

# LT in Focus

Tax & Legal



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## Russia suspends tax treaties with unfriendly states

The Russian President has signed a [decree](#) suspending certain provisions of Russia's tax treaties with unfriendly states with effect from 8 August 2023.

Read on to learn more in our new LT in Focus.



## Background

Back in March, Russia’s foreign affairs and finance ministries had [put forward](#) a joint proposal to suspend tax treaties (DTTs) with all unfriendly states.

They suggested that the President issue a respective decree in response to sanctions against Russia, including its blacklisting by the EU among the jurisdictions that are considered non-cooperative for tax purposes.

The President signed the decree on 8 August 2023.

The original idea was to suspend the tax treaties as a whole (like it was done with Latvia’s DTT), but eventually Russia opted for a milder scenario.

DTTs have not been suspended altogether – the suspension effected only selected articles (mainly those that relate to tax benefits).



## What is the legal basis for suspension?

A tax treaty does not provide for suspension, only for withdrawal of the contracting states.

Unilateral withdrawal from a tax treaty generally involves a number of rather lengthy procedures.

However, Russian legislation allows the President to **suspend** international treaties in situations requiring urgent action.

In particular, please refer to [paragraph 4, Article 37](#) of Federal Law No. 101-FZ "On International Treaties of the Russian Federation" dated 15 July 1995.

These provisions are referenced in the decree signed by Vladimir Putin.

The Russian government will next submit a respective bill to the State Duma for approval.

Theoretically, if the Duma turns down the bill, the tax treaties in question shall resume their effect.

Yet, we believe that in the current environment the vote in Duma is merely a part of the legal formality.

Please note that the treaties are suspended **from the effective date of the decree, not the law** that will follow it.

The decree took effect on 8 August 2023, and therefore the tax treaties shall be deemed suspended from that date.



## Which countries have been impacted?

Albania	Finland	Luxemburg	Singapore
Australia	France	Malta	Slovakia
Austria	Germany	Montenegro	Slovenia
Belgium	Greece	New Zealand	Spain
Bulgaria	Hungary	North Macedonia	Sweden
Canada	Iceland	Norway	Switzerland
Cyprus	Ireland	Poland	UK
Croatia	Italy	Portugal	USA
Czech Republic	Japan	Republic of Korea	
Denmark	Lithuania	Romania	



## *Which provisions have been suspended?*

As noted above, the suspension mainly concerns certain articles, and not each individual treaty as a whole.

First and foremost, these are articles providing tax benefits for various types of income.

All passive income paid from Russia to foreign persons located in the impacted unfriendly states will from now on be taxed according to the Russian Tax Code.

The withholding tax rates will be increased significantly to:

- 15% for dividends (previously the rate could have been reduced to 5-10% under most treaties);
- 10% for income from international transportation services (previously not taxable under most treaties);
- 20% for interest, royalties and other passive income (previously not taxable under most treaties).

The articles that set the taxation rules for certain types of individuals' income have also been suspended, the same as the provisions that determine the criteria for creating permanent establishments.

Thus, from now on the provisions of the Russian Tax Code will be the only instrument for determining whether a company has a permanent establishment.

Below we provide an illustrative list of the suspended articles using the example of the [tax treaty between Russia and Switzerland](#):

- Permanent establishment
- Income from immovable property
- Business profits
- Shipping and air transport
- Associated enterprises
- Dividends
- Interest
- Royalties
- Capital gains
- Independent personal services
- Dependent personal services
- Directors' fees
- Artists and sportsmen
- Pensions
- Government service
- Students and business apprentices
- Other income
- Capital
- Non-discrimination
- Anti-conduit rules



## *Which provisions are still effective?*

**The suspension shall not apply** to the articles dealing with:

- general definitions;
- general scope and taxes covered;
- the procedure for determining tax residency (that is good news, as the suspension of this article would have created the dual residency risk for many foreign companies that had voluntarily assumed Russian tax residency or had completed re-domiciliation to a special administrative district (SAD) in Russia before removal from the register in the country of origin);
- elimination of double taxation (taxpayers should be able to retain their entitlement to a foreign tax credit);
- mutual agreement procedures (given the difficulties surrounding liaison with the tax authorities of unfriendly states, keeping these provisions in force does not have much practical value);
- exchange of information (maintaining these provisions does not guarantee the actual exchange of information as the tax authorities of many unfriendly states have been repeatedly reported not to respond to requests from the Russian tax authorities);
- Termination of DTT.

Obviously, suspension of only selected provisions means that a treaty is still effective.

This clears up a number of issues related to the use of certain privileges of the Russian Tax Code that are subject to having an effective tax treaty.

Some of these privileges allow taxpayers to:

- enjoy exemption from withholding tax on loan interest generated from placement of Eurobonds ([subparagraph 8, paragraph 2, Article 310](#) of the Russian Tax Code);
- determine a CFC's profits based on their financial statements, without an auditor's report ([subparagraph 1, paragraph 1.1, Article 309.1](#) of the Russian Tax Code);
- exempt a CFC's profits on the grounds of a high effective rate or in connection with placement of tradeable bonds ([paragraph 7, Article 25.13-1](#) of the Russian Tax Code);
- not to certify documents confirming the payment of the tax on a CFC's profits abroad with the competent authorities of a foreign state ([paragraph 10, Article 232](#) and [paragraph 11, Article 309.1](#) of the Russian Tax Code);
- enter into multilateral pricing agreements involving the competent authorities of foreign states ([paragraph 2, Article 105.20](#) of the Russian Tax Code);
- claim a credit for tax withheld in Russia when individuals receive dividends from Russian companies through companies in foreign states ([paragraph 1.1, Article 208 of the Russian Tax Code](#));

Considering that Russia still has effective tax treaties, the above benefits should be available to Russian taxpayers.

