



Russian Court agreed with requalification of royalties for the use of know-how into dividends



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On 07.05.2021 the Arbitration Court (State Commercial Court) of Krasnoyarskiy Kray rendered a decision on the case N A33-5437/2020, in which it agreed with conclusions made by the Russian tax authorities that payments of a taxpayer in favor of foreign affiliated company for the use of intellectual property rights (know-how) are in facts dividends.

Background

Taxpayer (OOO 'Johnson Matthey Catalysators') paid to foreign affiliated company (Johnson Matthey PLC) royalties for the use of intellectual property.

The payments were performed in accordance with the license agreement for the transfer of technical information for production and commercialization of

products ('know how') and the Taxpayer considered such royalties to be deductible expense.

However, the Russian tax authorities requalified the royalties into dividends. As a result, license payments were excluded from the list of deductible expenses and additional amount of corporate profits tax were charged to the Taxpayer.

Moreover, whereas the Taxpayer treated payments as royalties exempt from Russian withholding tax on basis of double tax treaty between Russia and



the UK¹, the tax authorities concluded that the Taxpayer had to perform obligations of tax agent, i.e. it was obliged to pay the withholding tax on income of foreign company from sources in Russia in the form of dividends. As a result, the withholding tax was charged. The Taxpayer challenged the decision of the tax authorities in the arbitration court of Krasnoyarskiy Kray (the Court).

Court's findings

The Court agreed with the position of the tax authority that the Taxpayer abused its rights by paying dividends under appearance of royalties. The findings were made on basis of the following circumstances.

1. The Taxpayer has not provided fully the technical information for review, it only submitted to the Court several first pages of documents with dates, signatures and general information as well as general tables with dates of transfer of technologies and their updates. However, court considered that such pages do not demonstrate what exactly is confirmed by the signatures and cannot be considered as proof of transfer of technologies;
2. Some documents, which were submitted to the Court by the Taxpayer, do not contain references to the license agreement under which the disputed license payments were performed. As a result, the Court considered it impossible to link them with the performance of the license agreement;
3. The documents submitted by the taxpayer are dated for tax periods other than the tax period in which tax authorities made additional tax assessments;

4. The technical information was partially provided to the Taxpayer before the conclusion of the license agreement, which deprives the information of the feature of being unknown to the licensee and, therefore, of the commercial value of receipt of such information;
5. The obligation to pay royalties is dependent on the Taxpayer's operating profit. In the absence of profits, the royalties shall not be paid. This demonstrates the influence of the interdependence (affiliation) of the parties on the terms of the license agreement and confirms that the real goal of license agreement is to allow the withdrawal of profits;
6. The amount of royalties in some period significantly (10 times!) exceeded the income from sale of products produced presumably with the use of technologies;
7. The Taxpayer (the licensee) and foreign company (the licensor) are affiliated companies of the same group: the foreign company indirectly participates in the capital of the Taxpayer through other companies of the group.

Summary

To sum up, it should be noted that taxpayers must pay significant attention to the 'paperwork', in particular, they must ensure proper drafting and dating of documents.

In the case of preliminary (i.e. prior to the conclusion of the license agreement) transfer of information ('know-how') to licensee for its review and evaluation, it must be ensured that the know-how cannot be used by the licensee without the conclusion of the license agreement. Otherwise, the authorities can consider that conclusion of the license agreement does not have commercial value for the latter due to its awareness of its contents.

¹ The Convention dated 15.02.1994 between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Russian Federation for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains

And of course, the commercial terms of the license agreement must correspond to the terms that would be agreed

between independent (unaffiliated) persons.





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