



Russia's take on tax disputes

A tax agent may recover an amount of tax it paid from its own property on behalf of a foreign person by using the institution of unjust enrichment

The Commercial Court^[1], in the case of the Organising Committee of the 2014 Olympic and Paralympic Winter Games in Sochi^[2], has recognised as lawful the application of the civil law mechanism for recovering from a foreign person an amount of unjust enrichment in the form of tax that a tax agent has paid on behalf of the foreign person, together with interest for using the other party's money.

The facts of the dispute

Between 2012 and 2013 the Organising Committee and Pico Projects International Limited (a Hong Kong resident, "Pico Projects") entered into agreements for the lease of facilities (tent structures) to ensure the temporary infrastructure of the Olympic Games.

When paying the lease payments to Pico Projects, the Organising Committee erroneously did not withhold, as a tax agent, the amount of corporate income tax^[3]. After the error that had been committed was identified, the Organising Committee calculated and paid at its own expense the relevant tax amount.

Clause 2 of Resolution No. 57 of the Plenum of the Russian Supreme Commercial Court dated 30 July 2013^[4] provides for the cases when tax is paid from the property of the tax agent:

- the money from which the tax agent had to withhold tax was paid to a foreign person which is not registered with the Russian tax authorities, and therefore is not subject to tax administration;
- the tax agent has withheld the tax amount, but has not transferred it to the state budget;

if special rules in this respect do not result from the provisions of part two of the Tax Code (for example, article 231(2) of the Tax Code).

Subsequently, the Organising Committee filed a written complaint with Pico Projects requesting that the amount paid in excess be transferred back to the Organising Committee. Pico Projects did not agree with the complaint.

The Organising Committee filed a claim with the Commercial Court for the Krasnodar Territory to recover from Pico Projects the amount of the unjust enrichment and the amount of interest for using another party's money.

Pico Projects insisted that the Organising Committee had selected an inappropriate remedy and, in particular, that there was no money belonging to the Organising Committee in the lease payments paid to Pico Projects.

Having assessed the arguments of the parties regarding the above, the commercial courts upheld the Organising Committee's claim.



The courts' position in the case

When the courts upheld the Organising Committee's claims to recover the unjust enrichment, they proceeded on the basis that, since the Organising Committee has fulfilled its obligation to make the tax payments under the leases in dispute (which is not challenged by the parties and is supported by the tax authority), Pico Projects had accumulated an unjust enrichment from the property of the tax agent; the amount of the unjust enrichment was equal the amount transferred in excess which was to be withheld in order to be transferred as tax to the Russian state budget.

Taking into account that the lease payments were made in US dollars, the courts determined that the unjust enrichment and the interest for using the other party's money were payable to the Organising Committee in US dollars.

The courts paid attention to the following circumstances:

- The Organising Committee made payments for the leased property.
- According to article 309(1)(7) of the Tax Code, the income of foreign companies which do not perform activity through a permanent establishment in Russia that such companies earn from the leasing out of property used within Russia is classified as income from sources in Russia and is subject to the corporate profit tax.
- The Organising Committee transferred through a permanent establishment tax on the income of the foreign company Pico Projects which was not related to its activity in Russia.
- The obligation to calculate, withhold and transfer the tax for the taxpayer is imposed on the tax agent. The obligation to pay the tax is considered fulfilled by the taxpayer from the day when the tax agent withholds the tax amounts from the taxpayer's money.
- The tax agent is still obliged to pay the tax if the foreign person is not registered with the tax authority and tax administration is impossible.
- As at the date when the claim was raised against Pico Projects, the tax agent had fulfilled its obligation to make the tax payments (a reconciliation statement with the tax authority was provided which confirms that the tax agent does not have any outstanding taxes, levies, default interest, fines, or interest; the desk tax audit has not identified any violations).

Conclusions: the probability of recovery

The recovery/payment, from the money of a tax agent, of tax on the income of a foreign company which the tax agent has not withheld despite the taxpayer remaining an obliged person, remains a topical issue. The Plenum of the Russian Supreme Commercial Court pointed out in its Resolution No. 57 dated 30 July 2013 that there is a probability that the tax amount will be recovered from the property of the tax agent owing to the Russian tax authorities being unable to administer the foreign person.

