

Russian international tax planning & transfer pricing developments

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Plan



- 1) Base erosion & profit shifting in Russia – description of problem
 - 2) Multilateral Convention to Implement BEPS and other forms of countering the problem in Russia
 - 3) Countering treaty abuse: details of Russian “economic” approach to application of beneficial ownership concept
 - 4) Practice & court cases on international tax
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Base erosion & profit shifting in Russia



- 1) Share of holding & low-tax jurisdictions in FDI stocks in Russia is stable and significant:
 - by July 1, 2017 (outward FDI: Cyprus – 38%, Netherlands – 14%, BVI – 10%; inward FDI: Cyprus – 31%, Netherlands – 10%, Luxembourg – 10%)
 - by January 2018 (outward FDI: Cyprus – 40%, Netherlands – 11%, BVI – 9%; inwards FDI: Cyprus – 33%, Luxembourg – 10%, Netherlands – 9%)

 - 2) Use of offshore artificial ownership & management holding structures for tax reasons with intermediary companies in DTT-countries;

 - 3) Transfer of dividends, excess interest & IP payments to affiliated foreign companies;

 - 4) Use of trading companies on low-tax & holding jurisdictions for export of commodities and transfer mispricing not in line with “value creation”;

 - 5) Transfer of profits offshore and infinite delay of taxation until repatriation of profits back to Russia
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Defensive shift in Russian international tax policy



What have already been done:

- Joining MLI BEPS
- Implementation of new TP and CbC documentation rules
- Review of Russian regimes for harmful tax competition criteria
- VAT taxation of digital services at the state of consumer
- Unilateral tax policy measures (CFC rules, beneficial ownership, indirect transfer of immovable property, corporate tax residence at place of effective management, GAAR)
- International information exchange initiatives (exchange-on-request, AEOI)

What is coming:

- Transfer pricing changes in relation to (1) commodity transactions, (2) intangibles, (3) FAR analysis of risks & capital, (4) increased analysis of factual circumstances
 - Analysis of “principal purpose”/“business purpose” of arrangement
 - Technical settings of international tax rules (look-through approach)
 - International exchange of tax rulings
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Improving competitiveness of Russian tax system



- Dispute resolution improvement under BEPS Action 14
 - Multilateral advance pricing agreements with FTS – now available
 - Internal offshore zones on Island Russkiy & Island Oktyabrskiy (draft law)
 - Tax amnesty for foreign capitals (2nd stage) & liquidation of offshore companies without tax consequences until March 1, 2019
 - Voluntary claim for Russian corporate tax residence
 - Look-through approach for beneficial ownership
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Beneficial owner – Russian approach (FTS Letter from April 28 2018 № CA-4-9/8285@)



