



# **BENEFICIAL OWNER OF INCOME. TRENDS IN RUSSIAN COURT PRACTICE**

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# The beneficial owner concept in Russia

- "... legal framework of the beneficial owner concept both in international and Russian laws has some imperfections, and the approach to determine the person with the status of a beneficiary owner of income is to be shaped by law enforcement practice"

Deputy Head of the Federal Tax Service, D.V. Egorov

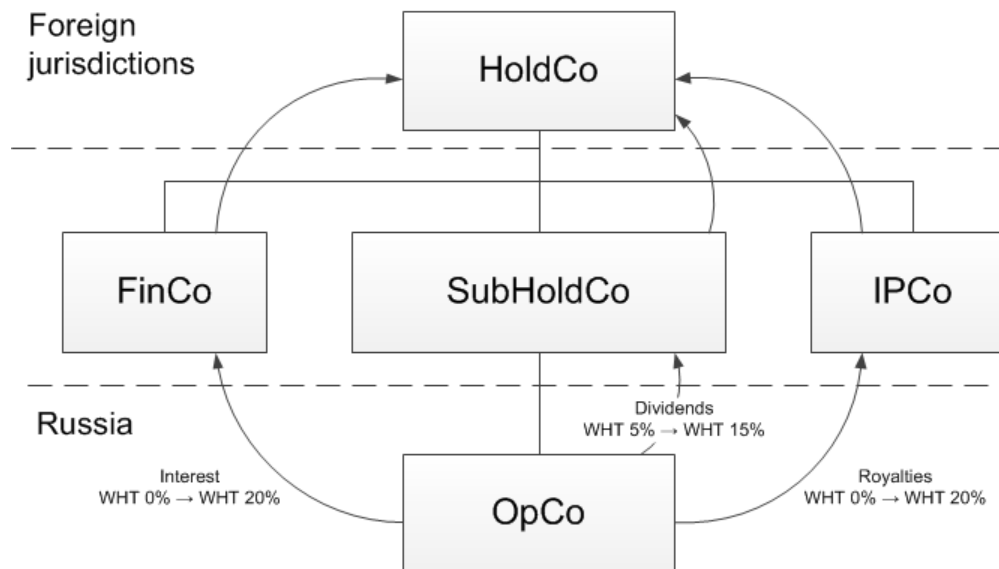
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# Development of the beneficial owner concept in Russia

- Amendments to the Russian Tax Code in relation to the beneficial owner of income have been in effect since 2015 (Article 7 and Article 312 of the Russian Tax Code)
- Multiple letters from the Russian Ministry of Finance (No. 03-08-05/16994 dated 27 March 2015; No. 03-08-05/64201 dated 12 December 2014; No. 03-00-RZ/16236 dated 9 April 2014; etc)
- Previously, the use of this concept was very limited:
  - eg letter of the Russian Ministry of Finance in relation to "Eurobonds" dated 30 December 2011
  - limited court practice (eg Court Decision of 2012 on Eastern Value Partners - interest under a loan agreement)
- The "domestic fiscal meaning" rather than the "international fiscal meaning" concept is currently applied in Russia in practice
- Practical trends - application of the beneficial owner concept in conjunction with the unjustified tax benefit concept

# Key aspects

- Three elements to determine where beneficial ownership lies:
  - Control (via direct / indirect participation or by virtue of other circumstances)
  - Right to independently use and dispose of income
  - Functions and risks should be taken into account
- Applies to dividends, interest and royalties
- "Look through" approach is introduced
- Onerous documentary requirements to confirm beneficial ownership
- Functions and risks should be assumed with regard to the income being distributed or the income of the recipient in general - ?:
  - Federal Law No. 32-FZ dated 15.02.2016 changed the wording of item 3 of Article 312 of the Russian Tax Code



