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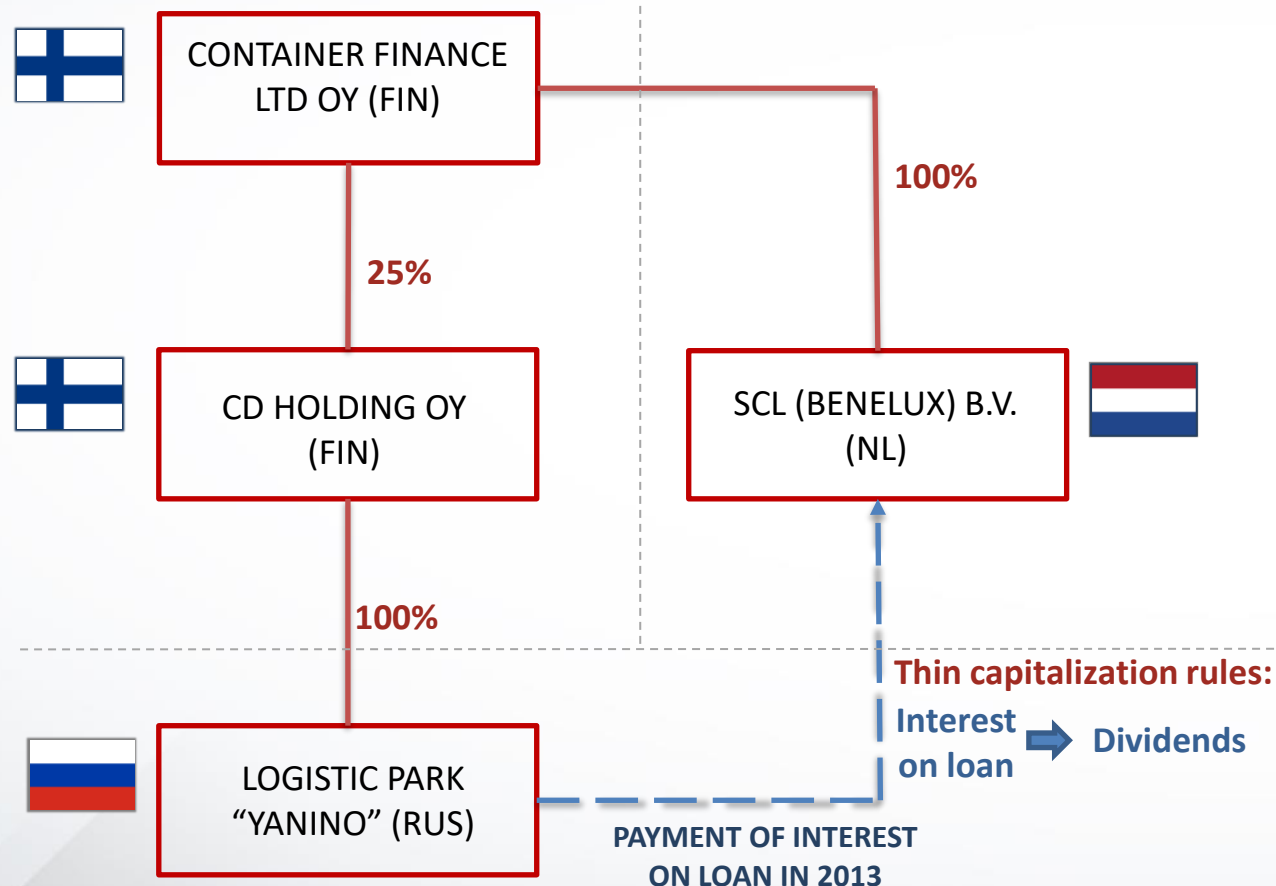


Online-Conference
“TAX TREATY CASE LAW AROUND THE GLOBE”
6-7 MAY 2021

Taxation of interest reclassified as dividends under national thin capitalization rules:

“Logistic-Park “Yanino” vs. Tax Authorities”
case No 307-ЭC19-8719, par. 35 in the 2020 review of Russian Supreme Court Practice,
approved by the Presidium of the Supreme Court of the Russian Federation, 10 June 2020

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Facts:

Tax authority reclassified excessive interest as taxable dividends under Russian thin capitalization rules and applied article 10(2)(b) of Russia-Netherlands DTT to tax payment at 15% tax rate.

Issues under consideration:

No debate on the applicability of thin capitalization rules.

The arguments concern taxation of payments as dividends:

- Which double tax treaty is applicable – Russia-Netherlands or Russia-Finland?
- Are there grounds to apply the 5% treaty tax rate for dividends?



