

RUSSIAN MINISTRY OF FINANCE ISSUES CLARIFICATION ON PERMANENT ESTABLISHMENT STATUS UNDER RUSSIA – U.S. INCOME TAX TREATY

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To Our Clients and Friends:

The Ministry of Finance of the Russian Federation (“the Ministry”) recently provided helpful clarification on the concept of “permanent establishment” (“PE”) under the existing Russia-U.S. income tax treaty (the “Treaty”) and held that a U.S. company does not have a PE in Russia solely as a result of holding board of directors meetings in Russia (Letter No. 03-08-05, dated May 7, 2009 (“the Letter”)).

HIGHLIGHTS OF THE LETTER

At the request of a taxpayer, the Ministry analyzed whether a U.S. company has a PE in Russia under the Treaty as a result of holding board of directors meeting where:

- the board members attend the meetings in person in Russia; or
- some board members, while staying in Russia, participate in the meetings via telephone or videoconference.¹

Generally, under the Treaty (and the OECD Model Tax Convention), a PE is defined as a “fixed place of business” through which a resident of a treaty country (*e.g.*, the U.S.) carries on business in the other treaty country (*e.g.*, Russia).

In the Letter, the Ministry takes the view that a “place of business” could exist in Russia, even if no premises are available or required for such business. However, the Ministry clarified that, in order to constitute a PE in Russia, a fixed place of business in Russia should perform activities similar to the principal and usual activities of the foreign company, *i.e.*, the business objective of the activities performed in Russia should be of the same nature as the activities normally performed by the foreign company in its head office.

In concluding that the U.S. company does not have a PE in Russia in either situation, the Ministry took into consideration that all of the U.S. company’s assets, personnel and

¹ *The clarification does not comment on the frequency of such board meetings.*

commercial operations were located or carried out in the U.S., and therefore the goal of the principal activities of the company in the U.S. was different from the goal of the board of directors meetings in Russia.

STATUS OF PRIVATE CLARIFICATIONS OF THE MINISTRY

The position of the Ministry outlined in the Letter may be helpful for taxpayers having a similar tax dispute with the Russian tax authorities. However, the position expressed in the Letter should be considered and applied cautiously.

First, even though the Letter refers to certain other conditions relevant for PE status under the OECD Model Tax Convention (actual existence of a place of business, its “fixed” nature and a connection between the business and such fixed place), the Ministry did not examine whether these conditions were met in the case described in the Letter. Therefore, in a similar situation where the nature of the activities performed in Russia differs from the nature of the activities normally performed by a foreign company in its head office, the Ministry may reach a different conclusion because other conditions relevant for PE status are met.

Second, written clarifications issued by the Ministry in response to a particular taxpayer’s request, such as the Letter, do not become part of the tax jurisprudence and are therefore published as a non-binding recommendation. A taxpayer may not rely on such a letter issued to another taxpayer and such a letter would not be binding on the Russian tax authorities.²

The Letter, although a helpful clarification, does not obviate the need to analyze the specific circumstances of a given case and, in particular, does not provide a safe harbor against penalties and fines. Nevertheless, it is an indication of the Russian tax authorities’ current thinking, and in this sense it is helpful indeed.

We will be happy to answer any queries you may have on this or any other Russian tax issues.

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² Generally, the tax authorities are obliged to follow the written recommendations of the Ministry (Art. 32.1.5 of the RF Tax Code). However, only public clarifications are viewed as binding (this position is confirmed by the RF Supreme Arbitration Court in its Ruling No. 12547/06, dated January 16, 2007).