LT in Focus
Russia Joins Multilateral BEPS Convention

On 7 June 2017, the Russian Federation among other 68 countries and jurisdictions joined the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting of 24 November 2016 (the "Convention").

The Convention will enter into force after ratification. The first amendments to the Russian tax treaties are expected to come into effect in the beginning of 2019.

Convention in a nutshell

The Convention was developed under BEPS Action 15 as the first multilateral instrument of a kind.

The need for such instrument was dictated by the OECD's effort toward the consistent implementation of the tax treaty-related BEPS measures (hybrid mismatch arrangements, treaty abuse, artificial avoidance of the PE status, dispute settlement), which would otherwise have required a re-negotiation and revision of more than 3,000 bilateral tax treaties.

To avoid the time-consuming bilateral negotiations with no guaranteed result, the G20 leaders approved the approach, which advocated the adoption of a multilateral international instrument meant to efficiently adopt supplemental or substitute provisions to the bilateral treaties without modifying each of them.

It has taken an international team of experts, including from Russia, two years to develop the Convention, aiming to streamline the implementation of the document on the basis of "one negotiation - one signing – one ratification" principle.

Convention in action

Unlike the protocols to the double taxation treaties, which amend their texts, the Convention is applied alongside the existing treaties, modifying their application.

The Convention applies to a list of treaties each country selected.

The multilateral instrument contains provisions that are mandatory for each signatory, as well as a number of optional provisions that will be applied to particular treaties at each country's discretion.

The minimum standards that are mandatory for all signatories (Russia among them) include the following provisions:

- A preamble is added to each treaty, stating that double taxation treaties do not apply to persons who abuse them to evade taxation
- A provision is added to each treaty, restricting the usage of double taxation benefits depending on the results of the "Principal Purpose Test", or "PPT", used to determine whether a transaction or arrangement is genuine or is meant solely to obtain a tax benefit.
  Each jurisdiction may combine the PPT with other limitations; Russia has chosen a "simplified" option (see below).
- Each tax treaty is supplemented with a provision enabling the taxpayers to initiate a mutual agreement procedure ("MAP") by applying to the competent authorities of any of the contracting jurisdictions to resolve a dispute arising out of the tax treaty application.

[1] The OECD's Action Plan on Base Erosion and Profit Shifting.

The optional provisions are applied at each country's discretion.

Russia has accepted most of the above-mentioned provisions that potentially toughen the existing tax treaties.

In our opinion, the most critical amendments to be introduced to the existing treaties are the following:

- In addition to the PPT, each treaty will be amended to include the **Limitation of Benefits clause**.

  Russia has opted for the so-called "Simplified Limitation on Benefits" provision which restricts most treaty benefits to "qualified persons" expressly named in the Convention.

  Holding companies, as well as companies performing intergroup administration, financing and/or investment (excluding banks, insurance companies or registered securities dealers) are specifically named as as non-qualifying persons. To be eligible for the tax treaty benefits, such persons will have to provide proof that their activities are genuine, i.e. to pass the PPT.

- The **Taxation of Dividends** clause is amended to restrict the application of a reduced tax rate with the ownership criteria, which shall have been met throughout a 365-day period up until the date of the payment of the dividends.

- The capital gains from the alienation of shares or interest in entities, whose assets are mostly represented (directly or indirectly) by real estate, should be taxed in the jurisdiction in which such real estate is located, provided that real estate had dominated in the asset composition of such entities for 365 days preceding the alienation.

- **New provisions expanding and refining the Permanent Establishment concept:**

  - A permanent establishment is created if an agent acts in a contracting jurisdiction on behalf of an enterprise and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts

  - The definition of preparatory and auxiliary activities has been limited

  - Splitting-up of construction contracts is banned to avoid the abuse of the timing criteria

It has been resolved that the Convention will apply to 66 tax treaties signed by the Russian Federation.

The Convention will not apply to the treaties with the countries that were not represented in the OECD's Working Group and to the treaties with Sweden and Japan due to the pending re-negotiation of new treaties with account of the Convention provisions.

The mandatory provisions accepted by Russia will apply to the selected tax treaties once the Convention is ratified.

The application of the optional provisions will depend on the choice of other contracting jurisdictions. Thus, the Convention provisions accepted by Russia will apply to a tax treaty with another state, unless such state has expressly refused from applying them. Therefore, the toughening of a treaty by Russia may be restricted by the other contracting jurisdiction's approach.

It is important to note that Russia is entitled to opt out of optional provisions of the Convention until its ratification, as well as to amend or qualify the reservations.

Once the Convention is ratified, Russia will only be able to opt out of the optional provisions or remove the reservations it added earlier.

Implications

From now on, the taxation regime will have to be determined based on the provisions of the national laws, tax treaties, and the Convention.

MLI positions of the signatories can be viewed at the OECD's website.

To enable applicability checks between the Convention and the existing tax treaties with the OECD's partner jurisdictions (with account of their position), the OECD has developed a Toolkit for Application of the Multilateral Instrument for BEPS Tax Treaty Related Measures ("MLI Toolkit").

By the end of 2017, the OECD also plans to design an online tool allowing to model the potential overlaps in the application of the Convention by its signatories according to their positions.

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

Best regards,

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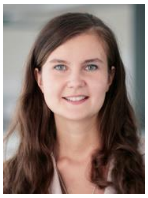

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