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COVID-19 AS A USEFUL TOOL TO AMEND DOUBLE TAX TREATIES

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On 25 March 2020 the Russian President in his speech on the measures taken by the Russian authorities against Covid-19 mentioned, among other, the need to change the taxation applicable to "those taxpayers who '*pull out*' their income in the form of dividends to foreign accounts". The President used the expression 'vyvodit' (pull out) income, which has a negative connotation and usually describes the situation, when formally lawful (but in essence illegal) profit withdrawal scheme is being applied. He proposed that a 15% withholding tax rate be established for such dividends.

In order to implement this change, it is necessary to amend double tax treaties in force with certain countries, and therefore the Russian Government was given the task to propose the relevant amendments to the countries concerned. If the foreign partner does not accept this proposal, the Government was instructed to unilaterally withdraw from the relevant treaty[1].

It is worth noting, that the President only referred to dividends in his speech.

Step one

The Russian authorities started to implement the President's request from Cyprus. In the letter sent to the Government of Cyprus, they proposed to introduce a number of changes in the double tax treaty in force between Russia and Cyprus. More particularly, they proposed to change the withholding tax rates applicable to dividends and interests, and set them at 15% for all companies without any exceptions. Currently, dividends paid from sources in Russia to shareholders resident of Cyprus are subject to 5% withholding tax, provided that such shareholder invested in the capital of a Russian company an amount equal to at least Euro 100,000. If the amount of the investment is lower, then dividends are taxed at the rate of 10%. Interests paid from sources in Russia to Cyprus should not be subject to Russian withholding tax.

Should the authorities of Cyprus refuse to amend the treaty, the Russian Government may withdraw therefrom by sending a written notification to that effect. In such case, the income from sources in Russia would be taxed according to the rates provided by the Russian domestic tax legislation, namely, withholding tax will be charged at 15% rate on dividends and at 20% on

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[1] The full text of the speech is available on the Kremlin's official website: www.kremlinrus.ru/article/181/118762/

interests. The termination of the treaty would also affect the taxation of other types of income paid from sources in Russia to Cyprus residents, in particular, royalties, which currently may only be taxed in the country of the resident (20% rate will be applied).

Step two

On 13 April 2020 the Russian Ministry of Finance reported that proposals to change the double tax treaties were also sent to the competent authorities of Luxembourg and Malta. As in the case of Cyprus, the Russian authorities proposed to increase the tax rates applicable to dividends and interests up to 15%[2].

Further steps?

As reported by the media[3], the Russian Foreign Minister Sergei Lavrov declared that Russia intends to change the terms of all double tax treaties in place with EU Member States, so "similar proposals will be sent to all EU Member States, with which the Russian Federation has double taxation treaties."

However, the Russian Ministry of Finances, in its letter,[4] gave a different justification. The Ministry explained that the proposed changes (namely, the increase of the rate of withholding tax on income deriving from dividends and interest) are dictated by the difficult economic situation of both the Russian Federation and the world at large, caused by the threat of the coronavirus infection.

The Ministry also clarified that the changes shall only apply to transit jurisdictions, where: (i) local companies do not independently manage the revenues, and (ii) through which the revenues pass in transit. As a rule, companies in such jurisdictions are incorporated with the purpose to benefit from the reduced rates established by the double tax treaty with such country.

According to the Ministry, the Russian Federation is beginning to apply this approach towards countries, where significant resources of Russian origin pass through, because this issue is very sensitive for the Russian economy. Therefore, the changes proposed are aimed at combating tax evasion through the use of schemes, which allow that most of the income of Russian origin is actually paid to Russian beneficiaries through a transit jurisdiction.

The Ministry did not provide the list of the jurisdictions concerned. In the light of the above clarifications, it is unlikely that Russia may propose to amend double tax treaties entered into with countries with a high tax burden (such as Italy, France, Germany and the United States). It could be expected that proposals for change may be sent to States, which are perceived by Russia as transit jurisdictions (e.g. The Netherlands, Singapore and Switzerland).

Conclusions

In our opinion, it may be expected that Russian authorities decide to review the tax rates applicable to dividends and interests, established by some double tax treaties. This proposal may be seen as a further step in the so-called 'process of de-offshorization' mainly aimed at repatriating funds belonging to Russian beneficial owners back to Russia.

The obvious drawback of these proposed changes is that they may also have negative side effects on genuine foreign investors. Therefore, foreign companies and international groups may need to review and reconsider their holding and financing structures in relation to Russian companies. It

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[2] The information is available on the website of the Ministry of Finance of the Russian Federation: www.minfin.ru/ru/press-center/?id_4=37027minfin_rossii_napravil_pisma_ob_izmenenii_soglashenii_ob_izbezhanii_dvoinogo_nalogooblozheniya_s_lyuksemburgom_i_maltoi

[3] https://cyprus-mail.com/2020/04/03/russia-changing-double-taxation-deal-with-cyprus-nothing-political/

[4] The letter of Ministry of finances dated 29.04.2020 No. 03-08-05/35110.

may be worth considering the transfer of holding company in other jurisdictions. One of the options worth mentioning is to incorporate holding company in Russia.

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Il presente articolo ha esclusivamente finalità informative e non costituisce parere legale.

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