- 1) context of purpose and meaning of tax treaty & substance-over-form and preventing treaty abuse. Narrow technical understanding of beneficial concept is not applicable;
 - 2) beneficial owner concept can be applied towards all types of income, not only passive income;
 - 3) for rejecting in providing tax treaty benefits FTS shall prove only the fact of absence of beneficial owner status of the income recipient. FTS shall not find beneficial owner of income;
 - 4) taxpayers shall prove business purpose and economic soundness of entrepreneurial risks when involving foreign companies in their transactions;
 - 5) criteria for analysis:
 - economic substance (staff, office, intangibles, functions, assets, risks, level of business activity, etc.);
 - right to use and enjoy the income;
 - presence of transit of financial flows;
 - 6) holding companies generally are not treated as beneficial owners of income, because of their limited economic activity and because they receive only passive types of income
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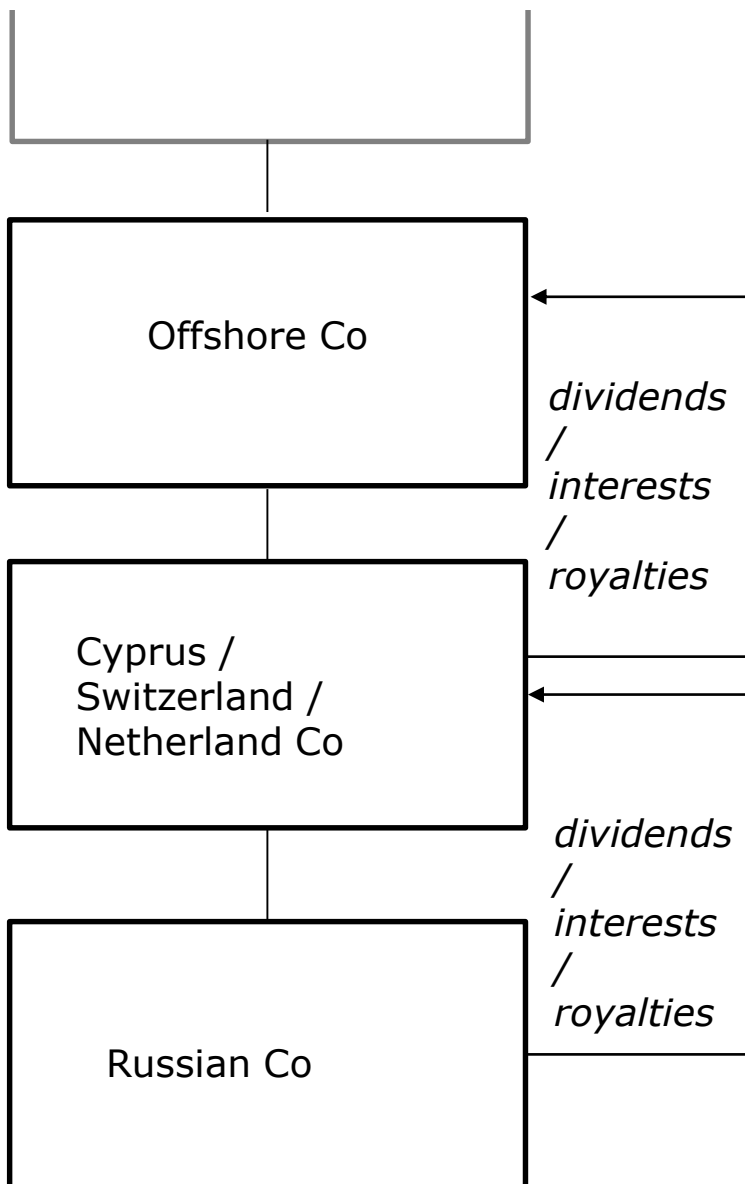
Application of DTT tax rates - how???



1. Beneficial owner criteria (analysis of functions/assets/risks for transit of flows)
2. Documentary proof of beneficial owner status
3. Limitation of Benefits (LOB) in BEPS MLI & Russian DTT – India, USA, China, Japan...
4. Principal Purpose Test (PPT) in BEPS MLI – commercial & economic motives in taxpayer's arrangements – NL, Lux, CY...
5. Substance over form, economic substance approaches
6. GAAR (Article 54.1 Tax Code) – “business purpose” test

All together ???

Court disputes review (Beneficial ownership)



