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Recent Developments in International Taxation Russia

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Amendments to the double tax treaties (DTTs)

In March 2020, the President of the Russian Federation instructed the Government of the Russian Federation (the 'Government') to initiate negotiations with foreign states to increase the withholding tax rates on dividends and interest payable from Russia up to 15 per cent.

The Government must report to the President of the Russian Federation on the completion of this order by 25 December 2020.

Currently, there is no exact list of the DTTs to be amended, but the Ministry of Finance of the Russian Federation has published information stating that the list will include Cyprus and other so-called 'transit' jurisdictions.

Further to this publication, the Ministry of Finance of the Russian Federation sent notes asking for the increase of withholding tax rates to Cyprus, Malta and Luxembourg. It is yet to be seen whether the list will be extended further.

All notes include the ultimatum that in the case of the non-reaching of agreements with foreign states, the Ministry of Finance of the Russian Federation will terminate Russia's participation in the respective DTTs unilaterally.

Considering the deadline set before the Government and provisions regulating the process of amending the DTTs, it is possible that the mentioned DTTs will be either amended or terminated by 1 January 2021.

Application of the Multilateral Convention (MLI)

On 30 April 2020, the Russian Federation notified the Depositary of the Organisation for Economic Co-operation and Development (OECD) of the completion of the internal procedures required for entry into force of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS ('MLI') with respect to the DTTs with 27 jurisdictions.¹

The Russian Federation accepted most of the initiatives proposed by the MLI, including the simplified limitation on benefits (SLoB) provision, allowing only 'qualified persons' expressly named in the DTT to receive benefits, while most contracting jurisdictions have chosen the application of the principal purpose test (PPT). Therefore, the SLoB will not be applicable to most Russian DTTs.

In addition to the assessment of the principal purpose of the taxpayer, other significant changes are expected, in particular:

- the implementation of a 365-day holding period of capital (shares/participation interests) for the application of preferential withholding tax rates on dividends;
- granting the jurisdiction where real estate is located the right to tax income from the sale of shares (participatory interests) in so-called 'property-rich companies'; and

¹ Australia, Austria, Belgium, Canada, Denmark, Finland, France, Iceland, India, Ireland, Israel, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, New Zealand, Norway, Poland, Qatar, Serbia, Singapore, Slovakia, Slovenia, Ukraine and the United Kingdom.

- the change of rules related to permanent establishments, including narrowing the definition of 'preparatory and auxiliary' activities, expanding the concept of an 'agency' permanent establishment and prohibiting the artificial splitting of contracts when carrying out activities on a construction site.

It is expected that the provisions of the MLI with the aforementioned jurisdictions will apply from 1 January 2021, and the participating states will start preparing for the forthcoming changes (eg, the competent authorities of the Republic of Singapore have already published the new addendum to the DTT with Russia).

Development of the mutual agreement procedure (MAP)

Historically, the application of MAPs was not so popular in Russia due to the absence of appropriate internal regulations. This mechanism was used mainly by the Ministry of Finance of the Russian Federation to negotiate a common approach to the application of the particular provisions of the DTTs with the contracting states.

In September 2019, provisions regulating the general aspects of the MAP were included in the Tax Code of the Russian Federation. Separately, the regulation of specific issues (eg, requirements on persons who can request the MAP, the list of documents that shall be attached to the application of the MAP and terms for the submission of the application) was delegated to the Ministry of Finance of the Russian Federation, being the competent authority responsible for MAPs in Russia.

In March 2020, the Ministry of Finance of the Russian Federation published draft guidance on the application of the MAP. The first draft raised some discussions within the business community about its doubtful provisions and some mismatches with the MLI (eg, discretionary powers of the Ministry of Finance of the Russian Federation to deny initiating the MAP and opportunity to initiate the MAP only after receiving the tax authorities' decision based on the results of a tax audit). It is expected that the draft will be further amended and will allow companies to apply the MAP much more frequently.

Separate to the MAP's guidance, the Ministry of Finance of the Russian Federation has prepared a draft law amending the procedure for concluding advance pricing agreements (APAs).

One of the key amendments includes an opportunity to apply the transfer pricing methods used in the foreign state along with the methods provided by the Tax Code of the Russian Federation, assuming that the competent authority of such a state takes part in bilateral or multilateral APAs. If the draft law is adopted this year, it will enter into force on 1 January 2021.

VAT on e-services and introduction of the digital services tax (DST)

Since 2019, Russia has applied new rules relating to the taxation of electronic (online) services (eg, provision of rights to use software remotely; access to online databases; streaming music, films and gaming services; hosting; and website support) in the business-to-business (B2B) sector.

In accordance with these rules, all non-Russian companies providing e-services to Russian-based customers are obliged to register with the Russian tax authorities, prepare VAT declarations on a quarterly basis, and calculate and pay VAT.

Registration is obligatory, even if the e-services are VAT-exempt in Russia (eg, provision of rights to use software and databases under license agreements) and/or provided under intra-group agreements.

As of the date of this report, the new rules have triggered a number of unresolved questions and technical problems connected with their application. As a result, the business community awaits further amendments in this respect. In particular, the state authorities are considering the following options proposed by the business community:

- setting thresholds on the amount of income from e-services, exceeding which the foreign provider obtains the obligation to register for VAT in Russia;
- introducing the concept of a 'special tax agent' that will be able to withhold VAT on e-services provided in the B2B sector and remit it to the budget; and
- excluding intra-group agreements on the provision of e-services from the scope of the new rules.

Separately, the Ministry of Finance of the Russian Federation proposed the introduction of new rules for the taxation of profit generated in the digital economy.

The announced proposal to tax the profit of digital companies based on the location of their users is close to the DST, which is currently under discussion and implementation worldwide in line with the OECD's position on this issue.

Introduction of a new mechanism for protecting investors

On 1 April 2020, the Federal Law 'On protecting and promoting capital investments in Russia' was officially published in Russia. This law allows investors to conclude investment protection and promotion agreements (IPPAs) with the state authorities.

The IPPA is an agreement based on which the company undertakes an obligation to invest in a Russia-based project, while the state authorities commit to ensure a stable tax regime for the project and provide other types of aid and support.

The new instrument applies to projects with the amount of investment exceeding RUB 200m (approximately \$3m). The duration of the stable tax regime depends on the amount of investment in the project (but cannot exceed the duration of the contract):

- six years, if the amount of investment is lower than RUB 5bn (approximately \$70 m);
- 15 years, if the amount of investment is in the range of RUB 5bn (approximately \$70m) to RUB 10bn (approximately \$140m); and
- 20 years, if the amount of investment starts from RUB 10bn (approximately \$140m).

The types of taxes covered by the 'stabilisation' commitments depend on the level of authorities that take part in the respective IPPA. The maximum guarantees are provided for the IPPA with the simultaneous participation of the federal, regional and municipal authorities.

If the amount of investment exceeds RUB 10bn (approximately \$140m), certain additional commitments connected with other payments (eg, payments for the negative impact on the environment and utilisation fees) may apply.

The business community expects that IPPAs will become one of the leading mechanisms supporting substantial investment activities in Russia, starting from 2021. Currently, the law still requires the adoption of a number of by-laws to be in full operation.