



Tax Directors Forum

“Navigating through the financial crisis – Tax issues”

Session 1: Intra-group financing

14 May 2009

Session 1: Intra-group financing



Part I

Loans

Forgiveness of debt

Free financing

Contribution to property (for LLCs)

Contribution to share capital

Tatiana Kirgetova, Senior Lawyer, Gide Loyrette Nouel

Loans

☐ Russian Tax issues:

- **Interest free loans - no Russian tax consequences** (*Regulation of the Presidium of the Supreme Arbitration Court of the RF No.3009/04 dated 3 August 2004, Clarifications of the Ministry of Finance of the RF, in particular, Letter No. 03-03-04/1/128 dated 20 February 2006*);
- **Loans bearing interest:**
 - **Deductibility of interest for profit tax purposes:**
 - **General rules for deductibility;**
 - **Arm's length principle;**
 - **Thin capitalisation rule;**
 - **Can provisions of double tax treaties signed by the Russian Federation be applicable in respect of the thin capitalisation rule?**
 - **Withholding profit tax (Russian legislation and provisions of double tax treaties signed by the Russian Federation).**

☐ Russian currency regulation issues.

Forgiveness of debt

- ❑ **Russian tax issues** (*Article 250.8 and Article 251.1.11 of the Tax Code of the RF, Clarifications of the Ministry of Finance of the RF, in particular, Letter No. 03-03-06/1/27 dated 21 January 2009*).
- ❑ **Russian civil law issues:**
 - **A shareholder of a joint stock company is not permitted to fulfill the payment of the shares of the joint stock company by means of setting off demands against the joint stock company in question** (*Article 99.2 of the Civil Code of the RF*).
 - **A participant of a limited liability company is not permitted to make a contribution to the charter capital of the limited liability company by means of setting off demands against the limited liability company in question** (*Article 90.2 of the Civil Code of the RF*).

Free financing/Contribution to the property of a Russian legal entity registered in the form of a LLC



❑ Russian tax issues:

- **Profit tax** (*Article 250.8 and Article 251.1.11 of the Tax Code of the RF*);
- **VAT** (receipt of monetary funds is not subject to VAT, unless it is connected with payment for goods, works or services);

❑ Russian currency regulation and civil law issues:

- **“Gifts” between legal entities are not allowed** (*Article 575 .1 of the Civil Code of the RF*).
- **Contribution to the property of a limited liability company** (*Article 27.1 of the Federal law 14-FZ dated 8 February 1998*).

Increase of share capital

❑ Russian tax issues:

- Contribution of monetary funds to the share capital is not subject to the Profit Tax or VAT;
- Insignificant State duties, in particular:
 - state duty for the registration of an issue of securities placed by way of subscription (based on nominal value) - 0.2%, however, no more than 100,000 Roubles.

❑ Russian civil law issues:

- The share capital increase is a lengthy procedure due to a large number of formalities that are required to be accomplished, in particular, registration of the amendments to the Charter.

Conclusion

- ❑ **A combination of different forms of financing can be considered.**
- ❑ **It is advisable to obtain comments on tax and legal consequences in the related foreign country in respect of schemes of financing before making a final decision on such schemes for Russian legal entities.**

