LT in Focus

Tax & Legal

The Ministry of Finance of Russia suggests suspending tax treaties with unfriendly states

The Ministry of Finance of Russia jointly with the Ministry of Foreign Affairs of Russia has called for suspending tax treaties with unfriendly states in response to anti-Russia sanctions, the Ministry’s press service informed in its Telegram channel.

Read more in our new LT in Focus.

Background

On 15 March, the Ministry of Finance and the Ministry of Foreign Affairs of Russia have put forward a joint initiative to suspend tax treaties with all unfriendly states and requested the President to issue a respective decree.

The initiative is viewed as a response to the sanctions against Russia, including the recent blacklisting by the EU.

“Unilateral restrictive measures are a violation of international law, which entitles us to reciprocate”, the Ministry of Finance spokesman said.

How will the suspension be effected?

The suspension is not provided for by tax treaty terms; in fact, a country can only withdraw from a tax treaty subject to certain prerequisites.

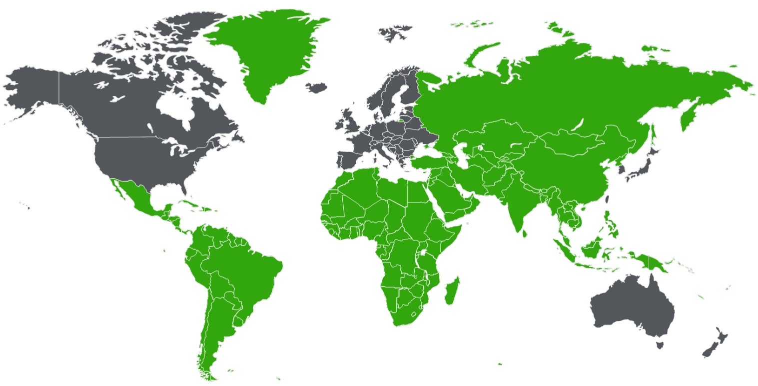
However, we can assume how things may unfold from the precedent with Latvia: the tax treaty with it ceased to apply as of 26 September 2022 on the basis of a Presidential Decree.

If the new initiative is backed up by the President, tax treaties with unfriendly states will most likely be suspended in a similar manner.

The provisions of tax treaties will cease to apply as soon as the respective decrees are published.

What countries may be in scope?

We assume that the initiative would cover the countries on the list of unfriendly states.



unfriendly states

Non-unfriendly states

As Russia has no tax treaties with some of unfriendly states, only the following countries are potentially in scope:

- Albania
- Australia
- Canada
- EU countries
- Iceland
- Japan
- Montenegro
- New Zealand
- Norway
- Republic of Korea
- Singapore
- Switzerland
- UK
- USA

What may the consequences be?

Suspension of tax treaties may have the following consequences:

- **all passive incomes** payable to residents of unfriendly states will be taxed in accordance with the Russian Tax Code at the following rates:
  - dividends – at 15 percent
  - international shipping – at 10 percent
  - interest (including on loans arising in connection with the placement of Eurobonds), royalties and other types of passive income – at 20 percent

- offsetting taxes withheld abroad will be **challenging** for Russian persons:
  - legal entities will not be able to offset tax on dividends; for other types of passive income, an additional set of documents will need to be collected
  - individuals will not be entitled to offsetting the WHT against their PIT, as it can only be done on the basis of a tax treaty
- exempting CFCs' profits from the Russian tax on the grounds of a high effective rate or in connection with the placement of tradeable bonds will no longer be available
- in general, as regards the CFCs located in tax treaty countries, Russian controlling persons are able to compute taxable profit based on their **financial statements** rather than guided by the provisions of Chapter 25 of the Russian Tax Code. If tax treaties with unfriendly states are suspended, this practice may be discontinued and using the CFC's financial statements to compute taxable profits will require submission of an auditor's report
- individuals will not be able **to offset** tax withheld in Russia when receiving dividends from Russian companies through entities in unfriendly states (Clause 1.1., Article 208 of the Russian Tax Code)
- referencing tax treaty provisions to settle **dual residency conflicts** of legal entities and individuals will not be possible, which increases the risks of double taxation
- **multilateral pricing agreements** and mutual agreement procedures involving unfriendly states will be unavailable
- **information exchange** with the unfriendly states may suffer
- in certain instances (for example, in Cyprus) additional tax withholdings resulting from the blacklisting of Russia by the EU, -can be avoided/mitigated on the basis of tax treaties. If Russia suspends tax treaties, **reciprocal measures** are likely to follow. In this case, the full rates of additional withholding taxes will apply

Some of the above-mentioned privileges granted by the Russian Tax Code are subject to "having" a tax treaty.

So far, it is not entirely clear how the "suspension" of tax treaties will be interpreted in this regard.

On the one hand, the suspension does not rule out the existence of a tax treaty.

On the other, Russia will have tax treaties that are not effectively applied.

This will require clarifications from the tax authorities.

If the worst comes to the worst: we are there to help

The suspension of tax treaties will naturally impact foreign investors from unfriendly states; the tax burden on investments in Russia will grow considerably.

Russian corporate groups with subsidiaries in unfriendly states will also be adversely affected, with additional impact to follow once the "protective" measures are enforced e. g. due to Russia's blacklisting by the EU.

As the saying goes, one should hope for the best and get prepared for the worst.

There are several viable options on the table:

- to transfer the ownership of Russian subsidiaries to persons from non-unfriendly states
- to assign contracts envisaging the receipt of passive income to persons from non-unfriendly states
- to apply the look-through approach
- to redomiciliate in special administrative districts
- to change the tax residency of the foreign company.

The applicability of each will depend of your company's particular circumstances; DRT's cross-functional team will readily assist you with the analysis and implementation of an appropriate solution.

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

Contacts

Our team of experts

Natalia Kuznetsova
Partner
nkuznetsova@delret.ru

Elena Solovyova
Partner
esolovyova@delret.ru

Natalia Ivantsova
Director
nivantsova@delret.ru

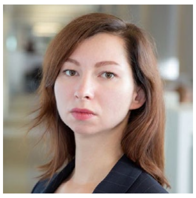
Yulia Krylova
Director
ykrylova@delret.ru

Tax & Legal Partners and Directors

Pavel Balashov
Managing Partner
Tax & Legal
pbalashov@delret.ru

Irina Androncheva
Director
iandroncheva@delret.ru

Emil Baburov
Director
ebaburov@delret.ru



Evgenia Bondareva
Director
ebondareva@delret.ru

Anton Zykov
Partner
azykov@delret.ru

Anna Klimova
Partner
aklimova@delret.ru

Elena Kovalevich
Partner
ekovalevich@delret.ru

Nikita Korobeynikov
Director
nkorobeinikov@delret.ru

Tatiana Kofanova
Partner
tkofanova@delret.ru

Contacts (continued)

Alexandra Kalinina
Director
akalinina@delret.ru

Tatiana Kiseliova
Partner
tkiseliova@delret.ru

Dmitry Kulakov
Partner
dkulakov@delret.ru

Anastasia Matveeva
Director
amatveeva@delret.ru

Yulia Orlova
Partner
yorlova@delret.ru

Ekaterina Sivenkova
Director
esivenkova@delret.ru

Yuriy Khalimovskiy
Director
yukhalimovskiy@delret.ru