LT in Focus

Russian government approves draft of new tax treaty with Japan

In April 2017, the financial ministries of Russia and Japan closed a round of negotiations initiated to update the double tax convention between the countries, developing a draft of the new document and a protocol to it (the Convention). On 24 August 2017, the Russian Prime Minister tasked the Ministry of Finance to negotiate the signing of the Convention with Japan, provided any amendments to the earlier approved drafts are immaterial.

Double taxation matters between Russia and Japan are currently regulated by the Double Tax Convention signed by the USSR and Japanese governments in 1986. Read on for an overview of the key changes and their implications for the business.

Key changes

The Convention is based on the provisions of the existing OECD's Model Tax Convention and incorporates the 2017 updates issued as part of the BEPS package (the Multilateral Convention to Implement Tax Treaty- Related Measures to Prevent BEPS, or MLI). The new Convention is aimed at protecting the taxpayers against double taxation and is in line with the latest definitions of corporate and individual residency. It refines the permanent establishment criteria, updates the concepts and principles of the tax treatment of associated enterprises and "transparent" companies and introduces limitations on benefits. The Convention incorporates the much-anticipated provisions on mutual agreement procedures, which will help resolve a number of issues, including the signing of bilateral pricing agreements in cross-border transactions between Russian and Japanese residents.

Withholding tax rates

A comparison of withholding tax rates set by the 1986 treaty and the new Convention draft is presented below.

Type of income	1986 Convention	New draft
Dividends	15 percent	5 percent, if the shareholding exceeds 15 percent of voting shares held for over 365 days 15 percent, if over 50 percent of the shares' value is directly or indirectly represented by real estate, and 365 days following a decrease of the share of real estate in the capital 10 percent - in all other instances
Interest	10 percent	zero 10 percent – for interest calculated based on sales, profits, revenue and other cash flows of a debtor or dependent entity and depending on changes in the value of property, dividends
Royalties	zero - for literature, art or research works, including films 10 percent - for patents, trademarks, drawings or models, designs, and secret formula or process	zero
Sale proceeds	zero (except for the sale/indirect sale of immovable property, marine vessels and aircraft used for international shipping, and assets of a PE)	zero (except for the sale/indirect sale of immovable property *(including the instances where the sale of shareholding or similar rights took place within 365 days of the decrease of the share of real estate in the capital)*, marine vessels and aircraft used for international shipping, and assets of a PE)

Permanent establishment (PE)

The draft Convention contains a number of new provisions regulating permanent establishments (PEs). The exceptions envisaged for PEs will not apply to the instances when premises are used by an enterprise only to store, display or deliver goods or merchandise, but the enterprise itself or a closely associated organisation performs any other type of business in the same state, which creates a permanent establishment.

The Convention introduces provisions regulating the activities of an independent agent. Thus, the document sets forth that if a person is acting "exclusively or almost exclusively" on behalf of one or several enterprises to which it is closely related, such person will not qualify as an independent agent. For the purposes of the Convention, parties are considered closely related if one of them owns, directly or indirectly, over 50 percent of the other.

Limitation on benefits

A resident of a contracting state is entitled to tax benefits granted by the Convention in the instances below:

- A resident is a qualified person as at the time when the benefit is accorded

- A resident of a contracting state that is not a qualified person shall also be entitled to a benefit that would otherwise be accorded if, on at least half of the days of any twelve-month period that includes the time when the benefit otherwise would have been accorded, persons that are equivalent beneficiaries own, directly or indirectly, at least 75 percent of the beneficial interests of the resident

- A resident is engaged in business activities in one of the contracting states and his income sourced in the other contracting state is derived from such activities or is related to them

If a resident of a contracting state is not entitled to the benefits by virtue of the Convention, the competent authorities of the other contracting state may, nevertheless, grant such benefits at the resident's request, taking into account the object and purpose of this Convention and subject to the provision of the necessary proof.

Mutual agreement procedures

If a taxpayer believes that he is taxed or will be taxed in breach of the Convention following the actions of one or both of the contracting states, he may request MAP assistance from a competent authority of either contracting state.

Such request shall be filed within three years from the first notification of the action resulting in taxation in breach of the Convention.

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Apart from the application of the latest tax concepts, the draft Convention implies a substantial decrease of the tax burden in the country, in which the income is sourced. The enablement of mutual agreement procedures is another noteworthy point: although the regulations governing the signing of bilateral (multilateral) pricing agreements have long been pending approvals of different authorities, the respective Russian Tax Code provisions introduced in 2012 are still inapplicable. The Japanese companies will be among the first to reap the benefits of cross-border pricing agreements, which are expected to foster mutual investments and cross-country capital flows and have a strong positive effect on international commercial operations in general.

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We hope that you will find the information in this newsletter interesting and useful. Please feel welcome to contact us for more information on the topics covered.

Best regards,

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