

text
CHARALAMBOS SAMIR

RUSSIAN DE-OFFSHORISATION

A new law in Russia governing the taxation of International corporate groups comes into force in 2015, and with it new challenges and a new way of thinking for everyone involved in international structuring.

On 18 November 2014, the Draft Federal Law No. 630365-6 "Concerning the Introduction of Amendments to Parts One and Two of the Tax Code of the Russian Federation (Regarding the Taxation of the Profit of Controlled Foreign Companies and the Income of Foreign Organisations)" (the Law) was approved in the 2nd and 3rd hearings at the plenary meeting of the State Duma.

The new law on the taxation of controlled foreign companies (the 'CFC') received Presidential Assent on Monday 24 November 2014 and will come into force starting from 1 January 2015.

The main purpose of the Law is to set the legal framework and instruments for the Russian government to tackle tax avoidance by Russian taxpayers using international structures in jurisdictions with a low tax rate – and in many cases a zero tax rate.

The changes will influence all international corporate groups, as well as wealth planning and wealth management structures that are controlled or established by Russian resident individuals or companies. Some of the major changes are summarised below:

- The Law requires Russian tax resident individuals and companies to disclose ownership of foreign companies and wealth planning vehicles. Therefore full details of the ultimate beneficial owners must now be disclosed.
- It also imposes tax on them, regardless of whether the profits were distributed to the ultimate beneficial owners or not.

- Disclosure obligations apply to all Russian tax resident persons holding a share of over 10% in any foreign organisations and structures and on participation in CFCs. Moreover, special reporting rules are set out for foreign organisations holding Russian real estate directly or indirectly.

- Foreign organisations and non-corporate structures are deemed CFCs if they are controlled by Russian resident persons (individuals or companies). By default, a controlling person is defined as a person who directly or indirectly participates in over 25% (50% from 2015) of the share capital of foreign organisations or structures. However, a 10% participation share will be enough to deem a person to be a controlling person, if over 50% of the foreign organisation or structure is owned by any other Russian resident persons. The calculation of participation shares will take into account aggregated share percentages, with spouses and minor children included for the purposes of these rules. If default control does not apply, a person can still be deemed to be a controlling person on the basis of actual control criteria.

- Controlling persons will be subject to Russian tax on profits of CFCs.
- There are a number of exemptions from the taxation for certain categories of CFCs. The list of exemptions includes foreign organisations registered in treaty countries which also meet the effective tax rate test (75% of the average weighted tax rate, calculated on the





basis of the formula). It is worth noting that exemptions also apply to the taxation of CFCs' profits, but would not exclude reporting on CFCs for controlling persons.

- Exemptions apply to the profits of all CFCs up to 10 million RUB from 1 January 2017 (50 million RUB in 2015 and 30 million RUB from 2016).
- The Law provides for separate sets of rules on the non-territorial taxation of the disposal of Russian-based immovable property, and on the taxation of foreign companies managed and controlled from Russia, as well as a range of other provisions.

WHAT NEXT?

It goes without say that preparations for the changes in tax law should be initiated as a matter of urgency – if not already underway. Some of the steps that are deemed necessary to be taken are as follows:

- Analysing a group's corporate structure in order to identify companies affected by the CFC rules, including the proposed exemptions;
- Calculating the effective/blended tax rate for CFC purposes and the taxable profit of CFCs in compliance with the new legislative requirements (including determining the percentage of a CFC's passive income);
- Preparing and submitting CFC notifications and notifications of participation in foreign companies;
- Review of the foreign component of holding, financial, licensing and commercial structures, as well as the management structure of a group's foreign assets in light of the provisions of the Law;
- Development of foreign structures as an alternative to back-to-back ownership, financing and licensing structures;
- Strengthening of the management and control of foreign companies. In practice, many Russian corporate groups might not have an appropriate level of substance in the jurisdictions of incorporation of their holding, trading, financing or licensing structures. Consequently companies cannot show that the management, control

and day-to-day decision-making concerning business activities are taken in the country where such company is incorporated and located;

- Implementation of the proposed “de-offshorisation” measures will provide the Russian tax authorities with a legal mechanism for taxing structures with insufficient substance. Increased exchange of information will allow the authorities to track down those structures and tax their Russian owners. Consequently, it is strongly recommended that as a matter of urgency you should review your international arrangements from a management and control point of view.

It is evident that the new Law will definitely introduce a new way of thinking as far as international structures are concerned. However, this is not to be considered as a step back, since the Law is likely to assist Russian taxpayers to better evaluate their international structures and wealth planning vehicles. It should be emphasised that tax optimisation through legal international structures (for example Cyprus International Business Companies) with solid presence and substance in combination with the numerous Double Tax Treaties is not and cannot be deemed as tax avoidance. Therefore, the new way of thinking seems quite challenging, yet promising at the same time.

Charalambos Samir is an advocate and member of the Cyprus Bar Association. He is the Founder and CEO of ConnectedSky Legal & Corporate Consultants Limited as well as its affiliated law firm C. Samir & Co. LLC. He specialises in International Tax Planning, Formation of Trusts and Foundations, Mergers & Acquisitions and Establishment of International Structures.