Focus crystallising on international tax avoidance
- New anti-hybrid measures
- The digital economy

Still to come?

- Increased reporting and international exchange of information
- Restrictions on interest deductibility
- Restrictions on treaty benefits
- New CFC legislation

Increasing focus of tax authorities in their international tax enforcement activity

- Already affecting advance pricing agreements and cross-border tax rulings in some countries



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Mutual Agreement Procedures as an alternative way of dispute resolution

Arseny Seidov

Partner, Baker & McKenzie

MAP – General Highlights

- MAP - special procedure under tax treaty allowing the competent authorities of the contracting states to resolve international tax disputes involving cases of double taxation and inconsistencies in the interpretation or application of the respective treaty
- May be initiated by a taxpayer – resident of a contracting state; if the competent authority of this state finds the application well-grounded, it may commence the MAP procedure
- Statute of limitations – three years from the first notification of the action not in accordance with a tax treaty
- Deliberate minimum of procedural rules: intended to encourage direct communication between the relevant competent authorities and be an effective means of taxpayer protection
- May be used in parallel or instead of domestic legal remedies; may be applied for prior to formal assessment of additional tax liabilities
- Most treaties, including the OECD Model: an agreement shall be implemented notwithstanding any time limits in domestic laws

MAP – Practical Issues



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- The competent authorities are required to *bona fide* attempt to resolve the case, but are not required to reach an actual agreement
- Arbitration procedure with a mandatory binding outcome: paragraph 5 of Article 25 of the OECD Model. Russia has arbitration clause only in DTT with the Netherlands, and this clause is currently dormant
- Overlaps with domestic procedures:
 - Domestic deadlines for applying for local legal remedies may expire while the MAP is pending. Need to rely on the court's discretion for restoration of these deadlines
 - Launching two procedures in parallel may result in reaching conflicting decisions at the level of domestic court (binding for the relevant competent authority) and under the MAP
 - An adverse decision of a local court obtained prior to the MAP results could preclude a favorable outcome of MAP
 - Russian law does not provide for a mandatory suspension of court proceedings until a MAP agreement is reached. Need to rely on the court's discretion in each case

MAP – Use in Russia

- Very limited precedent base
- Official agreements reached mainly on general questions of application and interpretation of tax treaties
- A number of MAP cases in connection with tax practices of CIS countries (Kazakhstan, Kyrgyzstan)
- Isolated MAP cases involving non-CIS countries: typically, no official MAP agreement is concluded
- Limited possibility to use OECD recommendations and approaches in the course of MAP. The Russian Ministry of Finance: “to the extent this does not contradict the Russian tax legislation”
- Trend to disregard treaty provisions in favor of domestic tax laws
- Practical outcome highly depends on three factors:
 - timing of launching MAP (early stage of a potential tax dispute offers better chances of success)
 - readiness of the relevant foreign competent authority for action
 - non-tax factors (e.g. relations between Russia and the relevant state)

EXPERTS' ROUND TABLE « TAX PLANNING AND PROTECTION OF TAXPAYERS' RIGHTS IN THE NEW ENVIRONMENT »»

Moderator: Vadim Zaripov, Deputy
Chairperson of the AEB Taxation
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Q&A