

Newsletter

Changes to Russian Double Tax Treaties

September 25th, 2020

Dear Ladies and Gentlemen,

In recent months, a number of changes to the Russian tax legislation, implying long-term effects for both Russian taxpayers and foreign investors, are taking place. Amendments to the Double Tax Treaties ("**DTTs**") are among of the most important ones.

Below, we provide our consolidated analysis of the forthcoming changes and recommendations on steps to prepare for them.

(A) **Changes to the DTTs with jurisdictions widely used in tax planning**

Jurisdictions covered

Currently, negotiations with jurisdictions widely used in tax planning are being conducted to increase the withholding tax ("**WHT**") rates on incomes payable from the Russian Federation.

As a result, the Russian Federation and Cyprus signed a Protocol amending the respective DTT, on September 8th, 2020. Similar changes have already been agreed with Luxemburg and Malta¹. Negotiations with the Netherlands are in progress.

Following these, changes to the DTTs may be proposed to Hong Kong and Switzerland. It is yet to be seen whether the list of jurisdictions will be extended further.

New rates for dividends and interest payments

Under most of the Russian DTTs, 5% or 10% WHT rates apply to dividends and the exemption from WHT is provided for interest payments, if their recipient is the beneficial owner ("**BO**")² of the respective incomes.

In accordance with the amendments, WHT rates on dividends and interest are being increased up to 15%.

Please note that any changes have not been made with respect to other incomes (e.g. royalties are usually exempted from WHT under the DTTs).

Conditions for application of the lower rates

The number of entities entitled to the lower tax rates has been decreased sufficiently.

Thus, under the new Protocols to the DTTs with Cyprus and Malta³, the 5% WHT rate applies to dividends, if their BO is:

- 1) a company being a tax resident of the other contracting state;
 - a) whose shares are listed on a registered stock exchange, provided that no less 15% of the voting shares are in free float; and
 - b) which holds directly at least 15% of the capital of the company paying the dividends throughout a 365-days period ("**Public Company**");
- 2) an insurance undertaking, or a pension fund, of the other contracting state;
- 3) the Government, a political subdivision, or a local authority of the other contracting state;
- 4) the Central Bank of the other contracting state.

Under the Protocol to the DTT with Cyprus, the interest payments are taxable in the following way:

¹ On September 9th, 2020, the Chairperson of the Government of the Russian Federation signed the draft of the Protocol to the DTT with Malta.

² The entity that actually benefits from the received income and has a right to determine the further economic destiny of income, free to use and dispose of it.

³ The drafts of Protocols to the DTTs, with other-mentioned jurisdictions, have not been published yet.

- 1) the 5% WHT rate is provided for the BO of income being the Public Company;
- 2) exemption from WHT is provided for the BO of income:
 - a) being one of the entities mentioned above in points (2), (3) and (4), or a bank;
 - b) receiving interest in respect of the following securities listed on a registered stock exchange: (i) government bonds, (ii) corporate bonds or (iii) Eurobonds.

As for the draft of the Protocol with Malta, the exemption from WHT is not provided for interest payments. All entities mentioned above are entitled to the 5% rate.

Entry into force

According to the mentioned Protocols, changes shall apply from January 1st, 2021.

We expect that such approach may apply to all jurisdictions with which the DTTs will be changed.

(B) Changes connected with MLI

Jurisdictions covered

Earlier this year, the Russian Federation notified the Depository - the Organization for Economic Cooperation and Development (OECD) - of the completion of the internal procedures required for entry into force of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS ("**MLI**") with respect to the DTTs with 27 jurisdictions⁴.

PPT and SLoB

One of the main changes is application of the Principal Purpose Test ("**PPT**"). According to the PPT, tax benefits under the DTTs cannot be granted, if their receipt is one of the principal purposes of the structure, or transaction.

To pass this test, the taxpayer must demonstrate the justified aim and business reasons for setting up the structure/entering into the transaction (e.g. the attractive investment climate, flexible legislation in the particular jurisdiction, improving the efficiency of business management, etc.) and the absence of aims related to the tax savings.

