

LT in Focus

The Russian State Duma approved a draft law formalising the concept of unjustified tax benefit in the Russian Tax Code

The [respective draft law \(the "Draft"\)](#) passed the third reading on 7 July 2017. These amendments are a much welcomed and long-awaited implementation of one of the most broadly discussed recent initiatives.

Until now, the application of the concept has been governed solely by Resolution of the Russian Supreme Commercial Court Plenum No. [53](#) of 12 October 2006 (the "Plenum Resolution"), the most cited ruling in tax disputes.

As the disputes over the applicability of this concept constitute the bulk of all tax litigations in Russia and their share keeps growing, the importance of giving a formal definition to unjustified tax benefit is hard to overestimate.

This issue focuses on the amendments proposed by the Draft and offers an assessment of their consequences for the taxpayers compared to the existing approach, where the Plenum Resolution is applied by the tax authorities despite the uncertain applicability criteria.

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Proposed changes

It took a while to develop the Draft: it was originally submitted to the State Duma in 2014 and passed the first reading in 2015. The document was substantially altered for the second reading that took place on 5 July 2017, but after that remained unchanged.

For instance, the original Draft contained the concept of "abuse of right" which was further turned down.

The finalised Draft proposes supplementing the Russian Tax Code with Article 54.1, which defines the unjustified tax benefit as an understatement of the tax base/tax payable as a result of a misrepresentation of business operations/taxable assets by the taxpayer.

If no such misrepresentation occurred, the taxpayer shall be entitled to reduce its taxable base/tax, subject to the following conditions:

- The avoidance of payment (partial payment) and/or obtaining the refund of a tax is not the primary purpose of the transaction
- The obligations under the transaction were discharged by the party to the agreement and/or its legitimate assignee.

The draft expressly states that the signing of source documents by an unidentified/unauthorised person, a breach of tax legislation by a counterparty, and the possibility to use other available options to achieve the same economic result shall not in itself be deemed evidencing the wrongfulness of the taxable base/tax reduction.

Therefore, the applicability of the concept will be primarily tested by assessing the genuineness of the transaction – in other words, whether the taxpayer intended to misrepresent the tax data.

If adopted, the law will come into force one month after the official publication.

The provisions governing the proving of unjustified tax benefit by the tax authorities will apply to desk audits of tax returns filed after the law enactment as well as to field tax audits and transfer pricing audits scheduled by the tax authorities after the enactment of the law.

Implications for taxpayers

The Draft provisions are pretty much consistent with the approach applied by Resolution No. 53 of the Russian Supreme Commercial Court Plenum.

The Russian Federal Tax Service has recently released [clarifications](#), easing the formal approaches towards proving the unjustified tax benefit that are also in line with the Draft.

Nevertheless, despite its seemingly higher tolerance (vs. the previous Draft's wording) for formal breaches, the Draft cannot be said to be 100 percent "taxpayer friendly".

The document leaves open quite a few issues:

1. It does not envisage provisions obliging the taxpayers to exercise vendor selection "due diligence". However, we believe that even though the obligation is not formalised, the taxpayers cannot be considered fully released from it, as the evidence of due diligence can be used to prove the lack of tax avoidance intent.
2. The Draft proposes a generalised and ambiguous concept of the "misrepresentation of business operations/taxable assets by the taxpayer".
3. The term "primary purpose" of the transaction is pretty much judgemental. It is not clear how the tax authorities are going to interpret it and whether having a business purpose along with a tax benefit will suffice to deem the benefit justified. In the courts' opinion, the fact of having a business purpose does not always justify the tax savings (cases No. [A11-6203/2016](#), [A50-17405/2016](#)).
4. The Draft requires that a transaction be discharged by the counterparty named in the contract. Therefore, apart from the actual purpose, the tax authorities might also challenge a transaction if a counterparty lacks the necessary resources (staff, fixed assets, licences) to perform its obligations under the transaction. In the end of 2016, the Russian Supreme Court ruled that the lack of resources should not necessarily be indicative of an unjustified tax benefit (case No. [A40-71125/2015](#)). Given the provisions proposed by the Draft, the court practice may change.

To sum up, we do not expect any major changes in the tax authorities' approach towards the unjustified tax benefit.

We encourage the taxpayers to thoroughly look into their tax risks, especially when they doubt their counterparties' integrity. Special attention should be paid to who actually performs the contractual obligations and whether the counterparties have the resources required to perform their obligations under the contracts.



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"The Draft operates a number of ambiguous terms implying multiple interpretations. For instance, the taxpayer shall be entitled to reduce its taxable base/tax only if the avoidance of tax (partial payment) is not the primary purpose of the transaction. However, the legislator does not offer any criteria of how such primary purpose should be determined, leaving the interpretation at the discretion of the law enforcers, primarily, the tax authorities, who will expectedly interpret the provision in their favour and see tax avoidance elements in many of the taxpayers' operations/transactions.

In tax disputes, the courts will have the last word; however, it is now hard to foresee which criteria the courts will apply to assess the transaction purposes. A consistent court practice might not be established, and the taxpayers might have to wait for the Supreme Court's clarifications that are likely to become yet another "Plenum Resolution No. 53".

We hope that you will find this newsletter interesting and informative. Should you have any questions, please refer to your regular Deloitte contacts or Alexei Sergeev.

Kind regards,

Deloitte CIS Partners

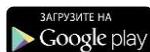
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