



Corporate Tax

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Russia

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Overview of corporate tax work over the last year

Russia is a member of the Group of Twenty (G20), the Financial Action Task Force (FATF), the Global Forum on Transparency and Exchange of Information for Tax Purposes (OECD). Russia confirmed its activity in the international BEPS project in 2017 by signing the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI). The first round of automatic exchange based on the Standard for Automatic Exchange of Financial Account Information in Tax Matters/Common Reporting Standard (AEOI/CRS) by OECD is expected in September 2018. Seventy-four countries have suggested an opportunity of automatic exchange on financial accounts with Russia, while 23 of them have confirmed their intention to exchange in 2018 (among them – the United Kingdom, China, Australia). Therefore, within the last five years, Russia has been following all the latest taxation trends and actively reforming the tax system according to the international principles of transparency.

The main notable aspects of taxation in 2017–2018 are stated below:

Transfer pricing

Russian Transfer Pricing (TP) rules represent the partial adaptation of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations that were originally approved by the OECD Council in 1995, despite the fact that Russia is not a member of OECD. Russia introduced its TP rules in 2012 for the first time and they are still being reviewed by jurisprudence. Talking about developing practice, it is important to mention that the Russian transfer pricing law is distinguished by two fundamentally different methods of TP rules application:

- (a) First way – the “general order”, is intended for large holdings operating within the country (the threshold is that the group’s transaction turnovers exceed 1bn rubles, equivalent to €14m or \$16m). Advance pricing agreements (APAs) as well as a corresponding adjustment of income and expenses in the affiliated companies are available to this category of taxpayer. Moreover, tax audits in this category are conducted by the specialised body that was created as a part of the Federal Tax Service (FTS) of Russia. Since June 2018, for the largest Russian taxpayers, the conclusion of APAs in regards to cross-border transactions with foreign companies is available, which allows a unification of approaches in determining the price between the Russian and foreign body and avoids the double taxation of international holdings. Despite all of this, the practical application of the “general order” of the TP rules in 2017 was statistically low and only applied by a very specific group of large taxpayers. According to official data, from the time this became the norm until the beginning of 2018, only nine APAs have been made and only 34 special audits have been conducted.

(b) However, tax authorities actively apply the TP rules for casual fiscal checks, even though the law provides neither APAs, nor corresponding adjustments. For example, all transactions with a foreign-affiliated person (“parent” holding) or non-affiliated person from an offshore jurisdiction (there are currently 41 countries and territories in the Russian “offshore black list” of jurisdictions) fall under TP rules. In practice, the application of transfer TP rules to such transactions is more common than the “general order”. By the end of 2017, taxpayers reported more than 124 million controlled transactions (i.e. transactions falling under Russian TP regulations) executed in 2016. Therefore, currently the Russian TP rules are being formed as the instrument for regulating relations in cross-border transactions and as the regulatory instrument for capital migration to other jurisdictions.

The key event in 2017 was that, on 26 January, the Russian Federation signed the Multilateral Competent Authority Agreement on Country-by-Country Reporting (CBC reporting). According to the new requirements, the largest Russian holdings whose consolidated revenue for the fiscal year is more than 50 billion rubles (about €700m or \$800m) have to submit a special report containing the financial and tax performance of their foreign-affiliated entities. Having adopted the rules in 2017, Russia has provided its residents with the right to submit a CBC report for 2016. This decision was made to avoid foreign tax authorities’ claims that the corresponding rules could have been introduced earlier and could require the reporting of subsidiaries located in their jurisdictions if the Russian head company had not reported on them within the Multilateral Competent Authority Agreement. However, submission of reports for 2016 is voluntary for Russian holdings. Determining the jurisdictions that require reporting will need to be done before 30 June 2018, when the Russian tax authorities will end the voluntary reporting period.

Controlled foreign corporations (CFCs)

The first CFC declaration campaign in Russia’s history ended in April 2017. During this campaign, the Russian owners and beneficiaries of foreign companies had to submit tax declarations on revenues of their foreign companies for 2015. Russian CFC is largely similar to the American model and has probably been “inspired” by it. CFC rules apply to tax resident individuals and entities (tax rate of 13% and 20% respectively). Though the relevant Section of the Russia Federation Tax Code has been applied only to two declaration campaigns (2017 and 2018), essential amendments to it have been made more than six times, the latest significant ones being adopted in December 2017.

It is difficult to say whether the campaign in 2017 was unambiguously successful. According to the available data, information about 6,000 controlled companies was voluntarily submitted, with total profits of 20 billion rubles (approximately €285m or \$330m). According to various estimates, the undeclared assets of Russian residents exceed the available data by multiples of ten. It is obvious that, in Russian tax law, the CFC is now one of the most complex and problematic tax institutes, with a multitude of ambiguous nuances and technical gaps, the application of which raises questions not only to taxpayers but also, in some cases, to territorial tax authorities.

