

CREATION OF SERVICE PERMANENT ESTABLISHMENT IN RUSSIAN FEDERATION WHEN PROVIDING R&D SERVICES BY FOREIGN SPECIALISTS**

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The subject. The author examines the criteria of creation of service permanent establishment (PE) in Russia and possibility of creation of this type of PE in providing R&D services in Russia by foreign specialists.

The aim of the paper is to confirm or refute the hypothesis that the provision of R&D services by foreign specialists in Russia creates a service permanent establishment. The author also analyzes the current science legislation of Russia and suggests ways of its improvement to reduce tax risks.

The methodology. The author used general scientific dialectical method of scientific knowledge, the formal-logical method, in particular analysis and synthesis in examining criteria of creation of service permanent establishment. The author also uses a systematic method and a simulation method to establish the relationship between the science legislation and tax legislation.

The main results. The activity of foreign scientific specialists in Russia potentially originates the risk of creation of a permanent establishment on the territory of the Russia for the foreign organization, which sent that specialist to provide the relevant services. However, when comparing the international and domestic law enforcement approach, the author revealed a feature of the latter, which consists in applying the criteria of the physical type of permanent establishment to a service permanent establishment, which in turn gives rise to legal uncertainty and the risk of double taxation in some situations. There is no relevant judicial practice on the topic. Budgetary scientific organizations have a certain priority over commercial scientific organizations when involving foreign specialists in R&D activities in Russia.

Conclusions. The criteria for the creation of service permanent establishment (including the provision of R&D services) in domestic practice have an ambiguous, evaluative interpretation. However, the risks of discretion in assessing the criteria for creation of service permanent establishment can be eliminated by clarifying these criteria in the Tax Code of the Russian Federation. Amendments to the science legislation can also eliminate above and foregoing risks.

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1. Introduction

The improvement of science and technology is an inevitable process that stimulates the growth of the economy and the development of the state. In the domestic scientific literature, there are studies confirming the positive effect of investment in R&D, which give a tangible impetus to the introduction of domestic enterprises to international markets [1]. According to the Global Innovation Index for 2019 Russia ranks 46th out of 129 in the ranking of world countries in terms of innovative development [2]. Experts say that due to the lack of domestic researchers with the necessary qualifications, it is necessary to look for them in the international intellectual labor market [3, p. 136]. Some authors assess the overall economic situation in Russia as critical and associate it with the results of the reforms of the 1990s, as well as critical financial and technological dependence on geopolitical opponents [4, p. 37, 47].

However, it is necessary to agree with the well-known statement that science has no nationality, and the above-mentioned circumstances indicate that the influx of foreign scientists to Russia is necessary for the development of the domestic sector of science and economics. Russia currently takes the position of developing countries that often use the technologies of developed countries and interested in the dissemination of technological information and knowledge [5, p. 140]. However, the activities of foreign specialists in Russia potentially create tax consequences for foreign enterprises. One of them is the risk of deeming a permanent establishment of a foreign enterprise, which is traditionally a debatable issue in the domestic tax law [6–9].

At the present stage of the development of the world economy, regional integration unions play an active role. The authors note that their popularity is associated with the slow and difficult process of trade and investment liberalization at the multilateral level, the lack of progress in international trade negotiations [10, p. 519]. From the point of regional integration,

the most significant for Russia is its participation in the BRICS and the EAEU. In our opinion, any integration process may sooner or later face the problem of tax competition and the priority of tax sovereignty over the above-mentioned advantages of liberalization of economic relations between states. Tax experts rightly point out that this is a point of tension between the interests of the member states of the integration union, who need to increase their incomes, and the interests of the integration union itself, whose interest is to create an internal market [11, p. 189].

From January 1, 2020, a single market for research and development services and implementation in the field of social sciences and humanities began to operate on the territory of the EAEU (hereinafter - the single market for R&D services, R&D services). The formation of a single market for R&D services is now receiving close attention of the scientific community both in individual articles [12–14] and in monographic studies [15, 16]. Specialists also consider the issues of labor migration [17], which, among other things, have an impact on the formation of a single market for R&D services.

It seems reasonable to study the possibility for foreign specialists to provide R&D services in Russia and, in this regard, the deeming a permanent establishment of a foreign enterprise in Russia, since the functioning of single market for R&D services potentially expands the attraction of scientists from the EAEU member states. In addition, according to statistics, Russia (out of all EAEU member states) holds a leading position both in number of organizations and number of personnel who perform research and development activities¹. Therefore, at the initial stage of the formation of a single market for R&D services, Russia can act as a center that unites the scientific potential of all EAEU member states.

