



## Russian Thin Capitalization Rules Clarified

**Daniil Ruderman**

*Tax Consultant and Representative, Moscow  
and*

**Alexis Tsielepis**

*Director, Head of Taxation*

**5 October 2015 - Russian authorities have issued two letters in which, despite the explicit wording of the Russian Tax Code, they argued that loans provided to Russian companies by their non-Russian sister companies may be subject to Russian thin capitalization rules.**

Under the Russian Tax Code, there are only three cases where loans provided to the Russian corporate borrower may be subject to thin capitalization rules:

- I. the loan is provided by a non-Russian company owning directly or indirectly more than 20% of the Russian borrower;
- II. the loan is provided by a Russian affiliate of the non-Russian company mentioned in (i) above; and
- III. the loan of the Russian borrower is guaranteed in any form by companies mentioned in (i) and (ii) above.


In the above three cases, if the debt to equity ratio of the Russian borrower exceeds 3 to 1 (for banks and leasing companies 12.5 to 1), the interest under the loan corresponding to the debt exceeding the ratio is non-deductible for the Russian company and taxed as dividends payable to the non-Russian parent company of the borrower.

As follows from the above, under the Russian Tax Code, provision of loans to the Russian companies by their non-Russian sister companies is technically outside the scope of Russian thin capitalization rules. Historically, this loophole was widely used by companies to avoid application of Russian thin capitalization rules in case of intra-group financing.

However, in the last few years this practice of providing loans from non-Russian sister companies was examined by courts that ruled that such loans may be subject to Russian thin capitalization rules. Recently, the number of such cases increased dramatically.

In addition, in June and August of 2015 the Russian authorities issued two separate letters on a related issue, namely the Russian Tax Service Letter No. GD-4-3/10807@ dated 22 June 2015 and Russian Ministry of Finance Letter No. 03-08-05/46443 dated August 12, 2015.

The letters referred to the general logic of the Tax Code provisions and OECD Commentary to the Model Tax Convention arguing that if both companies, the Russian borrower and the non-Russian sister company lender, are controlled by the same parent company (i.e. they



are companies of the same group), the loan provided to the Russian borrower by its non-Russian sister company may be subject to Russian thin capitalization rules. The Tax Service letter also contains a reference to recent court decisions confirming its logic.

In view of the abovementioned court precedents and recent letters issued by the Russian authorities, provision of loans to the Russian companies by their non-Russian sister companies to avoid application of Russian thin capitalization rules represents a significant risk.

It is advised that such structures should be avoided in the future and current group financing structures should be reviewed to determine whether they are subject to the above risk and how they can be improved.