

# The company is accused in business fragmentation. How to win a case against the Federal Tax Service

The article describes dangerous signs of business fragmentation that the Federal Tax Service notices. Only a quarter of decisions are made in favor of taxpayers, and a single IP address can become a reason for an audit.



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**T**he number of disputes related to business fragmentation for tax purposes has doubled since 2022. Pre-audit activities and on-site inspections on fragmentation issues are taking first place among the total number of control activities of the Federal Tax Service. In 2024, the legislator introduced the concept of business fragmentation into the Tax Code (Federal Law of 12.07.2024 No. 176-FZ).

In this article we will discuss:

- what the courts and tax authorities mean by business fragmentation;
- what signs of fragmentation are most often referred to by tax authorities;
- how to determine the beneficiary in a business splitting scheme;
- what signs of interdependence of persons are the most difficult to challenge in court.

## The sole purpose of splitting a business is to gain tax benefits.

At present, disputes regarding the illegal splitting of a business are based on the general provisions of Article 54.1 of the Tax Code on the prohibition of reducing the tax base or the amount of tax as a result of distorting information about the facts of economic life. The courts recognize the artificial division of a single

economic activity between several entities using special tax regimes. The sole purpose of such division is to obtain a tax benefit. In this case, information about the facts of economic life is deliberately distorted.

Most often, illegal splitting is recognized as the creation of structures using the simplified taxation system (STS). This is the easiest way to reduce the tax burden. But the tax authorities can also recognize the use of such preferential categories of taxpayers in the business structure as illegal splitting:

- IT companies;
- residents of the Scientific and Technical Center;
- Skolkovo residents.

Before the introduction of Article 54.1 of the Tax Code in 2017, when considering cases of business fragmentation, the courts relied on the Resolution of the Plenum of the Supreme Arbitration Court of 12.10.2006 No. 53 "On the assessment by arbitration courts of the validity of a taxpayer receiving a tax benefit" (hereinafter - Resolution No. 53). This resolution contained several theses that formed the basis for further judicial practice on fragmentation issues, as well as Article 54.1 of the Tax Code introduced in 2017:

- a tax benefit cannot be considered justified if the taxpayer received it outside of the context of carrying out actual entrepreneurial or other economic activity<sup>1</sup>;

- a tax benefit cannot be an independent business objective<sup>2</sup>.

Thus, the courts agreed with the additional assessment of taxes if the taxpayer received a benefit as a result of the artificial division of the business. At the same time, the division of the business itself is legal if the activity is real and bona fide.<sup>3</sup>

The courts still adhere to a similar position. Thus, the Volga District Arbitration Court decided that companies that applied the simplified tax system carried out real activities and therefore have the right to a tax benefit. The possibility of achieving the same economic result with a smaller tax benefit is not a reason for recognizing the tax benefit as unjustified.<sup>4</sup>

### **Additional taxes will be charged to the beneficiary**

When considering a dispute about splitting, it is necessary to understand who in the split group bears tax liability. The beneficiary in splitting is the person who:

- manages the fragmentation scheme;
- receives the main tax benefit from this scheme.

① paragraph 1, clause 4 of Resolution No. 53

② paragraph 2, clause 9 of Resolution No. 53

③ Constitutional Court decisions from 27.05.2003 No. 9-P, from 03.06.2014 No. 17-P

④ resolution AS of the Volga District from 15.04.2024 in case No. A57-1578/2023

⑤ decrees

Central District AS  
from 07.12.2023 in case  
No. A36-1120/2021,  
AS of the Volga District  
from 11/28/2023 in case  
No. A55-35233/2022

⑥ resolution

AS of the Volga District  
from 02/27/2024 in case  
No. A12-6276/2023

⑦ definition of the Supreme Court

from 12.08.2021 in case  
No. A27-7789/2020

⑧ Resolution 15AAC

from 05/25/2023 in case  
No. A53-26471/2022

If the tax authority fails to prove the combination of these features, the court will invalidate the decision made against the taxpayer. In this situation, it does not matter that the illegal splitting of the business has been proven. Thus, the court refused to assess additional tax because there was no evidence that the taxpayer managed the splitting scheme.<sup>5</sup>

But it is not always possible to prove that the taxpayer is not the beneficiary in the splitting scheme. Thus, the court noted that most of the legal entities participating in the splitting were created by one taxpayer. The taxpayer created companies under his control sequentially as the need for labor resources increased. These companies also had a similar type of activity. Taking into account these circumstances, the court decided that it was the taxpayer who organized the scheme and received a tax benefit.<sup>6</sup>

## A set of signs of illegal business fragmentation

Since splitting up in itself is not a violation of the law, the tax authority must identify and prove signs of illegality of such a business scheme and the resulting tax savings. In most cases, the courts evaluate several signs at once that indicate the illegality of the tax benefit received.