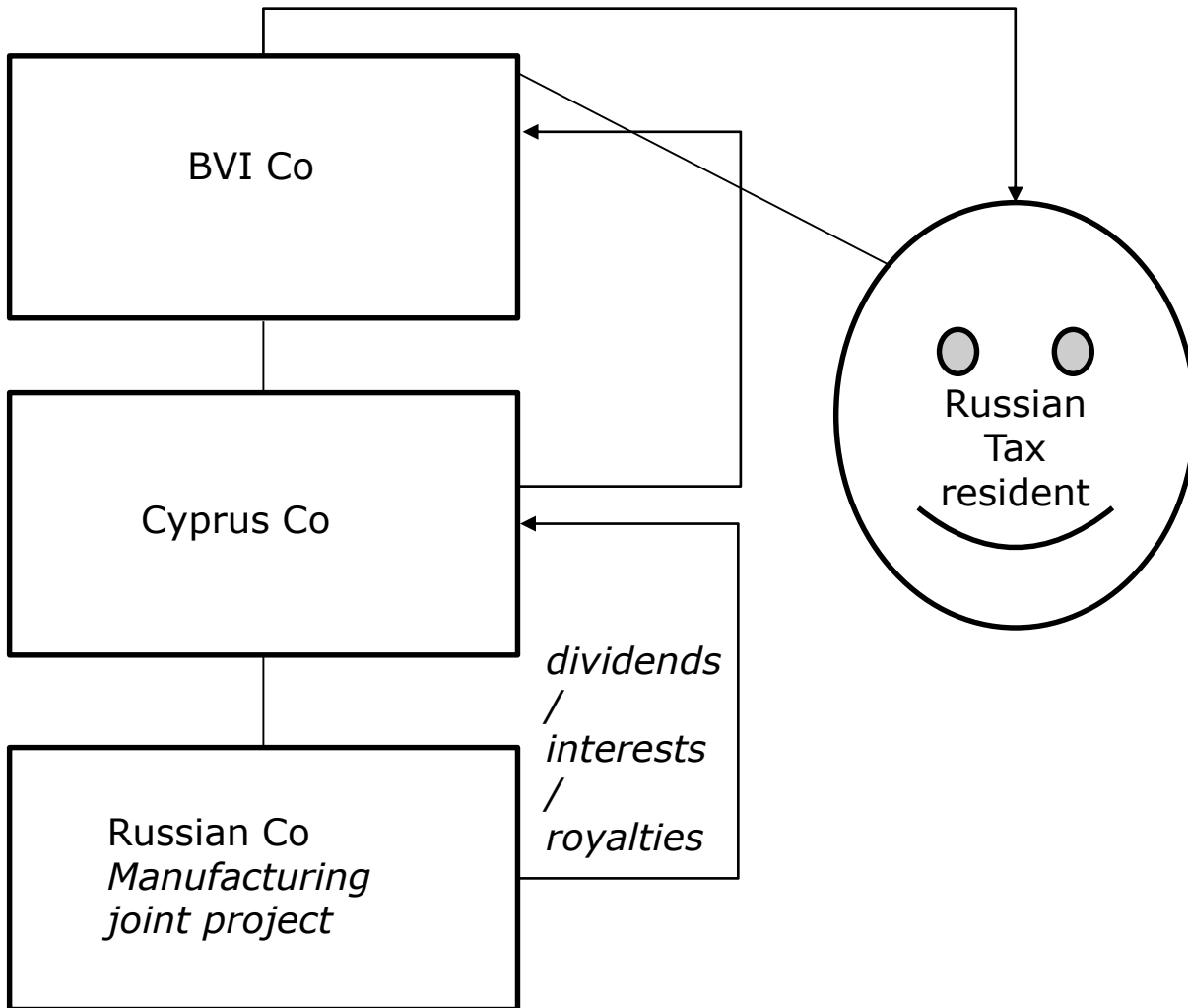
Risks:

- *back-to-back transfers;*
- *absence of substance;*
- *absence of company "economic functions" inside MNC group;*
- *high share of passive received / paid income in total income*

However:

