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Taxation of dividends paid out of undistributed profits of previous years

The Supreme Arbitrazh Court of the Russian Federation clarified some matters considering taxation of dividends paid out of the undistributed profit of prior years in decision No. VAS-13840/12 dated 29.11.2012 (hereinafter the "Decision").

The Decision was made on a claim of OJSC "Sibirskaya energeticheskaya kompaniya" (hereinafter the "Company"): the Company challenged the legitimacy of the Ministry of Finance of the Russian Federation's Letter No. 03-03-10/34 dated 04.04.2012 (hereinafter the "Letter").

The Letter suggests that there are no grounds to apply the zero profit tax rate provided by the sub-clause 1 of clause 3 of article 284 of Tax Code of the Russian Federation to the dividends which Company pays in 2011 to its shareholder out of the undistributed profits of previous years in case when the Company gained no net profit in 2010.

The Ministry of Finance of the Russian Federation alleged that the dividends (cl.3 of article 284 of the Tax Code of the Russian Federation) paid after 01.01.2011 out of undistributed profit gained over the periods before 2010 shall be taxable by profit tax at the rate of 20 percent. Such conclusion has been derived from amendments to the Tax Code of the Russian Federation introduced by the article 5 of the Federal Law No. 368-FZ dated 27.12.2009 (hereinafter the "Law 368-FZ"). Particularly, the Law 368-FZ provided that the provisions of the clause 3 of article 284 of the Tax Code of the Russian Federation should be applied only to the dividends assessed on the basis of the operating results of the company in 2010 and in subsequent periods from 01.01.2011.

The Supreme Arbitrazh Court of the Russian Federation came to conclusion that the clarifications contained in the Letter contradict to the legislation. The Supreme Arbitrazh Court stated that provisions of the article 5 of the Law 368-FZ refers to operation of amendments introduced by the same Law 368-FZ, and do not impose any additional restrictions which are not explicitly mentioned in clause 3 of article 284 of the Tax Code such as prohibition to apply zero tax rate in case of distribution of dividends out of undistributed profits of previous years. The Supreme Arbitrazh Court clarified that the net profit and the undistributed profits are identical in their economic nature, so that it precludes the applying different tax regime to them. It is emphasized that the interpretation provided by the Ministry of Finance in the Letter leads to the establishing of the new tax regulations regarding the dividends and changes the tax calculation procedure regarding the distribution of the profit collected before 2010. Thereof, the said interpretation contradicts with the provisions of clause 2 of article 5 of the Law 368-FZ. Taking the foregoing into account the Supreme Arbitrazh Court declared the Letter as non-effective in full.

The Supreme Arbitrazh Court made its statements on the issue of normative (statutory) nature of the Ministry of Finance's letters in its practice earlier. Thus, it was stated in decision No. 5182/06 dated 06.03.2007 that in case when the interpretations of Ministry of Finance are sent to lower tax authorities for use in work and for information of the taxpayers they should be qualified as a normative (statutory) instruction issued by the authorized federal executive body, for such interpretations (1) do not exclude the possibility of multiple applying the provisions which they contain, (2) produce legal effects for indefinite range of persons, and (3) can be used in work of tax authorities during the tax control measures.

However, the Ministry of Finance maintains the position that such letters (which addressed to the Federal tax service and not to applicants personally) are lacking the status of normative (statutory) acts, they do not contain any statutory rules and do not direct to establishment, amending or cancellation of statutory rules (Letter of the Ministry of Finance of the Russian Federation No. 03-02-07/2-138 dated 07.08.2007).

It is worth noting that later the Federal Tax Service provided its lower territorial departments with the explicit instruction to follow the established case-law and court decisions entered into legal force in their practical activity with the aim to reduce the number of lawsuits lost by the taxpayers and exclusion of adoption of court decisions to the disfavour of tax authorities due to the decisions made as a result of tax inspections and participation in court processes with taxpayers (Letter of the Ministry of Finance of the Russian Federation No. SHS 6 18/716@ "On a procedure of appliance of Ministry of Finance of the Russian Federation's explanations regarding the matters of appliance the legislation of the Russian Federation on taxes and tax collections" dated 14.09.2007).

Taking into account the specified positions established since 2007 in the Supreme Arbitrazh Court practice, on the one hand, and the tax authorities practice, on the other hand, the Decision came to conclusion that interpretation provided by the Ministry of Finance in the Letter leads to the establishing of the new tax regulations regarding the dividends and changes the tax calculation procedure in considered case. Therefore, the Letter meets the criteria of a normative (statutory)act – with the reference to criteria provided by the Ministry of Finance itself: namely, it establishes and amends the statutory rules (Letter of the Ministry of Finance of the Russian Federation No. 03-02-07/2-138 dated 07.08.2007).

The Supreme Arbitrazh Court continues to apply consistently its established approach in assessment on normative (statutory) nature of the letters of the Ministry of Finance based on the idea that their content should prevail over the formal criteria. It's worth noting that the Ministry of Finance in spite of the relevant negative court practice maintains the opinion that the letters issued by the Ministry of Finance do never meet the criteria of normative (statutory) act.