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TAX | RUSSIA |

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RECENT CHANGES TO TAX LEGISLATION

71 COUNTRIES, INCLUDING RUSSIA, SIGN MULTILATERAL TAX CONVENTION

The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the "**Convention**") has been signed by 71 countries, including the Russian Federation. It will come into the force after its ratification. Once the Convention comes into force, taxation rules should be determined taking into account not only national tax law and applicable double tax treaties but also the Convention.

DOUBLE TAX TREATY BETWEEN RUSSIA AND JAPAN

The Governments of Japan and Russia signed a new Double Tax Treaty (the "**Treaty**") on 7 September 2017, which will replace the previous one.

In particular, the Treaty (i) provides an exemption from withholding income tax on income in the form of interest and royalties, and (ii) reduces the withholding income tax rate for income in the form of dividends, provided that certain conditions established by the Treaty are met.

It is expected that to come into force from 1 January 2018.

AMENDMENTS TO TAX CODE

Numerous amendments have been introduced to the Tax Code of the Russian Federation (the "**Tax Code**"). The amendments will come into force from 1 January 2018, subject to certain exceptions, and were introduced by Federal Laws No 56-FZ, No. 57-FZ and No. 58-FZ, all dated 3 April 2017, as well as Federal Laws No. 25-FZ dated 7 March 2017, No. 163-FZ dated 18 July 2017, No. 254-FZ dated 29 July 2017 and Federal Law No. 286- FZ dated 30 September 2017.

The main amendments to the Tax Code are the following:

- Article 54.1 is introduced to the Tax Code, outlining signs of good faith by taxpayers. In particular, according to this article, taxpayers can decrease their taxable base and/or amount of tax in accordance with the rules established by the relevant chapter of the Tax Code, as long as (i) the main purpose of the transaction is neither the non-payment (underpayment) of taxes nor the offset (refund) of taxes *and* (ii) the obligation under the transaction is performed by the counterparty, and/or by an entity to whom the obligation under the transaction is transferred under the agreement or by law.

- The receipt of property, property rights and non-property rights in the amount of their monetary valuation by a Russian legal entity in the form of a "contribution to assets" to a Russian legal entity, within the rules established by Russian civil legislation, will *not* be subject to Russian profit tax under sub-point 3.7 of point 1 of Article 251 of the Tax Code (i.e. this amendment to the Tax Code is important for "contributions of assets" in respect of which the "exemption" from profit tax under sub-point 11 point 1 of Article 251 of the Tax Code cannot apply, in particular, for "contributions to assets" from a shareholder that holds not more than 50% of the share capital of such Russian legal entity.

- The forgiveness of a debt by a shareholder, with the aim of increasing the net assets of a subsidiary, will *not* be included on the list of non-taxable income under the amended sub-point 3.4 of point 1 of Article 251 of the Tax Code. However, the inclusion of this type of income in the list of non-taxable income under sub-point 11 of point 1 of Article 251 of the Tax Code should be analysed (in particular, where the relevant shareholder holds more than 50% of the share capital of the Russian legal entity).

- Obtaining free-of-charge guarantees will not be subject to Russian profit tax, as long as the parties to the relevant transaction are non-banking Russian legal entities.

- The list of R&D expenses that may be deducted for profit tax purposes with a 1.5 coefficient has been expanded, i.e. the list will include (i) incentive payments to R&D staff (including bonuses) and related accrued obligatory contributions to non-budgetary state funds, as well as (ii) expenses on the acquisition of exclusive rights for inventions, utility models or industrial samples, or the rights to use such intellectual property rights under a licence agreement, provided they are used solely for R&D purposes (this provision will be applicable until the end of 2020).

ADOPTION OF NEW FORM OF VAT INVOICE, AMENDMENTS TO VAT DOCUMENTATION

Regulation of the Government of the Russian Federation No. 981 dated 19 August 2017 (the "**Regulation**") introduced amendments to the Regulation of the Government of the Russian Federation No. 1137 dated 26 December 2011, in particular related to VAT invoices (a new form of VAT invoice has been adopted), VAT purchases and VAT sales books, and journals of issued and received VAT invoices.

The Regulation came into force on 1 October 2017, and the new form of VAT invoice applies from 1 October 2017.

OTHER ISSUES

In addition to recent changes to the tax legislation, please see the below brief on several important (i) overviews in respect of tax issues adopted by the Presidium of the Supreme Court of the RF, and (ii) letters from Ministry of Finance of the Russian Federation (the "**Ministry of Finance**") and the Federal Tax Services of the Russian Federation (the "**FTS**").

Transfer Pricing and Thin Capitalization Rules

An overview of court practice in respect of disputes related to the transfer pricing rules and thin capitalization rules has been adopted by the Presidium of the Supreme Court of the RF dated 16 February 2017.