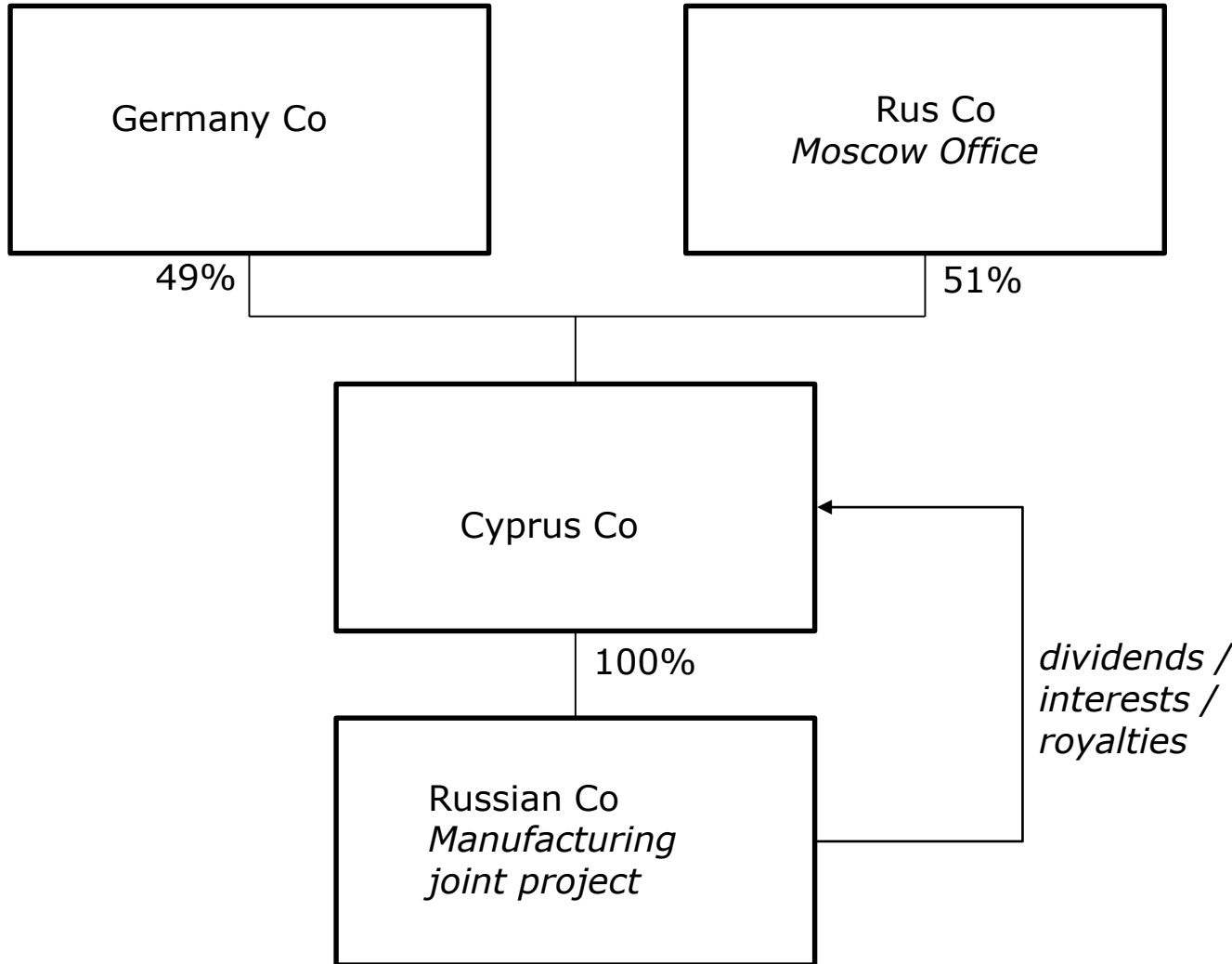
- *there was court practice of application of look-through approach to DTT;*
- *genuine foreign investors are not in focus of FTS attack;*
- *holding/financing/treasury companies can defend their beneficial owner status provided there is sufficient economic/strategic/commercial purpose or function*

Practice case (beneficial ownership look-through approach)



Russian tax resident can apply domestic personal income tax rate (13%) when receiving passive income through foreign holding structures (Cyprus – BVI – etc.)

Practice case (voluntary claiming corporate tax residence)