Tax amnesty – “the first and second wave”

Upon the beginning of automatic exchange of information and also bearing in mind the low success of the CFC declaration campaign, the Russian tax authorities are offering residents the preferential voluntary declaration of foreign capital. The last easements of the first wave tax amnesty ceased to be in force in December 2017, and even though it was initially supposed that amnesty would not be prolonged, in March 2018 a similar round of tax amnesty was announced.

Until the end of 2019, tax residents of the Russian Federation have an opportunity to declare income gained previously and undeclared foreign bank accounts (in the Russian Federation, tax residents are obliged to report to tax authorities possession of foreign accounts), or to liquidate the offshore company with distribution of its assets without tax consequences. It is obvious that the second wave amnesty will be more effective than the first wave, since a part of the capital is actively returning to Russia as a result of expectations of AEOI and the effect of the anti-Russian economic sanctions (in particular, the American CAATSA and its European analogues).

Foreign internet company VAT

Starting from 1 January 2017, foreign companies that provide electronic services and content in Russia are obliged to be registered with the Russian tax authorities for calculation and payment of VAT. For payment of VAT in Russia, it is necessary to be registered separately, since Russian law does not provide separate accounts for VAT such as in, for example, Europe. Until last year, only companies that were registered by calculation of income tax were obliged to pay VAT independently.

Amendments to the Tax Code of the Russian Federation were introduced by Federal law No. 244-FZ, informally named the “Google tax law”, since it stipulates for the taxation of services of mobile phone app stores (such as Google Play and Apple’s App Store). The law refers to: electronic services levied with VAT, including those relating to e-books, music, video and others; services granting rights to use computer programs on the internet, including games and databases; internet advertising services; services for placement of announcements; and the maintenance of electronic resources. Since the beginning of 2017, 155 foreign companies have been tax registered in Russia. Among them are several Amazon holdings, Apple Distribution, Bloomberg Finance, Facebook Payments, Google Commerce, Netflix International, Samsung Electronics, several of Uber’s operating companies and others.

Moreover, the future taxation of foreign shops and platforms that sell goods to Russian natural persons (iHerb, Aliexpress, eBay and similar) is being actively discussed and considered at the moment. For now, foreign trade shops do not fall under current VAT regulation. Perhaps in the future, their taxation will be settled by means of simply raising customs duties for natural persons.

Essential transactions and highlights illustrating corporate tax

A series of tax disputes related to non-taxation under double tax agreements (DTAs) was a key aspect of 2017, as well as previous years in general. However, the majority of these disputes affected taxpayers negatively. The tax authorities consistently assessed companies that could not confirm the status of the beneficial owner of income of foreign persons receiving interest, dividends or royalties from Russian companies, with additional taxes that had been underpaid in previous periods. Generally, the main issue was that the Russian daughter companies lacked adequate information about sufficient presence in the jurisdiction of domicile of the recipient of such income (in particular, the existence of an office in the jurisdiction of receipt, vigorous activity by the recipient company in the jurisdiction, and payment of local taxes were tested).

The enjoyment of easements by banking and financial groups when structuring cross-border client products is an important feature in the application of DTAs. There are several very similar situations that concern additional accruals by Russian financial companies that traditionally offered their clients products that were realised outside of Russia:

intermediary services by affiliated brokers; and activities of investment banks and financial intermediaries in Switzerland, Luxembourg and other world financial centres. The courts regard payments in favour of investment intermediaries as not having the right not to be taxed under a DTA, and toughening of jurisprudence has led to additional accruals receiving the same treatment. Among the parties to the disputes are not only Russian financial groups, but also international holdings (for example, the financial group FABI, an Intesa Sanpaolo subsidiary).

The fact that Russia joined the MLI on 7 June 2017 also demonstrates that the practice of DTA application will become increasingly complicated and that it requires close attention of all participants in their cross-border relations.

Key developments affecting corporate tax law and practice

Russia is following all of the modern trends in tax law and transparency. During 2017–2018, there has been a number of measures undertaken, allowing (a) state bodies to establish the structure of property of Russian companies, and (b) other persons to carry out Know Your Customer (KYC) procedures for Russian contractors successfully, making their relationships safer.

Russia does not use a centralised state register for companies' beneficiaries, and currently this question is not on the agenda. Nevertheless, in 2017, new requirements were introduced with regard to Russian companies: under the threat of a fine, they must keep internal registers in order to record information about beneficiaries, and must update it from time to time. In practice, beneficiaries are defined as natural persons – ultimate owners who, regardless of the complexity of intermediate structure, own at least 25% of the Russian legal entity, directly or indirectly. The tax authorities will conduct the first audits concerning compliance with this rule in 2018. It is supposed that this requirement may cause difficulties, in particular in branched groups of foreign persons with a large number of owners, family possession, foundations and trusts, or other features within its structure. Nevertheless, it should be noted that the legislation currently stipulates the issue softly, and prescribes that Russian subsidiaries must develop a reasonable system of data exchange with its parent structure, assuming that, if the beneficiary cannot be identified, it is possible to provide a reasoned refusal to identify such.