Key Issue:

Tax authority

Withholding agent*

Applicable double tax treaty

Russia-Netherlands DTT,
art. 10(2)(b), 15% withholding tax

Russia-Finland DTT, art. 10(1)(a), 5% withholding
tax (with maximum treaty tax rate being 12%)

**Application of the lower 5%
treaty tax rate for dividends**

Not possible (no detailed
comments on the issue)

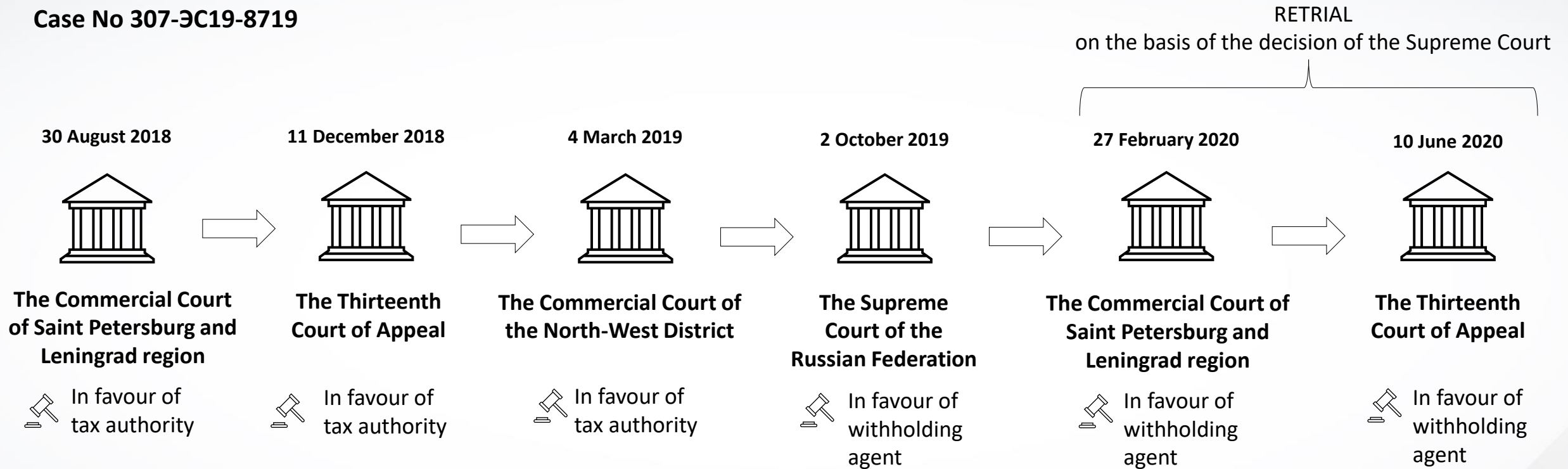
Possible:

- (a) the dividends should be treated as income of
the Finnish company, not of the interme-
diate Dutch company
- (b) conditions on minimum holding threshold
(*“holds directly at least 30 per cent of the capital of the
company paying the dividends”*) and minimum
investment (*“the foreign capital invested exceeds one
hundred thousand United States dollars (USD 100,000) or
its equivalent in the national currencies”*) are met

* The withholding agent has changed its position before the hearing in the court of cassation - The Commercial Court of the North-West District. Originally the Russian company referred to treaty definitions of dividends and interest and insisted that the payment could not be treated as dividends under DTT.



Case No 307-ЭC19-8719



10 June 2020

The Supreme Court of the Russian Federation included the summary of the case in the review of its practice (approved by the Presidium of the Supreme Court of the Russian Federation on 10 June 2020, par. 35)



Key arguments:

- under national thin capitalization rules interest paid out to the Dutch company can be regarded as the Finnish shareholder's income from its Russian subsidiary, providing there is no dispute over the beneficial owner of the income and the jurisdiction of its tax residence => the Russia-Finland DTT is applicable;
- 5% reduced treaty tax rate on dividends may be applied to interest reclassified as dividends under Russian thin capitalization rules and Articles 2(3) and 10(4) of the Russia-Finland treaty, and the value of the loan should be taken as capital;
- in this case application of the 5% treaty tax rate couldn't lead to granting of treaty benefits in inappropriate circumstances (for example, there was no proof that Finnish company lacked the beneficial owner status);
- the lower treaty tax rate on dividends aims to encourage foreign investments, and the tax authority's position prevents the use of the treaty benefits, while the fact of foreign investment into Russian economy is undisputed.



- ✓ The Supreme Court officially confirmed the previously expressed position (e.g., cases of SUEK-Kuzbass (2018), Kashirskiy Dvor – Severyanin (2018)) on
 - (a) applicability of Article 10 (“Dividends”) to all interest reclassified as dividends (based on national thin capitalization rules, articles 2(3), 10(4) of the Russia-Finland treaty; no reference to the OECD MTC Commentary given), and
 - (b) possibility to apply the 5% lower treaty tax rate on interest reclassified as dividends, including the treatment of the value of the loan as capital (based on reference to the para. 15 of the OECD MTC Commentary on Article 10(2)).

- ✓ With reference to national thin capitalization rules the Supreme Court classified payments to Dutch company as payments to Finnish company and applied Russia-Finland DTT, not Russia-Netherlands DTT. The given references to national tax legislation don’t seem to be a sufficient rationale for such a conclusion.

Contacts

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