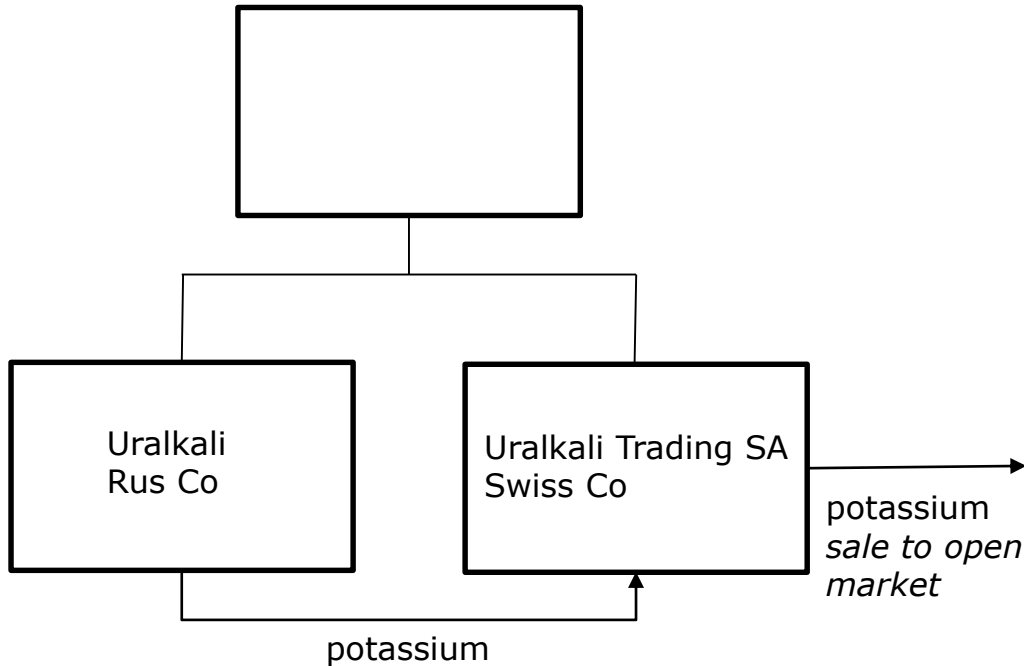
Option 1 - Cyprus Co voluntarily claims itself to be Russian tax resident

1. No CFC
2. No Beneficial Owner requirement
3. For Russian Co Russian domestic rate (0% for dividends under participation exemption)
4. For German Co – (DTT rates + beneficial owner documentation)

Option 2 - Cyprus Co is foreign company

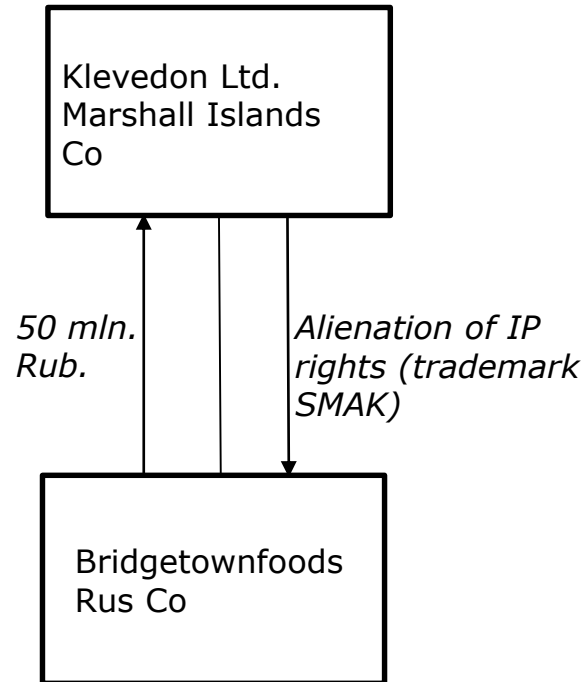
1. Subject to CFC (if more than 20% of passive income received)
2. Beneficial Owner requirement
 - look-through approach is possible, but highly uncertain;
 - documentation for all three companies)

Uralkali court case (transfer pricing of commodities)



- Taxpayer applied TNMM based on sales (*Bureau van Dijk*)
- Tax authority applied CUP (pricing agency – *Argus Media data*)
- *Argus media prices include both open market & related party transactions*
- *Argus media prices include both resale & final sale prices*
- *Uralkaliy has significant share of the market (about 20%)*
- *CUP is priority method under Section V.1 of Tax Code*
- *However, tax authorities must prove under Section V.1 that taxpayer's documentation/calculations are wrong*

Bridgetownfoods court case (alienation of IP rights)



- *Alienation of IP rights is not taxed at source under Article 309(1) of TC*
- *Alienation of IP is treated by FTS and courts in the same way as payments for the right to use of IP*
- *There is no DTT with Marshall Islands*
- *Currently case is under consideration at the Supreme Court*

Many thanks for your attention!

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