Since 2012, Russia has been consistently implementing the FATF regulation in relation to KYC and has been exercising counteractions to tax offences by banking businesses. At the end of 2017, during the centralisation of this process, Russian banks have received their first significant instructions from the Central Bank of the Russian Federation about control techniques for clients' tax obligations. The indicators that must be tracked by banks include the tax efficiency of the client's company, the level of salary paid to employees, transit operations with low margins and the economic nature of the relations with the client's contractors. In many respects, trends in banking control coincide with Europe's, although they remain less regulated, allowing some banks to operate their internal controls freely. All of that mentioned above makes Russian practice regarding KYC vary from bank to bank.

It is also planned that, in 2018, the financial statements of Russian companies will become publicly available in order to improve the transparency of relations. The reports of all companies that have a tax number will become available to anyone on FTS' website for free for previous years. It should be noted that the project for the publication of accounting reports was postponed for over a year because of technical reasons; however, it will be completed in summer 2018. Precautionary messages can currently be published, indicating

if a Russian company has not submitted reports and tax payments for over a year, does not have a credible registered address, if the company has a licence and various other information which is deemed to increase the level of credibility and transparency in relations with Russian persons.

Tax climate

Noted below are a few facts about the tax climate in Russia:

- Russia continues to have relatively similar level of corporate taxation in comparison to Europe, wherein corporate income tax is 20%, the VAT rate is variably 10%, 15%, 25% or 18% (for different cases), and there is also a very low taxation of natural persons (13%).
- One of the fundamental features in the Russian budgetary system is the specialised tax on income from minerals and oil and gas production (23%–25% of tax budget revenues for 2017). Moreover, tax on the corporate profit of legal entities (19%–20% of tax budget revenues), VAT and income tax (18%–19% of tax budget revenues) are almost equally important in the breakdown of the budget.
- One of the features of the Russian tax administration is the fact that 80% of the tax total is collected by 10 tax authorities: six specialised tax authorities for the largest taxpayers, working with large business and specific branches of economy (communication, transport, banks, insurance companies); and four territorial internal revenue services (capital regions – Moscow and the Moscow region, St. Petersburg and Khanty-Mansi Autonomous District – the centre of mining).

Tax administration practice in 2017 did not develop ambiguously – the Russian tax authorities started checking businesses much less, which, in return, facilitated business within the country.

The number of field/site tax audits has been reduced by two thirds in the last five years. At the same time, the amount of underpayments revealed has statistically grown a lot. The average additional accrual of taxes to legal entities is 16.5m rubles (\$265,000 or €230,000), while the amount is higher for businesses in the largest financial centre, Moscow, amounting to 42m rubles (\$700,000/€600,000). Thus, the Russian tax authorities have consistently introduced “the focused risk approach”, which is based on conducting tax audits in relation to taxpayers whose tax payments are suspiciously lower than those generally levied on similar activity.

At the same time, the level of loyalty of the courts has decreased because of the actions, appeal and decisions of the tax authorities. The number of rulings in favour of the taxpayer, which used to be nearly 70%, now has turned the opposite way – only 20% of decisions made by courts are in favour of the taxpayer. Therefore, the taxpayer to whom the tax has been additionally accrued has few chances to appeal the decision of the tax authority in court.

Thus, it can be noted that there is currently a preventive practice of taxpayers “self-checking”, where the taxpayer himself is keen to ensure that his activity is not seen as risky from the point of view of the tax authorities. This practice has formed recently and in particular is rather new for Russia. Hence, the general principles of risk identification in the activity of taxpayers are applicable. Ultimately, this a positive tendency that allows the taxpayer to plan its activity more responsibly.

Developments affecting attractiveness of Russia for holding companies

Russia is similar to the European jurisdictions as far as tax burdens for businesses are concerned (with a 20% rate for corporate income tax). In general, foreign investors

usually use Russia as a jurisdiction for the creation of regional companies in the production and trade sectors; traditionally there is a lot of foreign capital in auto and mechanical manufacture. Additionally, production of the equipment used in industries such as telecoms, IT and agriculture is becoming popular. In recent years, the attractiveness of the tax system for foreign investments has been maintained by creating special tax clusters, which offer investors the opportunity to reduce taxation on condition of capital investment in a particular region. One of the most famous and popular regions is Moscow Skolkovo – a centre for innovative technologies in a wide range of activities (with a possible tax rate of 0%). Dubna is another region near Moscow for companies in the technical sphere (with a possible tax rate of 2%). Alabuga, Tatarstan is popular for production companies and manufacturers (with a possible tax rate of 2%). The enclave of Kaliningrad, which is almost in EU territory, is intended for medical and IT companies (with a possible tax rate of 0%).