2. The state of science legislation in Russia:

¹ See the website of the Eurasian Economic Commission, section “Socio-economic statistics. Science and Innovation” [Electronic resource] URL: http://www.eurasiancommission.org/ru/act/integr_i_makro/ec/dep_stat/econstat/Pages/science.aspx (accessed: 02.12.2020)

the need and possibility of participation of foreign specialists in the provision of R&D services in Russia

Scientific and (or) scientific and technical activities in Russia are regulated by Federal Law No. 127-FZ of August 23, 1996 “On Science and State Scientific and Technical Policy” (hereinafter — Federal Law No. 127). In accordance with paragraph 1 of article 3 of the Federal law No. 127, scientific and (or) scientific-technical activity is carried out by private persons — citizens of the Russian Federation, foreign citizens, persons without citizenship within the rights established by the legislation of the Russian Federation and the legislation of constituent entity of the Russian Federation, and corporate persons, provided that scientific and (or) scientific-technical activities are stipulated in their corporate establishment documents.

As a general rule, scientific activity is not subject to licensing, but it is possible to control and license certain types of scientific and scientific-technical activities in Russia². Such control by the state is aimed at activities that are either carried out at the expense of budget funds³, or are associated with research that is critical for the state (society)⁴. Similar conclusions can be found in the scientific literature on labor law [18].

According to paragraph 1 of Article 4 of Federal Law No. 127, a researcher is a citizen who has the necessary qualifications and is professionally engaged in scientific and (or) scientific-technical activities. Positions of

researchers are provided for both in scientific organizations and in organizations that carry out educational activities for the implementation of educational programs of higher education and additional professional programs, as well as in other organizations that carry out scientific and (or) scientific-technical activities. This indicates that the qualification requirements for a researcher can be established only if he works in a scientific or educational organization. At the same time, these provisions of the law do not apply to private customers of R&D services and do not oblige them to apply the above-mentioned requirements to R&D performers.

Specialists engaged in the study of the regulation of labor relations of scientists, in this regard, distinguish the following categories [19]:

- 1) researchers of the Russian Academy of Sciences;
- 2) researchers of higher educational institutions;
- 3) researchers of state research institutions;
- 4) researchers of commercial and non-commercial legal entities;
- 5) foreign researchers who have entered into labor relations in Russia.

We believe that the statement that the provision of services in developing countries by enterprises from industrialized countries can be very profitable is also true for the provision of R&D services, since industrialized countries also demonstrate a high level of people employed in R&D sector. According to the OECD data for 2017, 40% of all R&D business is concentrated in Canada and USA, 55% – in Germany and Japan. The headquarters of 2 000 world's largest R&D corporations are located in a few countries, including USA, Japan, and China. Japan, Korea, and the United States account for more than 62% of artificial intelligence-related inventions [20]. It is obvious that specialists, including those from the above-mentioned countries, will be invited to other national markets both for the purpose of conducting new research and for implementing existing developments.

Statistics also indicate that the commercial component in R&D sector in developed countries is significant. Thus, the main source of funding for

² See Article 10 of Federal Law No. 127-FZ of August 23, 1996 “On Science and State Scientific and Technical Policy”.

³ For example, the Government of the Russian Federation exercises control over the protection and use of the results of scientific research in accordance with the Regulation on the implementation of control in the field of legal protection and the use of the results of scientific research, experimental design and technological work for civil purposes carried out at the expense of the federal budget, approved by the Resolution of the Government of the Russian Federation No. 696 of November 18, 2006.

⁴ For example, see Article 6 of the Federal Law No. 86-FZ of July 5, 1996 “On State Regulation in the Field of Genetic Engineering”.

science in Russia is state funds (67.8%). Its amount is much lower in developed countries: USA (33.4%), Germany (30.3%), Japan (16.4%), Israel (14.8%), and the most significant source of financing is the funds of the business sector: Japan (76.5%), China (73.9%), South Korea (73.7%). Share of foreign sources of financing is significant in some countries: Israel (42.8%), Great Britain (17%), Sweden (10.9%). The use of non-state sources, especially foreign sources, indicates a significant business application component in scientific developments abroad [21, p. 76]. Analyzing these indicators, one can conclude that investments in science and the involvement of foreign researchers have a positive impact on the development of science in a particular state.

