

Russian President announces significant changes to taxation of dividends and interest

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In an address to the nation on 25 March 2020, the President of Russia announced a number of tax initiatives, one of which concerns the taxation of dividends paid from Russia that may have a major impact on the tax treaty system.

The President said in his speech that "all income payments (in the form of interest and dividends) that flow out of Russia to offshore jurisdictions must be taxed appropriately." It is therefore proposed that "... for those who move their dividend income out of the country into foreign accounts, the rate of tax on such dividends should be set at 15 per cent."

A 15% rate currently exists for dividends paid to jurisdictions with which Russia has no tax treaty. Payments to entities in tax treaty partner countries are usually taxable at reduced rates of 5% or 10%. Russia has over 80 tax treaties but does not have them with countries traditionally characterized as tax havens.

It was also stated in the speech that "...this [decision to impose a 15% rate on dividends] will require adjustments to be made to our double taxation agreements with certain countries. I ask the Government to arrange for that to be done. If any of our foreign partners do not accept our proposals, Russia will unilaterally withdraw from those agreements. And we will begin with those countries through which significant resources of Russian origin pass, as having the greatest impact on our country."

Since amending the terms of current tax treaties is normally a long process, it is not yet clear how this measure will be implemented in practical terms.

It is uncertain at this point what is meant by “offshore jurisdictions” in the context of the proposed move (i.e., whether it refers to low-tax jurisdictions or all foreign jurisdictions) and whether the initiative is directed only at dividends or covers other kinds of passive income as well.

There are grounds to believe that the initiative would not apply to all existing tax treaties. The President’s address specifies that the measure is aimed primarily at countries through which significant resources of Russian origin pass, which would likely mean countries such as Cyprus and the Netherlands. There is unlikely to be a direct instruction to increase the tax burden on genuine investors based in countries such as China, France, Germany, Italy, and Japan, among others.

It is also possible that the proposal stems from the decision by some countries not to apply measures to limit tax treaty benefits. In signing up to the MLI,¹ Russia opted to apply the Simplified Limitation on Benefits Provision (S-LOB), but it only applies if both parties to a specific tax treaty have chosen that

option. Since, for example, Cyprus and the Netherlands have not declared their willingness to apply S-LOB, this may explain the decision to take other measures in form of a change to the tax rate itself. If this is the case, the expected changes should not affect tax treaty partner countries that are willing to apply the limitation on benefits rules.

An advisory message was published by the Finance Ministry on 26 March 2020. According to the advisory message, the planned increase in the withholding tax rate for income in the form of dividends and interest will only apply to so-called conduit jurisdictions. Companies are usually set up in such jurisdictions specifically for the purpose of applying reduced tax rates provided for in double taxation treaties. The measure will primarily affect Cyprus and a number of other similar jurisdictions. The changes will not affect interest income payable on Eurobond loans, bond loans of Russian companies or loans made by foreign banks. The changes are expected to come into effect on 1 January 2021 and will not apply to income paid from the Russian Federation in 2020.

Future Alerts will report on the planned changes and any new details about the proposed measure as soon as they are published.

Endnote

1. The Organisation for Economic Co-operation and Development (OECD) *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*.

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