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**Recent Developments in International Taxation**

**Russia**

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## **Application of double tax treaties**

In 2020, Russia entered negotiations with other states to increase withholding tax rates to 15 per cent on dividends and interest payable from Russia. This mostly related to traditional jurisdictions used by Russian and international businesses for the structuring and financing of Russian assets. As of the time of writing, the changes introduced into double tax treaties (DTTs) with Cyprus, Luxembourg and Malta.

Negotiations with the Netherlands were not successful; starting from 1 January 2022, the DTT with the Netherlands was abolished on the Russian side.

The Russian Ministry of Finance had also entered discussions with Switzerland regarding the increase of withholding tax rates on dividends and interest. Currently, negotiations have stopped and the conditions of the new protocol to the respective DTT have not yet been agreed.

According to information from the Ministry of Finance, changes to DTTs were to be proposed to Hong Kong and Singapore. It is yet to be seen whether the list will be extended further.

The position of the counterparties of the Russian Federation also influences the application of DTTs. Latvia announced the suspension of its DTT with the Russian Federation from 16 May 2022. Russia has not taken any official actions with respect to this issue. If the reciprocal approach is reapplied, negative consequences may arise for Latvian tax residents, including the increase of withholding tax rates on dividends (up to 15 per cent) and other passive income paid from Russia, including interest and royalties (up to 20 per cent).

The DTT with Latvia does not formally provide for the suspension procedure and it is only possible to terminate the DTT on the initiative of one of the parties. In such a case, the DTT will be terminated from the beginning of the year following the year in which the notification was sent (similar to the case with the Netherlands).

Based on the draft of the Main Directions of the Russian Tax Policy for 2023–2024, which are published annually by the Russian Ministry of Finance, it is expected that Russia will proceed to work on the network of DTTs, including the signing of new treaties (in particular, with Oman).

## **Introduction of an annual obligation for foreign organisations (structures) to report on their participants (founders and beneficiaries)**

From 2021, foreign organisations (structures) registered with the Russian tax authorities are required to submit annual information about their participants (founders and beneficiaries) as of 31 December of the year prior to the submission of the information.

It is necessary to disclose both direct and indirect participants if their share in the organisation (structure) exceeds five per cent. This must be done no later than 28 March of the respective year. Failure to provide the respective information may lead to a fine in the amount of RUB50,000 (US\$900).

Previously, this obligation applied only to organisations that owned Russian real estate, but the list of entities has been significantly expanded. Thus, in addition to owners of Russian real estate, it includes organisations (structures) that have:

- representative offices/branches in Russia;
- accounts opened with Russian banks; or
- vehicles in Russia.

The only exception applies to foreign organisations registered with the Russian tax authorities in connection with the provision of electronic services to Russian users. Such organisations are not obliged to provide the above information unless the other grounds for registration with the Russian tax authorities apply to them.

### **Legislation on the application of VAT on e-services**

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

In accordance with these rules, all non-Russian companies providing e-services to Russia-based customers are obliged to:

- register with the Russian tax authorities;
- file VAT declarations on a quarterly basis; and
- calculate and pay VAT in rubles to the Russian tax authorities.

Due to the sanctions introduced in 2022, foreign companies face difficulties with VAT payments to the Russian state budget. As a result, the Federal Tax Service of the Russian Federation issued an official letter (No СД-4-3/3807@, dated 30 March 2022) regulating payments of VAT in which it recommended all Russian customers (legal entities and individual entrepreneurs):

- withhold VAT from payments to the foreign providers of e-services and other services subject to VAT in Russia (if the amount of VAT is duly withheld and remitted to the budget by the Russian customers, the tax authorities will not oblige the foreign providers of e-services to pay VAT a second time and declare the respective transactions in VAT declarations); and
- inform their providers of e-services that VAT was withheld and paid by the customers themselves.

Foreign providers of electronic services should contact their customers in Russia to discuss the new approach and its application to further payments for e-services.

In July 2022, the withholding mechanism was introduced in tax law, effectively reverting the rules to the pre-2019 version. Russian companies and individual entrepreneurs purchasing e-services are obliged to withhold tax as tax agents and the foreign companies do not have to pay VAT in Russia themselves.

