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This issue contains a brief summary of Resolution No. 53 “On Estimation by Arbitrazh Courts of the Justification for Obtaining Tax Benefit” of 12.10.06 by the Plenum of the Higher Arbitrazh Court (HAC Plenum).

- The Russian HAC Plenum stated that a **tax benefit** means a decrease of tax liability, **in particular** as a result of tax base reduction, application of tax deduction, tax relief, application of a lower tax rate and the right to recovery/offset or refund tax from the state budget. At the same time it's supposed that the actions of the taxpayer aiming to obtain a tax benefit are economically justified and documented (*paragraph 1 of the Resolution*).

Effectively, the Russian HAC has abandoned the term “unconscientious taxpayer”, which was widely used in court practice, and introduced the concept of “unjustified tax benefit”. The wording adopted by the Russian HAC is rather broad and so the deduction of expenses in calculating the profits tax base is likely to be interpreted as a tax benefit (*section 1 of the Resolution*).

- The Russian HAC Plenum declared that submission to the tax authorities of all the duly issued documents established by legislation on tax and levies constitutes grounds for tax benefits. However, this provision shall apply only if the tax authorities fail to prove that the information contained in these documents is incomplete, unreliable and/or contradictory (*section 1 of the Resolution*).
- The HAC Plenum stated that the possibility of achieving the same economic result with a smaller tax benefit received by the taxpayer does not constitute grounds for considering the tax benefit as unjustified, but only if the taxpayer conducts operations that are established or not prohibited by law.

Elaborating on this statement, taxpayers have the right to plan their business activity and choose a way of doing business while taking due account of their tax liabilities. However, any actions performed solely in order to obtain tax benefits are unlawful (*section 4 of the Resolution*).

- The Russian HAC Plenum provided a list of conditions under which tax benefits can be regarded as unjustified. In particular, if for tax purposes the taxpayer included transactions not in accordance with their actual economical meaning or included transactions that did not have any reasonable economical or other matters (or business purposes). It means that tax benefit can not be considered as justified if the taxpayer applied it other than in connection with business activity (*sections 3, 4 and 5 of the Resolution*).
- The Russian HAC Plenum specified conditions which cannot by themselves constitute the grounds for considering a tax benefit unjustified. However, if a court considers them as a whole structure, the parts of which are correlated with other provisions specified in the Resolution, it can decide that the tax benefit obtained by the taxpayer is unjustified (*section 6 of the Resolution*).
- The Russian HAC Plenum stated that when re-qualifying legal nature of civil transactions, courts should take into account the fact that transactions not in compliance with a law or other legal acts as well as fraudulent and sham transactions are invalid regardless of whether or not the court classified them as such by virtue of Article 166 of the Russian Civil Code (*section 8 of the Resolution*).

Consequently the Russian HAC clarified that when changing the legal status of transactions under Articles 168 and 170 of the Russian Civil Code the tax authorities should not file a separate claim to court for invalidating a transaction.

- The Russian HAC Plenum declared that tax benefits cannot be regarded as a separate business objective. The actions of a taxpayer should be aimed at generating an economic effect as a result of conducting actual business or other economic activity. Tax benefit obtained by a taxpayer shall not

be regarded as justified or unjustified depending on the methods of attracting or effective use of capital for conducting economic activity (*section 9 of the Resolution*).

- The Russian HAC Plenum stated that the fact that the taxpayer's counterparty failed to meet its tax obligations does not by itself prove that the tax benefit obtained by the taxpayer is unjustified. However, tax benefits can be considered unjustified if the taxpayer acted without due care and caution and should have been aware of violations made by its counterparty (*section 10 of the Resolution*).
- The Russian HAC Plenum declared that recognizing a particular tax benefit as unjustified shall not affect other rights of the taxpayer provided for by legislation on tax and levies (*section 11 of the Resolution*).

For more detailed comments on the above, please contact the Tax Dispute Resolution Group, PricewaterhouseCoopers CIS Law Offices B.V. in the Moscow office of PricewaterhouseCoopers Russia at (495) 232-5757.

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