Session 1: Intra-group financing

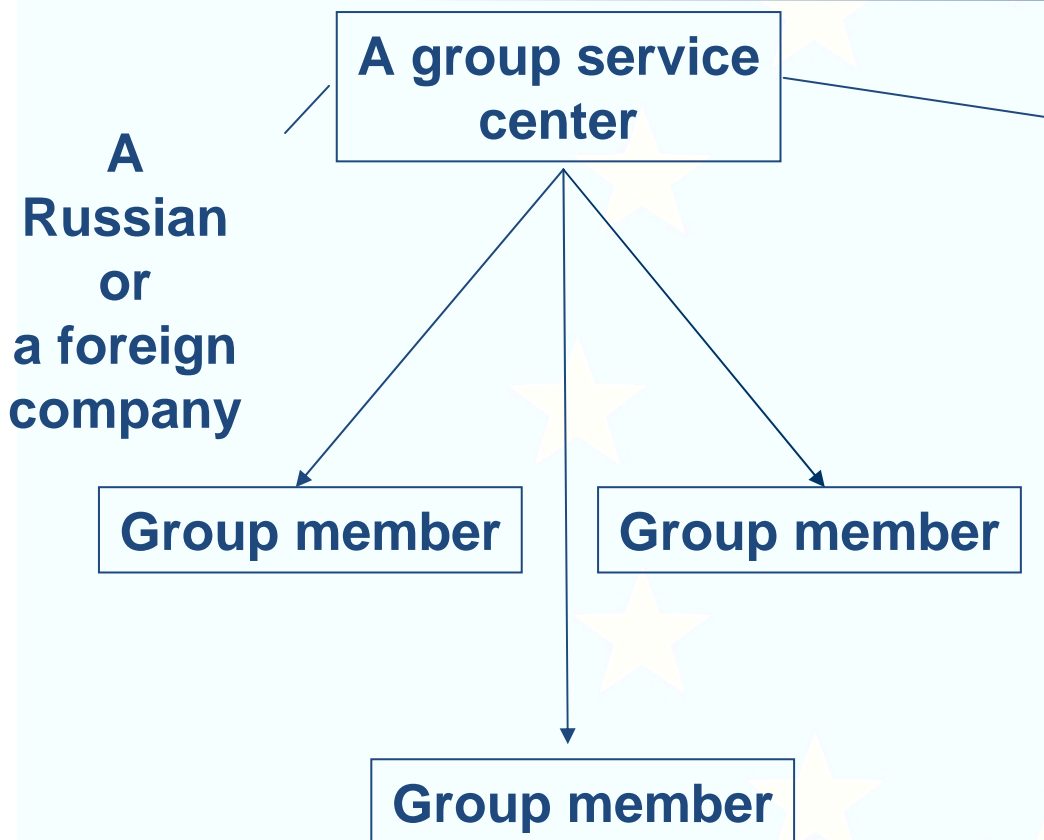


Part II

Cost sharing / cost allocation

Elena Orlovskaya, Lawyer, Beiten Burkhardt

Cost sharing / cost allocation



Arrange for services, to be available to group members, such as:

- administrative services
- financial services assistance in the fields of production buying, distribution and marketing
- services in staff matters
- research and development

Cost sharing / cost allocation

Russian practice

- The concept of cost allocation/cost sharing is unknown in Russia
- Only a service agreement with service fees (management fees) is a feasible option for intra-group services

Problem areas

- General deductibility provisions need to be observed:
 - Economical justification: fact of service's provision, duplication of functions etc.
 - Documentary support: service's results (reports etc.), numerous confirmation documents
- Transfer-pricing provisions apply both to Russian and cross-border intra-group services

Cost sharing / cost allocation

Intra-group services within a Russian group of companies

- Tax consolidation is a possible solution
- Transactions between group members and thus potential transfer pricing issues will be eliminated
- Will the provisions of the new law actually solve the problem or will a huge number of restrictions/limitations give it a second breath?

Cost sharing / cost allocation

Intra-group services within a multinational group of companies

- ❑ **Analysis of practice by the transfer of costs incurred by a foreign Head office to its Russian branch (PE)**
 - **Head office has to adopt the methodology for worldwide cost allocation and provide a sufficient grounding (for example, based on turnover)**
 - **No mark-up is required**
 - **Although allowed in most of the DTTs it is difficult to apply in practice (lack of methodology, numerous documentation requirements)**

Cost sharing / cost allocation

Intra-group services within a multinational group of companies

OECD Guidelines approach

- Two issues in the analysis:**
 - **Whether an intra-group service have in fact been provided, or would an independent enterprise in comparable circumstances be willing to pay for the service or perform it for itself?**
 - **What the intra-group charge for such services for tax purposes should be? (CUP, cost plus or other methods)**

- Tax administrations for practical reasons may merely allow allocation of cost of service in appropriate cases**

Cost sharing / cost allocation

Intra-group services within a multinational group of companies

Approach of other jurisdictions

Cost contributions arrangement (CCA) - i.e. a framework agreed among companies to share the costs / risks of acquiring assets, services, rights (based on the OECD guideline)

CCAs have been introduced by many countries (for example, Belgium, Canada, France, Denmark and recently by China)

Contacts



Peter Arnett
Partner, KPMG
Tel.: (495) 933-2787
e-mail: parnett@kpmg.ru

Elena Orlovskaya
Lawyer, Beiten Burkhardt
Tel.: (495) 232-9635
e-mail: Elena.Orlovskaya@bblaw.com

Alexandra Kadet
KempHoogstad
Tel.: (495) 544-3934
e-mail: alexandra.kadet@kemphoogstad.com

Tatiana Kirgetova
Senior Lawyer, Gide Loyrette Nouel
Tel.: (495) 258-3100
e-mail: kirgetova@gide.com

Andrey Bashkirov
Tax Manager, Procter & Gamble
Tel.: (495) 258-5860
e-mail: bashkirov.an@pg.com