

## LT in Focus

# The Russian Federal Tax Service (FTS) further clarifies the applicability of the concept of beneficial ownership of income

On 31 May 2018, the FTS released Letter No. [CA-4-9/8285@](#) 'On consideration of disputes over the application of the concept of beneficial ownership of income'.

The Letter is meant as a guidance for the tax authorities and formalises the approach applied by the FTS and the courts in the tax disputes over the application of the concept of beneficial ownership of income (the Concept).

The Letter contains a number of important comments that should be taken into account by the taxpayers.

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### The concept of beneficial ownership of income as a universally applicable instrument for fighting tax treaty abuse

The FTS Letter is largely consistent with the approach outlined a year earlier (for more details, please refer to LT in Focus of [1 June 2017](#)).

The regulator re-emphasised that the concept of beneficial ownership of income is not only used to determine the eligibility for tax treaty benefits, but is also a universal instrument for fighting the tax treaty abuse.

On a practical level, it means that the tools used to establish beneficial ownership, such as the analysis of functions performed and risks assumed by the parties to a transaction, will also be used to review the economic substance of deals involving foreign companies.

This is evidenced by the court cases referenced in the FTS letter that do not directly relate to the Concept.

Thus, in cases No. [A55-18894/2016](#), [A55-11332/2016](#), and [A55-9050/2017](#) (AO Volga Interregional Association of Radio and Telecommunications Systems), the court supported the tax authorities' position that equity contributions to foreign subsidiaries were solely meant for obtaining unjustified tax benefits, as the taxpayer's participation in these companies was nominal and the structuring of further equity sales through subsidiaries enabled avoiding the payment of the Russian profit tax.

In case No. [A11-9880/2016](#) (OOO Rusjam), the tax inspectorate discovered that the consultancy agreement with a foreign related party actually disguised the distribution of profit.

In case No. [A11-6203/2016](#) (OOO Mondelēz Rus), the court sustained a tax inspectorate's conclusion on the lack of a reasonable business purpose in structuring the consolidation as an M&A transaction and reclassified interest on a disputed loan into dividends.

## Clarification of conduit company criteria

The FTS named the following criteria of a foreign conduit company:

- No independent entrepreneurial activity
- Lack of other, non-Russian-sourced, income
- Further redistribution of income to shareholders or group entities
- Lack of material financial and commercial risks and payments common for a business activity
- Minimum administrative costs from nominal compliance with the requirements of the country of incorporation
- No economic benefit from income
- Employees perform minimal control and management functions.

The FTS also commented on the most common arguments offered by the taxpayers to prove that a foreign company has business substance:

- Income from information and consulting services, FX gains, high loan interest rates, one-off purchase of preference shares, ownership of shares (stock) in affiliates do not prove the business is real
- The purchase of stock cannot serve as an evidence of investment activity, if a foreign company is not involved in the investee's business
- Minutes of board of directors' meetings do not prove the engagement in investment and business activity, if its objectives are inconsistent with those of the foreign company's business operations, but pursue general purposes only
- Minor payroll and social contribution expenses do not evidence the employment of qualified staff
- Accounting costs incurred do not prove that a company is active.

The regulator underlined that the companies that merely serve the interests of their groups and affiliates are not eligible for tax treaty benefits, unless their revenues are economically justified.

### Statistics of disputes over beneficial ownership of income

#### Dividends:



Judgements in favour of tax authorities:  
Cases No. [A27-331/2017](#),  
[A27-27287/2016](#), [A40-73573/2017](#),  
[A40-113217/2016](#), [A32-18982/2016](#),  
[A27-20527/2015](#), [A27-16584/2016](#),  
[A40-73573/2017](#), [A11-9880/2016](#),  
[A64-3695/2016](#), [A50-29761/2017](#)

#### Interest:



Judgements in favour of taxpayers:  
[A21-2521/2017](#), [A43-20134/2016](#)

Judgements in favour of tax authorities:  
A40-116746/2015, [A40-195366/2015](#),  
A40-241361/2015, [A40-442/2015](#),  
[A62-3777/2017](#), [A05-4077/2016](#)

#### Royalties:



Decisions in favour of taxpayers: FTS  
Resolution No. [CA-4-9/1907@](#) of 9  
February 2016

Judgements in favour of tax authorities:  
No. [A40-12815/15](#)

#### Proceeds from the sale of shares:



Judgements in favour of tax authorities:  
No. [A11-6602/2016](#)

### Distribution of burden of proof

Building on its previous letter, the FTS noted that a tax authority is not obliged to identify the beneficial income owners to define the applicable withholding tax rate.

At the same time, if a taxpayer discloses the beneficial owner(s) of its income, the tax authorities may allow the application of tax treaty benefits.

The taxpayer must provide evidence that unambiguously proves the beneficial ownership of disputable dividends, witnesses their declaration and payment of relevant taxes.

### Conclusions

The FTS letter confirms that the transactions with foreign companies that resulted in tax savings will be scrutinised.

To avoid adverse tax consequences, the taxpayers must be ready to substantiate the involvement of foreign companies in their business operations and financial transactions and provide evidence that their choice was reasonable and entrepreneurial risks – justified.

The evidence must expressly prove that the foreign company has full-fledged business operations, that its income will either be contributed to its profit centre in its respective jurisdiction or channeled into the Russian economy.

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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.

Yours faithfully,

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