The Russian Federation also chose the Simplified Limitation on Benefits provision ("**SLoB**"), which automatically excludes the part of companies and structures from the list of persons entitled to the

tax benefits under the DTTs (holding companies, companies engaged in intra-group financing, etc.).

However, the SLoB provisions apply to the respective DTT only if they are chosen by both contracting states. Since only a few Russian partners chose the SLoB (Denmark, India, Iceland, Norway and Slovakia), this provision will not apply to the majority of the DTTs and the PPT will be used as the main instrument.

Other important changes

In addition to assessment of the principal purpose of the taxpayer, other significant changes will be in force, in particular:

- 1) implementing a 365-days' holding period for application of the preferential WHT rates on dividends (i.e., it will not be possible to distribute dividends using the preferential tax rate under the DTT, if at the time of distribution the shareholder of the Russian company owns its shares/participatory interest for less than 365 days);
- 2) granting the jurisdiction, where the real estate is located, with the right to tax income from the sale of shares (participatory interests) in the so-called "property-rich companies" (currently, this requirement is already included in a number of DTTs with the Russian Federation);
- 3) changing the rules related to the permanent establishments, including narrowing the definition of "preparatory and auxiliary" activities, expanding the concept of "agency" permanent establishment, prohibiting of the artificial splitting of contracts when carrying out activities on construction sites.

Entry into force

The above-mentioned provisions will be applied to the DTTs with the contracting states that did not express positions on non-application of them. To compare the positions of states, this special instrument at the OECD's website can be used (<https://www.oecd.org/tax/treaties/mli-matching-database.htm>).

It is expected that the new rules will enter into force from January 1st, 2021, and the tax authorities will start auditing the cross-border transactions and structures more carefully, taking into account the new requirements of the MLI.

⁴ Australia, Austria, Belgium, Canada, Denmark, Finland, France, Iceland, India, Ireland, Israel, Latvia, Lithuania, Luxembourg, Malta, Netherlands, New Zealand, Norway,

Poland, Qatar, Serbia, Singapore, Slovakia, Slovenia, Ukraine, United Arab Emirates and United Kingdom.

Actions to be taken

It is important to analyze existing structures and start adapting them to the new rules.

We recommend to:

- 1) determine whether the DTT, with jurisdictions subject to the increase of WHT on dividends and interest payable from the Russian Federation, or falling under requirements of the MLI⁵, applies to your structure/transaction;
- 2) evaluate
 - (A) the volume of financial flows passing through holding and financial companies registered in such jurisdictions;
 - (B) whether the current structure, or planned transaction, passes the PPT/falls under the SLoB provision;
- 3) develop your further strategy based on results of the analysis, e.g.:

- (A) prepare for application of the beneficial provisions of the DTTs, considering new rates and requirements; or
- (B) make payments of dividends and interest before 2021; or
- (C) use a "look-through" approach; or
- (D) restructure the group of companies and/or intragroup agreements.

Please note that any considered step should logically flow from the terms of contracts, standard business processes and law enforcement practices, as well as being commercially justified.

In this regard, we recommend choosing your strategy as carefully as possible and monitoring development of the legislation and related law enforcement practice.

ALRUD Law Firm is recognized in the market for our expertise in structuring and supporting our clients with the cross-border transactions and application of the DTTs. We will be glad to offer our support to you.

We hope that the information provided herein will be useful for you. If any of your colleagues would like to receive our newsletters, please send them the link to complete a [Subscription Form](#). If you would also like to learn more about our [Tax Practice](#), please let us know in reply to this email. We will be glad to provide you with our materials.

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If you have any questions, please, do not hesitate to contact ALRUD Partner



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⁵ We recommend checking all jurisdictions that can apply the MLI and amended DTTs in the future (71 jurisdictions

in total, <https://www.oecd.org/tax/treaties/beps-mli-position-russian-federation-instrument-deposit.pdf>).