However, the updated tax law did not release foreign providers of e-services in the B2B sector from the obligation to register for VAT purposes or file tax declarations; foreign providers are still obliged to register and file zero tax reports. It is recommended to monitor further developments regarding this issue.

Please note that this approach does not work for B2C operations: if a Russian customer is an individual without the status of an individual entrepreneur, the foreign provider of e-services is still obliged to declare and pay VAT in Russia from the payments received from such an individual.

### **Opportunity to forgive debts without tax consequences for Russian borrowers**

The Russian authorities temporarily extended the list of non-taxable income for Russian companies. These now include amounts of obligations terminated in 2022 under:

- loan agreements concluded before 1 March 2022 with a foreign company (or foreign citizen) that makes a decision on forgiveness of the debt; or
- rights of claim assigned to a foreign company (or foreign citizen) or Russian company (or Russian citizen) before 31 December 2022.

The exemption is not applicable to the part of the debt that relates to accrued but not paid interests, if such interest was earlier included into tax-deductible expenses. Therefore, until the end of 2022, international groups of companies can resolve issues connected with intragroup debts of their Russian subsidiaries without additional tax consequences in Russia.

### **Perspectives on the introduction of Pillars One and Two regulations**

Currently, the Organisation for Economic Co-operation and Development (OECD) is developing a new international taxation system for large corporations. The initiatives, named Pillar One and Pillar Two, include:

- a new basis for taxation and fairer rules for the distribution of profits of international group of companies providing digital services and services aimed at the end users (Pillar One). Multinational digital giants will be obliged to pay taxes where they have a significant customer base, even if these companies are not physically located in the territory of these states; and
- new rules for all multinational companies (not just digital ones), which will limit unfavourable competition in the tax sphere by introducing a minimum global corporate tax rate (Pillar Two).

In the Main Directions of the Tax Policy on 2022 and planned period of 2023–2024, the Russian Ministry of Finance stated that Russia will:

- continue participation in the work of the Inclusive Body created by the Group of Twenty (G20) under the OECD base erosion and profit shifting plan on the reform of international taxation in the context of the digitalisation of the economy; and
- will become a participant of international instruments to be developed by the Body that determine the taxation of profits of international groups of companies.

Therefore, the considered initiatives most probably can be implemented in Russia (however, no official drafts of the legislation have been published yet).

### **Clarifications from the Federal Tax Service regarding intragroup services**

In 2020–2021, the Federal Tax Service of the Russian Federation (FTS) issued several letters<sup>1</sup> with guidelines regarding the taxation of intragroup services. These guidelines can be used to develop approaches to the allocation of intragroup costs within international groups of companies.

Unlike generally accepted international rules, the Russian legislation does not contain special provisions allowing a Russian company (RusCo) to participate in the allocation of intragroup costs and recognise such costs for corporate profit tax purposes (only the general rules applicable to accounting of expenses are used).

Therefore, intragroup contracts and expenses related to them are subject to the particular attention of the Russian tax authorities. The deductibility of such expenses is often disputed within tax audits.

Based on analysis of the practice, the FTS recommended paying special attention to the following issues:

#### *Evidence confirming that services were actually provided*

In addition to a standard set of documents (contracts and acts on acceptance of services), the RusCo must have other evidence proving the provision of services: eg, intercompany policy on allocation of expenses, transfer pricing documentation, a list of entities of the group and their employees responsible for rendering particular services in particular regions, and deliverables. The FTS also recommends checking the existence of a transparent methodology for the determination of services costs, and the uniformity of its application within the international group of companies.

#### *Absence of duplication*

Since Russian companies usually have their own staff responsible for developing the Russian market, as well as their own in-house administrative staff, purchasing services may duplicate local functions and locally incurred expenses. As a result, the FTS states that tax authorities must ensure that the taxpayer does not pay for identical services to multiple providers.

#### *Commercial value of services*

It is presumed that the RusCo pays only for the services provided in its favour but not for the services provided in favour of third parties. Therefore, expenses for the services that are not connected with its activities should not be allocated to the RusCo.

#### *Absence of expenses relating to shareholder activities in the expenses allocated to the RusCo*

The letters state that the tax authorities shall distinguish between services actually provided and 'shareholder activities' expenses – which are often charged to all companies of the

international group despite the fact that such companies would not pay for them to an unrelated party or would not carry out these activities on their own.

