



The Look-Through Approach: When Can it be Used?

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On 10 April the Moscow Arbitration Court issued another ruling¹ relating to the application of the beneficial ownership rules and the use of reduced withholding tax rates under double taxation treaties signed by Russia.

The court wholly rejected the claims brought by Moskommertsbank AO (“the Bank”) after the latter adopted a new line on the issue of the beneficial ownership of income, which had already been addressed at previous stages of the appeal. On bringing the appeal to court, the taxpayer attempted to argue for the application of the look-through approach in determining the appropriate tax treatment for the transaction in question. However, the court rejected the taxpayer’s position, pointing out that the taxpayer had not raised the matter of applying the look-through approach at an earlier stage and relevant supporting documents had not been included in the case papers.

¹ Moscow Arbitration Court Decision of 10 April 2019 on Case No. A40-8065/18-115-371

Summary of the Dispute

The dispute arose over the charge that the Bank had unlawfully failed to calculate, withhold and remit tax on interest paid on deposits of foreign banks incorporated in Austria and Luxembourg, since the foreign banks were not the beneficial owners of interest income on the deposits.

When paying interest income to the foreign banks, the Bank had applied a 0% rate (an exemption from tax) under the provisions of the Russia-Austria² and Russia-Luxembourg³ tax treaties, which allow for interest income not to be taxed in the state in which it arises provided that the recipient of the income is the beneficial owner.

In the trial court hearing the tax authority successfully demonstrated that the foreign banks had not borne economic risks and had acted as intermediaries to enable the transfer of funds from the shareholder (the actual recipient of the income in question), Kazkommertsbank (Kazakhstan), to the Bank and the receipt of interest from the Bank in the interests of its shareholder (the channelling of funds). As a result, the tax authority ordered withholding tax to be paid at the standard rate of 20%.

The Bank's argument that the 10% rate provided for in the Russia-Kazakhstan tax treaty⁴ should have been applied was rejected by the court on the grounds that the Bank had not claimed that relief in the first instance (in its objections to the report on the on-site tax audit).

The Court's Position

In upholding the tax authority's position, the trial court made the following main points:

1. Responsibility for claiming relief and proving eligibility for it lies with the taxpayer.

2. The tax authority audits the person actually claiming the relief, and does not have an obligation to establish the actual beneficiary: it only has to prove that the recipient of income (a resident of a foreign state with which Russia has a tax treaty) is not the beneficial owner of that income.
3. Russian tax law provides for a person who is the beneficial owner of income to apply for a credit (refund) of overpaid tax where a tax agent has withheld tax on income of a foreign entity without applying reduced rates (tax exemptions) provided for in a tax treaty.
4. The fact that the company deliberately attempted to make unlawful use of benefits under the tax treaty and tax legislation to evade tax gives cause to reject its claims for the tax authority's decision to be invalidated.

What does it mean for you?

Since 1 January 2015 Russian tax law has allowed tax treaty provisions to be applied not only in relation to the recipient of income, but also in relation to the person who is the beneficial owner of that income, i.e. the income is taxed without regard to intermediary companies as if it had been paid directly (the look-through approach).

If the beneficial owner is a resident of a country with which Russia has a tax treaty, reliefs provided for in that treaty will be applicable (as long as the conditions laid down in the treaty itself are met). According to the position expressed by Russia's Supreme Court, the applicability of reduced tax rates under tax treaties must be assessed with reference to the actual economic substance of transactions⁵.

² Convention between the Russian Federation and the Austrian Republic of 13 April 2000 for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital

³ Treaty between the Russian Federation and the Grand Duchy of Luxembourg of 28 June 1993 for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Property

⁴ Convention between the Russian Federation and the Republic of Kazakhstan of 18 October 1996 for the Elimination of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital

⁵ Supreme Court Determination No. 304-KG17-8961 of 15 January 2018 on Case No. A27-25564/2015

The application of the look-through approach is conditional on the disclosure of the beneficial owner of the income concerned.

Although the decision may be contested in the appellate instance, taxpayers may wish to bear in mind the trial court's key conclusions, which are in keeping with the prevailing trend in case law on the application of the look-through approach, when making decisions regarding the taxation of income paid to foreign companies or when challenging the results of tax audits.

In particular, they should bear in mind that reliefs provided by double taxation treaties have to be claimed. To avoid refusal on technical grounds, it is essential to claim reliefs as early as possible, and no later than at the initial (pre-

court) stages of appealing against the results of tax audits.

The burden of proving beneficial ownership of income and the existence of grounds to claim relief rests with the tax agent, which must submit documents supporting that entitlement to the tax authority⁶.

In order to confirm the right to tax treaty benefits, therefore, it is essential to claim them at the earliest possible stage and to prepare documentation to support the company's position.

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⁶ Tax legislation does not prescribe a list of required documents. Generally, they would include documents confirming direct interest in a foreign intermediary company and indirect interest in the Russian company that

pays the income, a certificate showing the state of tax residence, etc.

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