

The Magnificent Seven Tax Events of 2016

2016 was a highly eventful year in terms of new developments in tax law and landmark court cases on various aspects of taxation. In this briefing we look at seven key trends and events of the past year that will shape the rules of the game in the sphere of tax in the years ahead.

1. Relief under double taxation treaties

There were a number of landmark court rulings in 2016 concerning relief and exemptions under double taxation treaties.

- In the *Intesa, Credit Europe Bank, Severstal* and *Krasnobrodskiy Yuzhniy* cases double tax treaty relief and exemptions were denied with respect to interest and dividends paid by Russian companies. In those disputes, the tax authorities' main argument was that the recipient did not have any 'actual right to the income' (i.e. was not the beneficial owner thereof) due to the conduit nature of the operations. In some cases the concept of an unjustified tax benefit was also applied in the context of the respective tax treaty application.
- In the *Olekminsky Rudnik* case, based on the 'main purpose' test, an exemption from withholding tax on interest paid to a UK company was denied, as it was found that the company became a UK tax resident for the sole purpose of claiming the relief under the Russia-UK double tax treaty.
- Another notable event was the tax authorities' successful attempt to apply withholding tax to the accrued coupon upon the sale of Eurobonds (the *Gazprombank* and *Otkritie* cases). Interestingly, soon afterwards the Ministry of Finance issued a number of letters indicating that such income is not subject to withholding tax, and the disputes ended with the conclusion of amicable agreements under which the banks paid the tax, while the tax authorities recognised the Ministry of Finance's position.

2. New tax treaties

In 2016, symbolising Russia's 'turn to the East', two tax treaties entered into force: a new treaty with China and, for the first time, one with Hong Kong. Both treaties apply with respect to Russian taxes from 1 January 2017. The main provisions of the tax treaty with Hong Kong are addressed in [our Client Briefing](#).

Also, effective 1 January 2017, the amended version of the double taxation treaty with Cyprus should enter into full force and effect (in accordance with the protocol signed in 2010), under which income from the disposition of shares or participatory interests in companies, more than 50% of the value of which is comprised of Russian real estate, is taxable in Russia.

However, on 29 December 2016 the Cypriot Ministry of Finance has made an official announcement that the application of the above amendments is postponed as agreed with Russian authorities. The new protocol is being finalised. However, in absence of any official amendments or modifications to the treaty or the existing protocol the reliance of such postponement is questionable.

3. Deductibility of expenses for profit tax purposes

Thin Capitalisation: In February 2016, substantial amendments were made to the Russian 'thin capitalisation' rules. For details regarding the amendments, please see [our Client Briefing](#).

Loss Carry-Forward: From 1 January 2017 to 31 December 2020 taxpayers cannot reduce their taxable profit by more than 50% on account of losses carried forward.

Debt-push-down: A first court case on debt-push-down in Russia was resolved positively for a taxpayer *Firma Radius-Servis*. In the case in question, the court rejected the tax authority's arguments that the sequence of transactions was meant to obtain an unjustified tax benefit. However, it remains to be seen whether this ruling will not be reviewed in the appellate court.

4. VAT on e-services

From 1 January 2017, the place of supply of a range of electronic services (such as sales of software over the Internet, advertising services and cloud-based services) is the place where the buyer is located. Foreign providers with no presence in Russia that sell electronic services to individuals who are not registered as individual entrepreneurs will have to undergo Russian tax registration and pay Russian VAT if there are indications that the individuals in question are located in Russia.

5. Application of the transfer pricing rules

In 2016 there were numerous disputes where tax authorities tried to apply transfer pricing rules to transactions that are technically not subject to transfer pricing control. It is our understanding that the Russian Supreme Court is currently preparing a set of clarifications on this issue.

6. Tax implications of employment termination payments

In the *Parliament Production* case, the Russian Supreme Court considered the deductibility of payments made upon termination of an employment contract as expenses for profit tax purposes. Among other things, it was found that the taxpayer must prove the economic justification for such expenses.

Other implications of such payments were also considered by the courts. In the *MRSK Siberia* case, the Russian Supreme Court found that payments upon termination of employment should not be subject to insurance contributions. In the near future, the Russian Supreme Court will also consider the *Murmansk Trawler Fleet* case regarding personal income tax implications of employment termination payments.

7. Implementation of BEPS in Russia

Actions to implement base erosion and profit shifting (BEPS) in Russia continue. Among other things, several draft laws

have been proposed to lay the foundation for country-by-country reporting (CbCR) and common reporting standards (CRS).

However, BEPS can also affect taxation in Russia due to actions taken by other countries. For example, it is possible that the Netherlands accedes to the OECD multilateral convention envisaging the taxation of gains derived from the sale of shares or participatory interests in real estate companies. This could impact many existing Russian real estate structures using the Netherlands as a jurisdiction for a holding company.

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