Going forward, some new benefits can soon be formalised in the Russian Tax Code, as is implied in the decree that instructs the Russian Government to take measures to mitigate the impact on the Russian economy.

Earlier, the Finance Ministry's representatives [said](#) that such benefits may include exemption from withholding tax on interest to independent banks.

Corresponding proposals may soon be submitted to the Russian State Duma.

### **Will taxpayers be able to claim a credit for foreign taxes?**

Under the existing provisions of the Russian Tax Code, foreign taxes paid by Russian taxpayers abroad shall be credited as follows:

- Russian entities are entitled to a credit regardless of whether Russia has an effective tax treaty with the foreign state ([paragraph 3, Article 311](#) of the Russian Tax Code).
- Different rules apply to Russian entities that claim a credit for tax paid abroad on foreign source dividends: such tax can only be credited subject to the relevant provisions in the tax treaty ([paragraph 2, Article 275 of the Russian Tax Code](#));
- Individuals face more difficulties: they are not entitled to a tax credit by default, only subject to the tax treaty provisions ([paragraph 1, Article 232](#) of the Russian Tax Code).

The provisions regarding the elimination of double taxation remain in effect, so it would be logical to assume that a foreign tax credit is still available.

In practice, it is not that simple.

Most tax treaties allow foreign tax credits for taxes paid **in line with the provisions of that specific treaty**.

Given that the special articles regulating the tax payment procedure have been suspended, taxes cannot formally be considered as paid in accordance with them, which may impede the receipt of a foreign tax credit.

Yet, the Russian authorities obviously sought to maintain the provisions that eliminate double taxation, as they have [repeatedly mentioned](#).

However, we believe that the current environment may create a legal uncertainty, which will likely require clarifications from the Russian Ministry of Finance.



## Important considerations

Settlements with parties from unfriendly states have almost completely ceased amid the current currency restrictions, so the impact of tax treaty suspension will actually be moderate.

In addition, the discussion around the suspension has been going on for five months, so businesses have had the chance to prepare for the present scenario.

That said, the companies that have managed to get permission for payments to foreign partners will certainly feel an increase in their tax burden.

These companies may include foreign investors that continue to work in Russia despite the headwinds, as well as Russian corporate groups that have entities in unfriendly states.

Currently, withholding tax is paid by the foreign recipient of income, but the tax burden may eventually be moved to the Russian buyer.

There are at least two options that the impacted companies may consider:

- compensate an increase in the tax rate with an increase in price;
- add a “gross up clause” (the transaction value is automatically increased by the amount of the tax to be withheld from the payment to a foreign recipient (we note that many foreign trade contracts already contain such a clause)).

Nevertheless, it is often the Russian party, not the foreign recipient of income, who is ultimately impacted by a rate increase.

And given the anticipated “protective” measures, for instance, those that will be taken by the European countries in connection with the Russia’s blacklisting by the EU, tax implications could be even more significant.

The EU measures may include:

- non-deductibility of certain costs incurred with respect to Russian residents;

- higher withholding tax on passive EU-sourced income;
- limitation of the participation exemption on dividends received from Russian companies.

At least one of the above-listed options is mandatory for each individual EU country, and the rest are at their own discretion.

We may also expect a response from unfriendly states. They may take tit for tat measures by suspending their tax treaties with Russia.

For example, Japan has already [lodged](#) a protest with Russia over Moscow's suspension of the Japan-Russia tax treaty, noting the impact of the decision on Japanese businesses and promising to take “appropriate action.”

If foreign partners suspend or — in the worst scenario — withdraw from their tax treaties with Russia, the tax burden may increase even more dramatically.

All the adverse factors, including payment barriers, suspended tax treaty provisions, growing tax burden and the risks of foreign asset freezes, necessitate consideration of withdrawing from unfriendly countries.

Some possible restructuring options include:

- transferring ownership of Russian subsidiaries to persons from states that are not designated as unfriendly;
- reassigning contracts envisaging the receipt of passive income from Russia to persons from states that are not designated as unfriendly;
- applying the look-through approach;
- redomiciliating to a SAD in Russia;
- changing tax residency of a foreign company.

We will be happy to help with a more detailed analysis of the available options.

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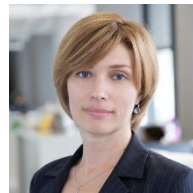
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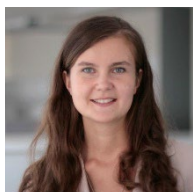
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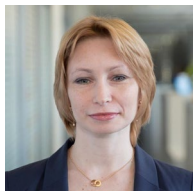
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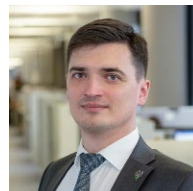
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