The shareholder activities are interpreted by FTS quite broadly and, inter alia, include preparation of a strategy for the development of the international group of companies, research of markets where the international group of companies is going to conduct its activities, strategic planning and budgeting, and preparation of internal standards and policies.

The proper interaction between foreign companies and their Russian subsidiaries is important to collect the necessary information and prove that intragroup costs meet the mentioned criteria. Otherwise, there is a high risk that the tax authorities will consider the costs as non-deductible.

Moreover, the tax authorities may try to requalify the payments for the disputed services into dividends (or distribution of any other profit), which are normally subject to withholding tax in Russia. This may result in additional tax claims and fines for the Russian subsidiary.

### **Increasing the attractiveness of Russia for foreign investors**

The current Russian legislation provides for special beneficial regimes for foreign investments (advanced development territories, special economic zones, special investment contracts, etc), as well as tax incentives for various forms of doing business. The government is attempting to create comfortable conditions for foreign investors and is developing additional guarantees to attract new investments. The list of measures includes:

#### *New opportunities for 'non-taxable' financing*

- A contribution into assets of the Russian company decreases the shareholder taxable income in the case of the further sale of shares/liquidation distribution (previously, this was provided for capital contributions that were not always suitable for investors due to the complexity of the procedure and requirements of Russian corporate regulations).
- Property and property rights can be transferred between direct/indirect shareholders with a share exceeding 50 per cent and a Russian subsidiary without corporate profit tax consequences (previously this opportunity was provided only for direct shareholders (parent companies) and did not apply to property rights).

#### *New zone with a preferential economic regime was set up in the Kuril Islands*

A federal law has been passed that provides significant tax benefits to companies that are doing business in the Kuril Islands. This act establishes:

- an exemption from corporate profit tax, property, land and transport taxes for 20 years; and
- the right for companies to apply reduced rates of social insurance contributions in the aggregate amount of 7.6 per cent instead of 30 per cent, also for 20 years.

To take advantage of such benefits a company must:

- have an actual presence in the Kuril Islands and not have separate subdivisions elsewhere;
- not be engaged in intermediary activity, production or processing of excisable goods, extraction or processing of hydrocarbon raw materials, or catching valuable crustacean species (except for artemia and shrimp); and
- have no more than ten per cent of income from passive activities (eg, receipt of dividends and interest income).

A company can undertake such activities as catching, harvesting, processing bioresources and running a hotel business.

#### *Implementation of new initiatives for the improvement of already existing special regimes for foreign investments*

The following legislative changes are currently being considered with respect to special economic zones (SEZs), one of the most preferred locations for foreign investors:

- expansion of the list of permitted business activities in SEZs;
- simplification of the procedure for investors to obtain the status of a SEZ resident; and
- reduction of the number of documents submitted for participation in projects.

#### *Improvement of business conditions for IT companies*

To create the most favourable environment for the intensive development of the IT industry, a zero per cent corporate profit tax rate was introduced for the period from 2022 to 2024 inclusive (instead of the three per cent rate that previously applied to IT companies). In addition, a 7.6 per cent rate applies for social security contributions.

These rates differ substantially from standard rates provided for ordinary taxpayers. Generally, companies pay corporate profit tax at a 20 per cent rate and social insurance contributions at a 30 per cent rate.

To apply these incentives, an IT company should:

- obtain state accreditation with the Ministry of Digital Development, Communications and Mass Media of the Russian Federation; and
- generate at least 70 per cent of its total revenues from certain IT activities.<sup>2</sup>

In addition, the Russian authorities provide a number of other benefits for IT companies and their employees that are not connected with taxes (such as lending on special terms and a preferential mortgage for employees).

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<sup>1</sup> Letters of the Federal Tax Service of the Russian Federation dated 12 February 2021 (N ШИY-4-13/1749@) and 6 August 2020 (N ШИО-4-13/12599@).

<sup>2</sup> The list of such activities includes: sale of copies of (exclusive rights on) the software and databases developed by the IT company; provision of rights to use the software and databases developed by the IT company under the licence and other agreements; developing, adapting and modifying the software and databases; and installing, testing and supporting the mentioned software and databases.