

## **Beneficial ownership concept and how this could affect your business in Russia**

*By Valeria Khmelevskaya*

Nearly every Russian company belonging to multinational enterprises (MNE) has inter-company or cross-border arrangements or pays out dividends which might be especially attractive due to applicable double taxation treaty (DTT) incentives allowing reduced withholding tax rates or taxation only in the country of the recipient of such income. To apply such DTT incentives, a foreign recipient should provide a Russian company with the certificate of tax residency and confirmation of the recipient's actual right to such income prior to payment, otherwise the withholding tax (WHT) based on the Russian Tax Code shall apply (15% for dividends, 20% for other payments from Russian sources). Later on, a foreign company may still claim back the relevant WHT.

Confirmation should contain all the necessary data regarding the recipient company (information on employees, assets, office, financial information, etc.) and in line with beneficial owner criteria and be adjusted to the relevant specific transactions. Further, more detailed information may be prepared as a so-called "defense file" and may be provided later upon request of the tax authorities. Such approach would give a taxpayer certain leeway and may serve for a better and more flexible position in case of disputes with the tax authorities.

Confirmation should serve to prove that the recipient is the beneficial owner (BO) of the income and satisfies several BO criteria, e.g., independence of directors in decision-making; power to dispose of the received income; real business activities; sufficient resources for such activities (office, employees, assets); no back-to-back transactions (lack of obligation of the recipient to transfer the income onwards); actual assumption of risks by the recipient regarding its assets.

In the view of the Russian Federal Tax Service, the tax authorities are allowed to deny tax treaty benefits when a foreign entity has no active operating business. They may not investigate who the real BO is, and so the mere fact that the first recipient is not a BO is sufficient for applying domestic withholding tax rates. Such an approach may eventually cause tax risks for several companies within the MNE group (e.g., entities with the intercompany treasurer's function or intercompany license hubs).

Should the recipient be not the BO, the Russian tax law currently allows "look-through" approach not only with respect to dividends, but also to other payments subject to certain conditions. Disclosure of a higher tier or a parent company may allow to be more compliant with BO criteria.

Considering the above, MNEs wishing to strengthen their tax position should check whether the tax certificates and confirmations are available, review their cross-border structures to indicate foreign recipients, including licensors, holding companies, companies performing purely treasury or administrative functions, where the tax position may be challenged based on the BO ap-

proach of the Russian tax authorities. At the same time, it might not always be possible for the MNEs group to declare a “look-through” approach or to rebuild the existing structures in a short time, as this may cause consequences for transfer pricing purposes of the whole group or trigger tax exposures or tax complications in other jurisdictions. Any adjustments to the structures would obviously require a lot of time and significant effort for analysis from the perspective of different jurisdictions and other aspects important for the whole group. As a temporary solution in such cases may serve the introduction of caveats and gross-up provisions with respect to payments made by the group’s Russian companies. This could also be a feasible solution for transactions with non-related parties who might not be willing or ready to provide information/documents for building up a defense file that is sufficient for Russian tax purposes.