One of the ways to solve the problem of Russia's lag in science, experts see in the creation of a public-private partnership that can help to develop cooperation between scientific institutions and higher education institutions with the real economy [22, p. 212]. In addition, some authors note that the success of R&D activity depends on the effectiveness of the mechanism for protecting the results of intellectual activity, since there is a problem in Russia of technology leakage and its illegal implementation in other countries; indicate that a significant part of intellectual property in creating the gross national product and added value is based on the effective functioning of the country's system of legal regulation of the creation of intellectual property, motivation and incentives for employees to register intellectual property rights, and then transfer the object of intellectual property to the user who can use it most expediently [23, p. 67].

The science legislation of Russia allows the participation of foreign researchers in the activities of commercial organizations, including R&D activities, if they are not carried out at the expense of budget funds. However, the absence of explicit restrictions in the legislation on access to the national market of R&D services does not always indicate its openness. Some authors note that the development of cooperation in the field of science and innovation within the EAEU is

quite limited by the fact that private capital and interested parties are not allowed to participate in such projects to a sufficient extent in order to improve the quality and level of economic development of the entire economic union [24]. Nevertheless, research on the market of R&D activities within the framework of the EAEU shows that all states support the principle of freedom of scientific activity (creativity), guaranteed by the Universal Declaration of Human Rights (Article 27) and the constitutions of the EAEU States [25, p. 336]. In addition, the formation of a single market for R&D services applies only to the implementation of research for private (commercial) customers, since state (municipal) procurement and state support measures are directly removed from the scope of the Liberalization Plans [25, p. 337].

In our opinion, the above suggests that the current state of science legislation in Russia does not prevent the access of either foreign researchers or foreign enterprises to the domestic market of R&D services. However, the legal regulation of this field has some gaps and problems, the solution of which will allow to increase qualitatively and quantitatively the indicators of domestic science and bring it closer to the level of the leading world countries.

3. Service permanent establishment: the concept and criteria of creation (international and Russian approach)

It appears that the market for R&D services is mainly formed by corporate entities, bearing in mind that private persons can rarely conduct large-scale or fundamental scientific research. Since both foreign enterprises and foreign private persons can perform R&D activities in Russia, tax consequences may follow such provision of R&D services in Russia by foreign enterprises and private persons. As we stated in the introduction to this paper, the activities of foreign specialists on the territory of Russia creates a risk of deeming a permanent establishment of a foreign enterprise. In terms of the provision of services, the deeming of a permanent establishment of a foreign enterprise has its own characteristics and distinctive features.

In the theory of tax law, a permanent establishment is defined as the tax status of a foreign legal entity in the territory of the income source state. Specialists define such status as a fiction [26, p. 129], as the degree of presence of foreign organizations in the state where they are not recognized as tax residents, but from the territory of which they derive income through the carrying out activities [27]. With the use of the term permanent establishment, it becomes possible to correctly assess the degree of tax presence of a foreign enterprise in the national jurisdiction of a third state, which most countries understand as generating a duty to pay taxes [28, p. 2].

Typically, permanent establishments are divided into two types: the main (physical PE) and agency (agency PE). Among other types of permanent establishments, the authors also mention the service permanent establishment (service PE) [29; 6, p. 19; 7, p. 64–65]. However, this type of permanent establishment is not widely represented in the Russian scientific literature. In our opinion, it can be explained by:

1. Features of the structure of Article 5 (Permanent establishment) in model tax conventions (in terms of the provisions of the service PE UN Model DTC and the OECD Model DTC have some differences, namely: provisions of service PE are rightly established in Article 5 of the UN Model DTC, while in OECD Model DTC it is mentioned only in the Commentary to Article 5 of the OECD Model DTC);
2. The fact that historically the UN Model DTC was issued later than the OECD Model DTC and to a large extent UN Model DTC uses the principles of the OECD Model DTC (respectively, most of the double tax treaties are written on the basis of the OECD Model DTC. The state bodies of Russia also use the provisions of the OECD Model DTC in the process of formation of national tax policy) [30, p. 160].

Nevertheless, according to experts, many countries include service PE rules in their double tax treaties (42 percent of all treaties contain

such rules as of 2013 year) [29]. In addition, the service sector is one of the most promising sectors of the world economy, which is rapidly accelerating. With the complexity of production and the saturation of the world market with goods, the need for services is growing [31, p. 10]. So, it is possible to note the practical relevance in the study of service PE.

