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Elimination of Double Taxation in Russia: Practical Issues

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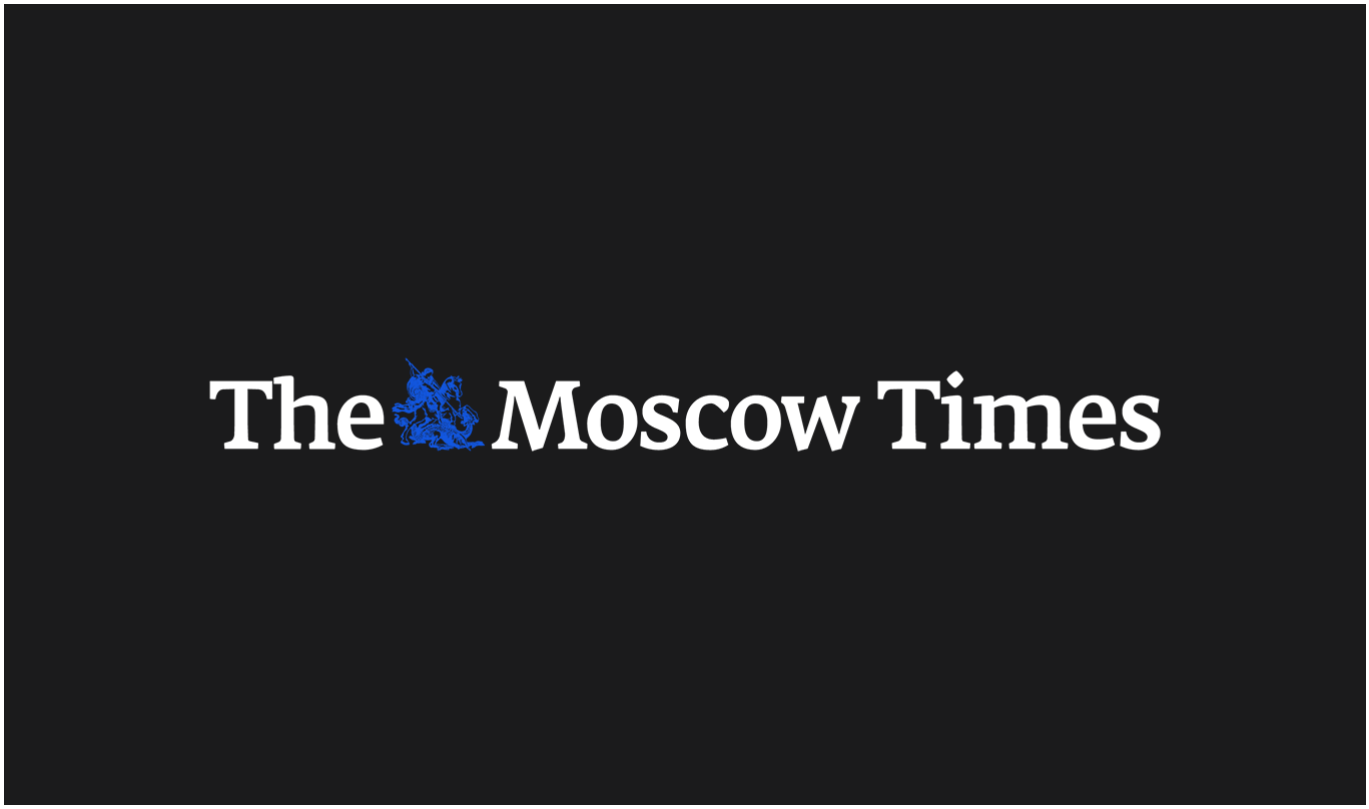

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Elimination of double taxation suffered by Russian companies carrying out cross-border activities is one of the cornerstones of the Russian tax system. Despite this, the topic has long been overshadowed by discussions of tax implications for inbound investments (withholding taxes, permanent establishments, nondiscrimination, etc). In conjunction with this, in practice, elimination of double taxation has become an important issue for Russian businesses. Although Russian domestic tax law on the matter is brief and plain, a number of important issues arise when it applies.

1. The law is clear that Russian companies may eliminate double taxation by crediting the foreign taxes paid against the Russian profit tax accrued in respect to their worldwide profits. However, the amount of credit, the law says, should not exceed the amount of Russian tax payable by these companies. Despite this, the law is silent on whether the foreign tax credit should be limited by the total amount of Russian tax liability of a company, or only by that portion of tax accrued in respect to foreign source income of the company. In principle, the lack of clarity regarding limitation of the foreign tax credit should be interpreted in favor of the taxpayers, and the latter should be given the right to credit as much foreign tax as fits within the overall amount of their Russian tax liability. Unfortunately, the tax authorities strongly oppose this approach (and limit the foreign tax credit up to the amount of Russian profit tax due for each particular item of foreign source income), although no persuasive arguments supporting this view have been made available. If a Russian company earns substantial Russian profits and the foreign taxes it pays for its foreign source income are higher than the Russian tax, then the question of limiting the foreign tax credit could significantly impact the overall tax liability of the company.

2. The law provides no clear guidance on the tax period when a Russian company may claim a foreign tax credit. The Tax Code only requires that the company claiming a foreign tax credit

provide written confirmation from the foreign tax authorities or the foreign withholding agent. However, in practice, it may take the taxpayer a long time to obtain such confirmation, and in such case the question arises whether the taxpayer may claim a foreign tax credit in the tax period when it receives all necessary papers or if should go back to the tax period in which the underlying foreign source income was recognized for Russian tax purposes. The situation could be even further complicated if the foreign source income is taxed in Russia on an accrual basis, but the foreign tax is not due until this income is paid to the Russian company.
In practice, tax authorities and courts have not reached a consensus on the timing of a foreign tax credit, and four different approaches have been suggested for when a foreign tax credit can be claimed. These are during the tax period when (i) the foreign source income is accrued for Russian tax purposes; (ii) the foreign tax is paid (withheld); (iii) the Russian company obtains all necessary papers confirming payment of foreign tax; or (iv) during any tax period at will. Such a variety of options may seriously affect enforcement of the foreign tax credit in practice. If the company has significant profits in some tax periods but earns much lesser profits or even incurs losses in other tax periods, then allocating the foreign tax credit to one fiscal year or another will definitely matter.

3. Finally, it should be mentioned that Russian tax authorities and Russian courts generally consider whether the state of the source of income was eligible to collect tax before they allow such tax to be credited against Russian tax liability. In particular, they consider whether the activities of the Russian company indeed constitute a permanent establishment in the source state (which grants the taxing jurisdiction to this state), whether classification of income employed by the source state (which may affect the withholding tax rate to apply in the source state) is correct, etc. Should they disagree with the imposition of the foreign tax, the taxpayer may face rejection of the foreign tax credit, leading to a failure to eliminate double taxation.

The above are only a few practical issues that Russian taxpayers should be aware of. Many of them are in dire need of further clarification in the law. With more and more Russian businesses becoming involved in cross border activities, the author expects that elimination of double taxation will continue to be an area of tax practice that attracts more and more attention from tax practitioners and the business community.

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