**Tax savings as the only goal.** Sun in 2021 confirmed the position of the Supreme Arbitration Court in Resolution No. 53, according to which obtaining income exclusively or predominantly through tax benefits when organizing a business cannot be considered as the main business goal<sup>7</sup>. A similar position was expressed by the 15th AAC, analyzing the activities of a group of persons<sup>8</sup>.

**Lack of real activity.** An important factor that determines the fact that the tax benefit obtained from splitting is illegal is the reality of the economic activity of the elements of the split. If the elements of the split do not conduct real activity, the courts may find that their existence is due only to tax savings, and not to a real business purpose. In such a case, the splitting of the business is illegal.

Thus, the court established that the taxpayer engaged contractors on the simplified tax system to provide services for the electronic declaration of goods and vehicles transported across the customs border.

At the same time, the persons involved did not conduct any real activity, and all services were provided by the taxpayer himself.<sup>9</sup>

In another case, the court sided with the taxpayer. The court noted that the group companies are independent subjects of economic and tax relations because:

- fulfill obligations under statutory activities;
- keep records of income and expenses;
- calculate taxes and keep records.

The court also assessed whether the companies had production facilities that allowed them to fulfill their obligations.<sup>10</sup>

**Interdependence of fragmentation elements.** Must have in view of the fact that interdependence as a circumstance indicating the receipt of an unjustified tax benefit has legal significance when such interdependence is used by the parties to the transaction for the purpose of carrying out concerted actions aimed at illegally understating the tax base.

The combination of signs of interdependence can also confirm the absence of reality of interaction between the elements of fragmentation and indicate a distortion of the actual meaning of the reflected operations.

The concept of “interdependence” in the context of tax disputes includes not only the “ordinary legal” interdependence provided for in Articles 20 and 105.1 of the Tax Code. Tax authorities pay significant attention to “actual” interdependence, when the elements of fragmentation are completely dependent on each other financially, organizationally, and managerially and represent a single economic entity.

Signs of interdependence include:<sup>11</sup>

- implementation of one type of activity;
- having one registration address;
- a single website on the Internet with a common reference service telephone number, a single ordering system, and a common list of addresses;
- single IP address;
- a unified pricing policy;
- use of a common trademark;
- the presence of identical suppliers, contracts with whom are concluded on the same terms, often signed by the same person;
- general management and administration, general accounting and the presence of a single personnel service;—
- accumulation of profits in one person;
- provision of loans by interdependent organizations to each other.

<sup>9</sup> resolution  
AS of Moscow District  
from 01.02.2023 in case  
No. A40-89752/2022

<sup>10</sup>th resolution  
AS of the Volga District  
from 15.04.2024 in case  
No. A57-1578/2023

<sup>11</sup> resolutions 9AAC  
from 13.10.2023 in case  
No. A40-51225/2023,  
from 10.06.2024 in case  
No. A40-148182/2023

**Controllability of persons to each other.** This concept is close to the interdependence, and they are often used together in court decisions. However, “controllability” is a narrower concept, implying not just the presence of common resources, but also the exercise of managerial and financial control by one person over another. All elements of a fragmented group may be affiliated with each other. However, they are often controlled by only one person - namely, the one who is the beneficiary in the fragmentation scheme. This was also pointed out by the Federal Tax Service: the deliberate actions of the taxpayer may be evidenced by established facts of legal, economic and other controllability<sup>12</sup>.

<sup>12</sup> Letter of the Federal Tax Service dated 23.03.2017  
No. ED-5-9-547/@

<sup>13</sup> resolutions  
AS of Moscow District  
from 12.05.2023 in case  
No. A40-202957/2022,  
AS West Siberian  
districts from 06.06.2024  
in case No. A45-37428/2022

Controllability may be evidenced by the nature of the distribution of monetary, labor or other resources between companies. The courts include the following as signs of controllability<sup>13</sup>:

- the fragmentation elements do not have the necessary personnel; this may mean that the fragmentation element uses the personnel of another company in the group, which makes it controlled by this company;
- coincidence of IP addresses; such a coincidence may indicate that accounting and tax records for all elements of the split are maintained by the same persons, which makes it possible to identify the “main” company and the taxpayers controlled by it;
- concentration of cash flows and revenues on one person; it indicates that other persons are under his control, who cannot manage their own revenues and transfer them to the level of the “main” company. In this case, funds can be transferred as payment for fictitious services or in the form of loans;
- absence of any advertising costs on the part of the persons; this feature may indicate that several companies are using the same trademark and other commercial designations. Thus, companies that do not have their own designations, and therefore, image and recognition, are controlled by the company that owns the rights to these marks;
- a company incurring advertising costs when it does not have the product it is advertising.

**Example from practice.** The inspection assessed additional tax in the amount more than 170 million rubles, because the company created a business fragmentation scheme, distributing income between interdependent and controlled persons (IP) for the application of the simplified tax system.