After the Plenum of the Russian Supreme Commercial Court adopted this resolution, in 2014 Russia ratified the joint OECD/Council of Europe Convention on Mutual Administrative Assistance in Tax Matters dated 1998. Then in 2016 it signed the Multilateral Competent Authority Agreement for the purposes of the automatic exchange of information under the CRS standard and for the relevant section VII.1 to be included in the Tax Code.

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This allowed the tax authorities to extend the range of tools they may use when carrying out tax audits and for recovering tax amounts specifically from the taxpayer as the beneficial owner of income, but not from the tax agent. However, in spite of that, the tax authorities are continuing to recover tax amounts from the property of tax agents.

The case of the Organising Committee of the 2014 Olympic and Paralympic Winter Games in Sochi clearly illustrates the probability of tax agents applying civil law mechanisms to protect their property interests to relationships arising in connection with tax agents paying taxes on behalf of taxpayers. In particular, tax agents may recover part of the amount paid to the foreign person which is equal to the amount of the paid (recovered) tax on the income of the foreign person, based on the provisions of Russian civil legislation on unjust enrichment.

Under article 1107 of the Russian Civil Code (the “Civil Code”), a person that has unjustifiably received or saved the property must return not only the amount of the unjust enrichment, but also income that has not been received, and must pay interest for using the other party’s money from the time when such person became aware or should have become aware of the money having been unjustifiably received.

Conclusions: the probability of enforcement

A court judgment regarding the recovery of unjust enrichment from a foreign person may be enforced under enforcement proceedings.

The tax agent may select the venue of enforcement in accordance with location of the foreign person’s property at whose expense the court judgement can be enforced.

If the foreign person has property within Russia, unjust enrichment may be recovered from such property through enforcement proceedings being initiated under the rules for which Federal Law No. 229-FZ “On enforcement proceedings” dated 2 October 2007 provides (article 10 and article 33(2) of the Law).

Otherwise, the court judgement adopted by the Russian court may be enforced within a foreign state in accordance with the place of registration of the debtor or the location of the debtor’s property.

The procedure for the decisions of Russian state courts to be recognised and enforced within foreign states may be set out in bilateral agreements on legal assistance between Russia and the states within which the enforcement is to take place, and in multilateral international treaties involving Russia.

Inter-state agreements may provide for various procedures for filing documents, for example:

- 1) with a Russian court that has made a decision (the court independently forwards the documents to the competent authority of the state within which the recognition and enforcement of the court judgement is claimed);
- 2) through the local authority of the Russian Ministry of Justice which subsequently transfers the documents to the competent authorities of the foreign state.

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Depending on the provisions of the applicable national legislation of the foreign state, the procedure for considering a petition to recognise and enforce a court judgement may differ (in certain cases the relevant petition may be considered either through a court hearing or without such a hearing).

What to think about and what to do

When taxpayers (tax agents) perform and plan their activity with the involvement of foreign persons, taxpayers (tax agents) in most cases face legal uncertainty with regard to whether tax must be imposed on the income paid for the benefit of the foreign person as well as with the issues relating to tax erroneously not being withheld for various reasons.

If the tax agent has paid the tax at its own expense or if the tax authority has recovered the tax at the tax agent's expense, the agent has the opportunity to recover the amount from the counterparty which is a foreign person based on the provisions on unjust enrichment (which is illustrated in the case of the Organising Committee).

[1] Resolution of the Commercial Court for the North Caucasian Circuit dated 6 August 2018 in case No. A32-23373/2015.

[2] Autonomous Non-Profit Organisation Organising Committee of the 2014 XXII Olympic Games and XI Paralympic Winter Games in Sochi (also the "Organising Committee").

[3] In accordance with article 309(1)(7) of the Russian Tax Code (the "Tax Code"), income from the leasing out of property used within Russia is subject to tax at the rate set out in article 284(1,2), which is 20% of the listed amounts.

[4] Resolution No. 57 of the Plenum of the Russian Supreme Commercial Court "On certain issues arising when commercial courts apply part one of the Russian Tax Code" dated 30 July 2013.