The most important positions related to the transfer pricing and thin capitalization rules, include:

- Only the FTS can inspect prices of the "controlled transactions" (i.e. local tax authorities cannot conduct such inspections during desk and field tax audits). However, the local tax authorities can apply transfer pricing methods established by Chapter 14.3 of the Tax Code during tax audits if, under the applicable chapters of the second part of the Tax Code, market prices should be used to calculate the taxes due on certain transactions (for example, the application of VAT in respect of VAT-able sales of goods, works, services, etc. free of charge).

- In general, in respect of "non-controlled transactions", the tax authorities should not challenge for tax purposes the price of the transaction established by the parties to the transaction. However, if the price of the transaction is many times different than the market price, this may be considered by the tax authorities as an indicator that an unjustified tax benefit is obtained and, in conjunction with other factors, might discredit the business purpose of the transaction.

- A report on market prices related to a certain transaction issued by an independent appraisal company can be used:
  - ✓ if the sources of information listed in Article 105.6.1 of the Tax Code are not available or not sufficient;
  - ✓ for a one-off transaction, provided the methods established in Chapter 14.3 of the Tax Code do not provide the possibility to define whether the price of the transaction corresponds to the market value; and
  - ✓ if the valuation of a transaction is obligatory under the legislation.

- A loan from a foreign company affiliated with a foreign mother company (in particular, a loan from a foreign sister company) may be subject to Russian thin capitalization rules.

Defence of Foreign Investors

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 most important positions related to the defence of foreign investors, 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.

- 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.

- 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[1] (i.e. "investments" should not be limited to increases of share capital).

[1] A double tax treaty signed between Russia and Switzerland was considered

- 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.

Clarifications on CFC Rules

A Letter of the Ministry of Finance of the Russian Federation dated 10 February 2017 No. 03-12-11/2/7395 provided clarifications in respect of 26 issues related to the application of Russian controlled foreign companies rules (CFC rules), including clarifications in respect of (i) accounting for the profit of a controlled foreign company if the financial year of the company does not correspond to the calendar year, (ii) accounting of losses of a controlled foreign company, and (iii) confirmation documents related to the amount of profit/loss of a controlled foreign company, etc.

Beneficial Ownership for the Application of Double Tax Treaties

In a Letter of the FTS dated 17 May 2017 No. CA-4-7/9270@, the FTS clarified to local tax authorities the issue of beneficial ownership for the application of double tax treaties provisions. In particular, the FTS outlined that:

- The Commentaries to the OECD Model Tax Convention on Income and Capital may be used for the purposes of interpreting the provisions of double tax treaties.

- The concept of beneficial ownership can be applied not only to income in the form of dividends, interest and royalties (the articles of double tax treaties on dividends, interest and royalties, generally include the beneficial ownership concept as one of the conditions to be met to apply a reduced tax rate under the respective treaty), but also to other types of income in order to avoid treaty shopping.

- Certain criteria that should be met by the recipient of income in order to be considered a beneficial owner of respective income, including: economic presence in the country of residence, wide authority related to using the respective income, in particular, in commercial activities by the recipient of the income, obtaining economic benefit from such income, taking commercial risks in respect of such assets, the absence of legal or actual obligations related to the further transfer of the income, etc.

Joint Methodological Recommendations of the FTS and the Investigative Committee of the RF Related to Identifying Circumstances Proving the Intent of a Taxpayer Aimed at Non- or Under- Payment of Taxes

In a Letter of the FTS No ЕД-4-2/13650@ dated 13 July 2017, the FTS and the Investigative Committee of the RF have issued joint methodological recommendations for local tax authorities and investigative authorities related to identifying circumstances proving the intent of a taxpayer aimed at non-payment (underpayment) of taxes (see the annex to the letter of the FTS No ЕД-4-2/13650@ dated 13 July 2017).

The methodological recommendations include: (i) examples of characteristic features of intent of non-payment (underpayment) of taxes, (ii) recommendations to the authorities on the procedure of conducting inspections (in particular, examinations, document seizures), as well as (iii) lists of questions that should be clarified by respective employees of a taxpayer (in particular, by the general director, etc.) in respect of the process of choosing of counterparties, the procedure of signing contracts, etc..

Overview of Court Practice on Obtaining by Taxpayers of Unjustified Tax Benefits from Business Splitting and Artificial Income Distribution

In a Letter of the FTS No CA-4-7/15895@ dated 11 August 2017, the FTS provided an overview of court practice related to obtaining by taxpayers of unjustified tax benefits from business splitting and the artificial distribution of income between interdependent parties.
The overview includes (i) a discussion of factors which may suggest that such actions are taking place, as well as (ii) examples of related court cases.

Clarification of the FTS in respect of Article 54.1 of the Tax Code

In a Letter of the FTS No CA-4-7/16152@ dated 16 August 2017, the FTS clarifies to the local tax authorities the application in practice of the provisions of Article 54.1 of the Tax Code (Article 54.1 of the Tax Code outlines the signs of good faith of taxpayers). The FTS, in particular, outlined that the tax claims are possible only if the tax authority proves that the taxpayer's counterparty did not actually perform the transaction, and that the conditions established by point 2 of Article 54.1 of the Tax Code are not met by the taxpayer.

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