The courts established that the company was created by three persons:

- Dense R.P.;
- Startsev S.I.;
- Titov A.I.

The company understated the taxable base because it attracted interdependent persons:

- IP Plotny R.P. (founder of the applicant);
- IP Startseva S.I. (founder of the applicant);
- IP Plotny A.R. (son of Plotny R.P.);
- IP Startsev E.V. (wife of Startsev S.I.);
- Individual Entrepreneur Shamrai S.S. (daughter of Startsev S.I. and Startseva E.V.).

The circumstances of the interdependence of the persons were not disputed. The courts supported the conclusions of the inspection that the activities of the company and interdependent persons were a single production process, and the division was formal. As evidence of the intent to deliberately split the business between the company and interdependent individual entrepreneurs, the inspection referred to the testimony of Startsev S.I., who explained that at the beginning of its activities, the company traded in petroleum products through its own gas stations, but the rise in prices for petroleum products led to



## The legislator introduced a definition of business fragmentation into the Tax Code. How will this affect judicial practice

After the introduction of Article 54.1 of the Tax Code, for a long time the tax authorities held the position that, due to the existence of many ways of doing business, it is impossible to formulate which actions would constitute illegal fragmentation and which would not.

But in 2024, when preparing large-scale changes to the Tax Code, the legislator formulated a definition of business fragmentation: "Business fragmentation is the division of a single entrepreneurial activity between several formally independent persons (organizations, individual entrepreneurs) (hereinafter in this article - a group of persons), over which control is exercised by the same persons, aimed exclusively or primarily at understating the amounts of taxes by applying special tax regimes in excess of the limits of the exercise of rights to calculate the tax base and (or) the amount of taxes provided for in Article 54.1 of the Tax Code" (Article 6 of the Federal Law of 12.07.2024 No. 176-FZ).

The above norm emphasizes that in the event of illegal fragmentation of a business, independence

the participating persons is formal, the actual control over them is exercised by the same persons, and their activities are aimed primarily at understating the tax amounts. Thus, the legislator identified the presence of a single activity, common controlling persons and the purpose of fragmentation as the main signs of illegality. Taking this into account, as well as the fact that the new definition is based on the provisions of Art. 54.1 of the Tax Code, it can be assumed that with a high degree of probability the entry into force of Federal Law No. 176-FZ of 12.07.2024 will not have a significant impact on judicial practice.

However, it can also be assumed that in the coming years, the courts will make more decisions in favor of the tax authorities. Currently, the share of decisions in favor of taxpayers in cases of fragmentation is quite high - about 25 percent. However, given the improvement of the methodology for conducting tax audits on fragmentation and the increase in the standards of evidence, we can assume that this share will decrease.



## The tax service automatically monitors whether companies have a common IP address

would lead to exceeding the maximum amount of income received, which gives the right to apply the simplified tax system. In connection with this, the founders decided to work by attracting individual entrepreneurs to the simplified tax system.

The court also rightly supported the tax authority's conclusion that the company is the ultimate beneficiary in the scheme applied.

<sup>14</sup> definition  
AS West Siberian  
districts from 08/26/2022  
in case No. A70-17448/2021

14.

### Some of the signs of interdependence cannot be disputed

Taxpayers most often cannot substantiate the presence of such signs of interdependence as:

- use of common labor resources;
- accounting and tax reporting by one person, reporting from one IP address;
- control or implementation of bank payments of different elements of the group by one person from one IP address.

These are key elements of business administration, and their transfer to other persons is difficult to justify. Thus, the court indicated as signs of interdependence the migration of officials and accounting for the entire group by one company<sup>15</sup>.

<sup>15</sup>th Resolution  
AS of the Volga District  
from 04/09/2024 in case  
No. A12-24987/2022

Tax authorities also pay attention to a single registration address and a single IP address used by group members. The presence of a common IP address is currently detected automatically by the tax authorities, and this factor alone may serve as a reason for an inspection.

<sup>16</sup> resolutions  
AS of Moscow District  
from 25.07.2024 in case  
No. A40-133527/2023,  
Central District AS  
from 14.03.2024 in case  
No. A35-5055/2018,  
AS Ural District  
from 19.06.2023 in case  
No. A47-7089/2021

It is practically impossible to justify the existence of a common IP address if taxpayers do not have lease agreements or contracts for the provision of accounting services with a company or individual entrepreneur operating at that address at the relevant address. When recognizing splitting schemes as illegal, courts also mention a single IP address from which access to the Client-Bank operating system is provided as a sign of interdependence<sup>16</sup>.

<sup>17</sup>p.9 tbsp. 6 Federal  
law of 12.07.2024  
No. 176-FZ

In 2026, a new legal institution will appear - the application of amnesty for business fragmentation<sup>17</sup>. A wave of cases related to the application of amnesty is expected.