# Court practice - Equity finance

**Tele2 Group case:** OJSC Votek Mobile (OOO "T2 Mobile").

- Ruling of the Supreme Court dated 21 December 2015 No. 310-KГ15-17102
- Application of a reduced tax rate (5%) on dividends for 2012
- Dividends recipient - Tele2 Russia Holding AB (Sweden)
- Arguments brought by the tax authorities included *inter alia* a disagreement with the position that Tele2 Russia Holding AB has the status of a "beneficial owner of dividends income"
- Key factors:
  - flow-through dividend payments
  - performance of a solely holding (investment) function
  - analysis of assets, risks and functions
- In favour of the taxpayer

# Court practice - Interest paid to a foreign sister bank

## **ZAO Credit Europe Bank case**

- 9<sup>th</sup> Arbitration Court of Appeal: Decision No. 09АП-43945/16 dated 30 September 2016 – in favour of the tax authorities
- Loans taken from a foreign sister bank (Credit Europe Bank (Suisse) S.A.) on a regular basis during 2010-2011
- The funds (deposits) were attracted by Credit Europe Bank (Suisse) S.A. from various legal entities and individuals
- Disallowance of 5% reduced rate applied to interest ZAO Credit Europe Bank paid to Credit Europe Bank (Suisse) S.A.
- Tax authorities:
  - Credit Europe Bank (Suisse) S.A. acted as an "intermediary" and therefore did not have the status of a "beneficial owner of interest income"
  - ZAO Credit Europe Bank could have identified the beneficial owners but failed to do so
- References to the Commentaries to the OECD Model Tax Convention

# Court practice - Interest reclassified into dividends under the thin cap

## **Manhattan Development LLC case**

- 12<sup>th</sup> Arbitration Court of Appeal: Decision No. A12-47731/2015 dated 23 June 2016 - in favour of the tax authorities
- Loans from a foreign sister company (Atrium European Management H.B.)
- Thin cap rules: requalification of interest into dividends (2011-2013)
- Including the issue of the application of a 5% reduced rate to interest reclassified under thin cap into dividends
- Treaty between the Russian Federation and Netherlands
- "Beneficial owner of income" was one of the factors considered in the course of the dispute
- No documents confirming that Atrium European Management H.B. had the status of a "beneficial owner of income" at the moment of paying interest (reclassified into dividends) were provided by the taxpayer



# Court practice - "Drop down" transaction / stock dividend

## **Capital LLC (Russia) case** – in favour of the tax authorities

- Ruling of the Supreme Court No. 307-KГ16-7111 dated 5 August 2016
- In-kind contribution of Severstal shares into Astromoon and Astrozone (Cyprus)
- Subsequent "transfer" of Severstal shares to Astroshine and Loranel (Cyprus): 50% owned by Astromoon and Astrozone (Cyprus) and 50% - by Anters and Lanton (BVI)
- Requalification for tax purposes: the above chain of transactions *de facto* represents the "distribution" of income in the form of assets (ie Severstal shares) from Russia to BVI for no consideration – subject to withholding tax in Russia
- Anters and Lanton (BVI) are "beneficial owners" of income associated with ownership of Severstal shares as they have *de facto* rights to the shares and exercise the control function
- Therefore, Anters and Lanton have *de facto* received income (in the form of assets) subject to withholding tax in Russia under items 1.2, 1.10 and 3 of Article 309 of the Russian Tax Code
- The tax base has been determined based on the market level of Severstal shares in the respective portion



# Beneficial owner. Outlook for the application of the concept

- Several of the following key factors:
  - the real presence of a foreign company in the country of incorporation (office, staff)
  - presence of a so-called business goal
  - legal capacity to take independent decisions on the further distributions of income
  - absence of "mirror" transactions
- Application of a "look through approach" (application of a treaty with a beneficial owner country) is permissible. Unlikely to be applicable to dividends flow
- Potential developments – application of the beneficial owner concept in conjunction with the unjustified tax benefit concept

# Contacts



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