According to both mentioned model DTCs an enterprise of a Contracting State shall be deemed to have a service PE in other Contracting State when three following conditions are met: (1) provision of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose; and (2) if services are provided for the same or a connected project; and (2) if the services are provided for a certain period of time⁵. All three of these conditions must be met together.

In addition to both mentioned model DTCs and double tax treaties, Russian national legislation also have the service PE provisions⁶. In accordance with paragraph 4 of Art. 5 of the Model tax convention of the Russian Federation, permanent establishment also encompasses the provision of services in other Contracting State (1) through an individual for more than 183 days in any 12-month period, and during this period more than 50 percent of the gross income from active business activities of the enterprise falls on such services, or (2) the provision of services for more than 183 days in any 12-month period, and these services are provided for the same or a connected project, by one or more individuals who are present and provide such services in that other State.

According to subparagraph 5 of paragraph 2 of Article 306 of the Tax Code of the Russian

⁵ The specified time period must be more than 183 days in aggregate in any 12-month period.

⁶ For the purpose of concluding of double tax treaties, the Government of the Russian Federation has developed the form of a Model tax Convention, which was approved by the Decree of the Government of the Russian Federation No. 84 of February 24, 2010 “On the conclusion of interstate agreements on the avoidance of double taxation and on the prevention of tax evasion on income and property”.

Federation, provision of services included in the list of activities that result in a permanent establishment in Russia. At the same time, the Tax Code of the Russian Federation does not specify the types of services. Scientific research is usually of a project nature, i.e., specialists are faced with the task to conduct relevant research over a certain period of time and to record its result. The exact terms of scientific projects are determined by their specifics, but one can find some summary data on their duration. For example, according to the Foundation for Advanced Research, in practice, the duration of the Foundation's projects is from 1 to 5 years⁷. We believe that this period is valid for the implementation of most R&D projects. Taking into account the fact that R&D services are usually of a project nature with a long duration of such projects (more than 183 days), the provision of such services by foreign specialists in Russia result in a service PE, both under international legal acts and domestic tax legislation.

A number of double tax treaties concluded by Russia with other states also have provisions on a service PE⁸. However, there are treaties where the provision of R&D research does not result in a service PE⁹, since R&D research is considered there as a preparatory or auxiliary activity. In such treaties expressly states that the term “permanent establishment” does not include, inter alia, the maintenance of a fixed place of business solely for R&D research or any other similar activity of a preparatory or auxiliary nature.

4. Service permanent establishment: features of Russian law enforcement

The courts, the Ministry of Finance and the Federal Tax Service do not currently consider the

provision of services as a specific type of business activity that result in a service PE in Russia. In our opinion, this may lead to incorrect taxation of R&D services and slow down the development of the EAEU single market for R&D services in its Russian part.

The explanations of the regulatory authorities on the application of subparagraph 5 of paragraph 2 of Article 306 of the Tax Code of the Russian Federation indicate that the Ministry of Finance and the Federal Tax Service interpret the provision of services as a business activity in general¹⁰. There is no case law in Russia on the application of subparagraph 5 of paragraph 2 of Article 306 of the Tax Code of the Russian Federation when the provision of services considered as a specific business activity. In such cases the courts investigate and evaluate general criteria result in a permanent establishment, namely: the regularity of business activities in Russia¹¹.

Experts note that the most common causes of legal conflicts in the field of taxation are the legal and technical imperfection of tax norms and the persistent distortion of their meaning in law enforcement practice [32, p. 344]. A well-known problem for taxpayers in Russia is also the discretion of the law enforcement authorities and the determination of the place of explanations of the tax authorities, which A.V. Demin has indicated in his research [33; 34]. In the case of a service PE (if in practice it is defined through general criteria that are not peculiar to it), we can say that its meaning is distorted by law enforcement authorities. In turn, this creates a potentially negative background for attracting foreign enterprises and specialists in Russia due to the lack of necessary legal certainty.

The Ministry of Finance and the courts in Russia refer in their explanations and decisions not only to national legislation, but also to the

⁷ See the website of the Foundation for Advanced Research, section “Answers to frequently asked questions” [Electronic resource] URL: <https://fpi.gov.ru/faq/> (accessed: 02.12.2020)

⁸ For example, provisions of service PE can be found in double tax treaties with Argentina, China, Luxembourg, Singapore, etc.

⁹ See, for example, double tax treaties with Italy, Mexico, Thailand, Switzerland.