Among the financial complexities when conducting global business is the Russian currency law. Russia strictly regulates cross-border operations “outside” of the banking system. Currency and banking regulation is becoming increasingly relevant in connection with external economic sanctions, which have exerted an impact on cross-border operations with Russian participation. Currently, currency restrictions are often a more crucial issue when planning transactions than corporate taxation.

Russian law strictly regulates monetary transfers from Russia to other countries; thus penalties can be up to 100% of the transaction, and in some cases there may be a criminal penalty. A few years ago, the administration of currency relations was transferred to the jurisdiction of the tax authorities, which is why the guidelines for such administration now include the control of such violations. According to statistics, in 2017, compared to 2016, in the international payments sphere offences grew by 50%, while total penalties increased by 16 times in the same period.

The following are the most relevant violations of foreign companies that are often neglected when planning cross-border relations, as they feature in Russian law with no equivalent in other countries, which causes difficulties when trying to make comparisons:

- Attempting to carry out non-monetary offsets for previously rendered services/ the delivered goods (in relation to foreign contractors, such offset is almost always forbidden).
- Unreasonable arrears in foreign trade contracts or credit contracts with foreign money which are not stipulated in the contract.
- Opening of accounts in a foreign bank by the Russian resident (including the Russian subsidiary of foreign group) without notifying the Russian tax authorities.

These points certainly make the activity of international holdings in Russia more difficult. Meanwhile, transactions to and out of Russia are not forbidden and remain in frequent practice. In 2017–2018, the Russian Government announced it would be making steps towards liberalising the currency law, and relevant laws were adopted. However, in practice, the measures had no basic positive influence on the relations between Russian companies and their foreign contractors/foreign parent companies.

The year ahead

Possible tax reform will be the most discussed question of 2018–19. The cornerstone measure for tax reform, discussed publicly in 2017, was the so-called “22/22 model”, proposing a reduction in the amount of the mandatory fees for medical and pension insurance collected from salaries (from 30–32% to 22%), with an increase in the standard VAT rate from 18%

to 22%. The reasons for the measure are obvious: VAT is calculated on the whole turnover of the company, while contributions only on salaries. VAT is also administered much better than insurance fee contributions. At the same time, it is obvious that it can significantly complicate the position of businesses: the VAT rate of 21–22% is, frankly speaking, very high, and may also be an obstacle for free turnover of services. As another option, the Government is also discussing a smaller increase in VAT – only to 20% – but without a relevant reduction of other taxes and charges.

Unfortunately, this is very probable outcome. The Russian budget needs additional payments. The budget is currently insufficient and there are two options to solve this issue: gradually increase the collection of taxes; or increase the rate of taxes. The international automatic exchange of information (AEOI), the automated VAT system (the tax authorities automated the tracking of VAT payments for entire transaction chains) and active control of banks in the taxation of clients have been made a bid to increase the collection of tax. The question is what effect these measures will have and, even more importantly, how soon. If within the next year the collection of tax has not significantly increased, an increase in tax rates is very likely to happen.

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Head of the tax practice and Deputy Head of the International Tax Planning Department of Cliff Legal Services, Natalia Kordyukova has more than 10 years' experience in tax law.

Natalya's main practice expertise lies in the areas of international tax planning, tax risk assessment, currency regulation, banking and corporate law, currency control, CFC legislation, protection of trusts and funds, financing and capitalisation of business.

She has profound experience in advising large holding structures on tax planning issues, optimising risks, as well as building the structure of asset protection and structuring of M&A transactions.

Ms. Kordyukova has shown exceptional expertise and flexibility in the resolution of complex legal cases, both for Russian and international business. Among her clients are large international construction, petrochemical and power engineering companies, jewellery trading houses, as well as banks and cross-border investment companies.

Closed projects:

- Structuring Russian investments in more than 60 countries, including Switzerland, Cyprus, Liechtenstein, the USA, the BVI and Belize.
- Advising a leading development company on the creation of its own mutual investment fund with the financing of projects by a well-known Swiss bank.
- Restructuring a world-leading producer of chemical products in order to build trade relations with Russia, the European Union and the African region.
- Legal accompaniment of a unique cross-border project for the creation of innovative solar cells (Hong Kong, China and Russia).

In addition, Ms. Kordyukova has broad expertise in the areas of asset protection by using special structures (trusts, foundations) and in the structuring of private investments.

Ms. Kordyukova speaks Russian, English and German.

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