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Foreign Companies Challenging Tax System

By Rachel Nielsen

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When Sergei Pepeliaev argued a tax case for the Severny Kuzbass mining concern last year in the Supreme Arbitration Court Presidium — the highest court that could rule on a foreign tax matter — there were a number of factors in his favor.

The Pepeliaev Group founder had more than two decades of tax litigation experience, three other arbitration courts in Russia had ruled in favor of Severny Kuzbass and international tax treaties prohibit double taxation of foreign companies and their Russian subsidiaries.

In a sign of what global companies are up against in the Russian tax system, however, the outcome wasn't in Pepeliaev's favor. In December, the Presidium ruled for the Federal Tax Service and against Severny Kuzbass.

In spite of that ruling — or perhaps because of it — corporate lawyers are now seeing an opportunity to win back money for companies by challenging the way Russian courts treat foreign companies operating here. What's more, there have been tax cases among European countries in the past year, including European Union cases during the last four months, that are encouraging lawyers in Russia to press their cases.

Corporate law firm CMS is researching "whether there would be Russian companies or investors in Russia who would be interested in bringing some claims" against tax authorities, said Andre Loup, a lawyer and senior associate with CMS in Moscow. In the European Union, CMS is already trying "to identify some countries where there's potential to bring some claims," Loup said in an interview. He said CMS could represent EU companies in such cases.

Loup was one of several international tax lawyers who discussed "tax discrimination" against foreign companies in Russia at the Novotel Moscow Centre on Tuesday. At a workshop organized by the French-Russian Chamber of Commerce and Industry and the Russo-British Chamber of Commerce, the Severny Kuzbass case was a major talking point.

"I don't think they fully understand the tax impact they are creating for themselves," Baker&McKenzie's Kirill Vikulov said of the Supreme Arbitration Court Presidium and the Severny Kuzbass ruling.

Vikulov, a lawyer and an associate at the corporate law firm's Moscow office, called the Severny Kuzbass decision "groundbreaking."

In an interview following the workshop, Loup took a negative view of the ruling. "It was a bad decision," he said.

Among major shareholders in Severny Kuzbass, a coal-mining company in western Siberia, is ArcelorMittal Holdings, the global steel and mining concern headed by Lakshmi Mittal and based in Luxembourg, according to the Severny Kuzbass website. In 2007, Severny Kuzbass received a loan from steelmaker Severstal, and that loan was transferred to Mittal Steel and then to ArcelorMittal Finance, according to Vikulov's workshop handout.

The Federal Tax Service informed Severny Kuzbass that the interest on the loan wasn't deductible, while the company argued that it was deductible under Russian tax rules.

Severny Kuzbass won the right to the Russian tax deduction in three arbitration court cases, but the Federal Tax Service appealed the third ruling to the Supreme Arbitration Court, said Andrei Tereshchenko, a Pepeliaev Group partner who was involved in preparing the case. The way the Russian tax service applied the tax law was "unfair taxation," Tereshchenko said in a telephone interview.

The tax treaties that Russia has with numerous countries, including China, the United States and 24 countries in the European Union, generally prohibit double taxation, or assessing the same tax in both of the countries under the treaty. Each of the treaties with the 24 EU countries has an anti-discrimination clause, Loup said.

Such treaties essentially force a country to avoid taxing a company at a higher rate just because it is registered in the other country.

The treaties also let companies keep a higher percentage of various income sources, such as dividends and tax deductions. They also stimulate foreign investment. According to Loup and Tereshchenko, the fact that Cyprus, Luxembourg and the Netherlands have favorable tax terms with Russia is the reason those three European countries are some of the biggest investors here.