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¹⁰ See, for example, Letter of the Federal Tax Service of the Russian Federation for Moscow of February 28, 2005 No. 20-12 / 12453; Letter of the Ministry of Finance of the Russian Federation of August 19, 2005 No. 03-08-05.

¹¹ See, for example, Resolution of the FAS of the Far Eastern District of April 03, 2008 No. F03-A59/08-2/802 in case No. A59-1208/06-C24.

Commentaries on OECD Model DTC. Statistics show that the number of court decisions on tax cases that refer to various OECD documents increases annually (from eight to more than 150 for the period 2010-2016, without an increase of the number of cases concerning the application of international tax agreements). In most tax cases Russian courts refer to the Commentaries on OECD Model DTC [35]. In legal literature such acts are named “soft law”. The most important function of “soft law” domestic tax law researchers calls the assistance that it provides in the interpretation of official sources of law [36, p. 67]. The stated attitude to the “soft law” acts can be supplemented by the point of view that these comments and additions exactly play a fundamental role in determining the status of the activities of a foreign enterprise that result in a permanent establishment [37, p. 48].

In our opinion, it is currently impossible to clearly define the role of “soft law” acts, since each of these documents is aimed at solving independent problems in the field of taxation¹². However, it is worth noting that together with the model rules, they create a basis for the uniform application of the provisions of Model DTCs.

5. Conclusions

The provision of R&D services by foreign specialists sent by a foreign enterprise to work in Russia potentially creates a risk that such a foreign organization will be deemed to have a service PE in Russia. At the same time, from the point of view of acts of international law, including “soft law” acts, the creation of such type of permanent establishment is based on several interrelated conditions: 1) provision of services by employees (personnel) of a foreign enterprise 2) within the same or related project 3) for a certain period of time (more than 183

days during a 12-month period).

Article 306 of the Tax Code of the Russian Federation, as well as the approach of Russian law enforcement authorities, when considering the creation of a service PE, are based on the general provisions and principles on creation of permanent establishment, which, in turn, leads to legal uncertainty: when analyzing the activities and actions of the taxpayer, the tax authorities and the courts rely on their own interpretation of tax legislation since the time period for creation of service PE is not currently defined in the Russian Tax Code, although in the Model tax convention of the Russian Federation and several double tax treaties such term is defined.

In turn such legal gap creates the risk of discretion in the absence of double tax treaty, i.e., different assessment of the actual circumstances of the case by law enforcement authorities. This may not only lead to the formation of an ambiguous case law in Russia, but also creates a risk of double taxation for a particular taxpayer.

The amendments to the Tax Code of the Russian Federation in terms of definition of time period of provision of services by foreign employees (personnel) in Russia, which result in service PE, can be one of the ways to eliminate this risk. The current wording on service PE available in Model tax convention of the Russian Federation may become the basis for these amendments.

Also, these risks can be eliminated by amending other regulatory legal acts. For example, in accordance with the Decree of the Government of the Russian Federation of February 6, 2012 No. 93, adopted pursuant to the subparagraph 8 of paragraph 4 of Article 13 of the Federal Law of July 25, 2002 No. 115-FZ “On the Legal Status of Foreign Citizens in the Russian Federation”, commercial scientific organizations that do not participate in state programs and are not residents of special economic zones are deprived of the opportunity to invite foreign researchers to work without appropriate permissions. It seems that it is necessary to extend the effect of this Decree to any commercial organizations whose main activity is scientific and (or) scientific-technical activities.

¹² For example, in addition to Commentaries on Model DTCs, the OECD’s BEPS (Base erosion and profit shifting) initiative is currently being actively promoted and used to counteract abuses of double tax treaties. BEPS contains 15 documents, each of which is dedicated to a separate problematic topic in the field of international taxation.

Today, such opportunities are available only to business companies and business partnerships created for the purpose of practical application (implementation) of the results of intellectual activity in accordance with Federal Law of December 29, 2012 No. 273-FZ “On Education in the Russian Federation” and Federal Law No. 127, i.e., educational organizations of higher education that are budgetary institutions or autonomous institutions, budgetary scientific institutions and autonomous scientific institutions.

Such amendments will make it possible to equalize the rights of budgetary and commercial scientific organizations and simplify the procedure for concluding labor contracts with foreign research teams. As a result, also can be transformed legal relations in the academic sphere between Russian commercial scientific organizations and foreign persons – from civil to labor relations, which eliminates the risk of creation of service PE in Russia.

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