Information Sheet No. 63

Russian De-Offshorisation Legislation

Russian De-Offshorisation

The new de-offshorisation law on the taxation of profits of controlled foreign companies ('CFC') and other related anti-offshore measures has been approved by the State Duma and President of the Russian Federation in November 2014 and has come into force as from 1 January 2015.

The main aim of Russian de-offshorisation drive is to combat the use of offshore companies by Russian tax payers, so as to prevent under-reporting of Russian taxes and to enhance transparency.

This law introduces significant changes in relation to the reporting of foreign controlled companies by Russian tax payers (CFC), Russian taxation of CFC related profit at the rates of 20% for companies and 13% for individuals, as well as various other provisions that may constitute a foreign company as a resident of Russia for tax purposes.

The de-offshorisation law revolves around three main areas:

1. Controlled Foreign Company ("CFC") rules
2. Management and Control / Tax Residency
3. Beneficial Ownership

Such rules are not a novelty of Russia, as many countries around the world have such provisions in their legislation in one form or another. The current OECD, G20 and various other global initiatives as well as the present media attention and sound bites on "tax dodging" and "fair share of revenue", will not have gone unnoticed to the reader.

In this context, you may refer to another detailed information sheet of our firm, which explains these issues as they apply globally along with potential solutions going forward. The content therein applies to a very great extent to the Russian de-offshorisation rules. Access information sheet No. 123 by clicking here.

Next steps?

It is strongly recommended that affected persons review their foreign related structures and the way they operate in the context of this new Law and consider restructuring opportunities where applicable.

Totalserve is closely monitoring the developments and can assist with a review of planned or existing structures based on the specific facts of each case. In the case of Cyprus companies, we can provide detailed Cyprus tax advice, advance Cyprus tax rulings and assist with restructuring transactions, management strategies as well as implementation of relevant substance elements. Cyprus is a strong international business centre through which international operations can be structured efficiently from a tax, legal and practical perspective and at the same time to actually justify the business case of why use Cyprus.

In brief, the main points of the Russian de-offshorisation law (the "Law") are the following:

1. CFC

In simple terms, this feature in the Law seeks to make it impossible for Russian resident tax payers to "shield" income from Russian taxation through the use of foreign companies or other vehicles such as trusts or foundations that they control. It is a form of an anti-avoidance and/or anti-deferral method through which the pertinent income is recognised and becomes taxable in Russia the moment it arises.

Whether foreign entities fall within the scope of the Russian CFC rules depends on a number of conditions; the most important of which relate to the definition of "controlling participation" of Russian tax payers on foreign entities and the effective tax rate at the level of the foreign jurisdiction. At the same time there are various exemptions. These exemptions as well as the matter of the effective tax rate are not analysed on this email as, at this stage, they are relatively vague.

Under the provisions of this Law, Russian tax payers who directly or indirectly hold 25% of the shares in a non-Russian entity that falls within the CFC rules, will have the obligation to notify the Russian tax authorities of such participation within a certain timeframe that can extend up to 2017 without any adverse implications. Failure to do so will result in fines – and in certain circumstances – may lead to criminal prosecution.

It should be noted that companies in often used holding locations such as Cyprus, Luxembourg, The Netherlands, Malta etc., may fall within the scope of the proposed Russian CFC rules. On its own, for such structures that had actual dividends repatriated and declared in Russia, the application of these CFC rules should not be an issue as the end effect will be the same with or without CFC.

There may be scope for some planning around these CFC conditions. For example, establishing irrevocable discretionary Trusts without any Russian based control whatsoever; structures with foreign companies in relatively low tax jurisdictions could consider mixing trading, financing and holding activities under a same company; or even using a 10% Russian withholding tax on dividends where the structure has underlying Russian operating companies. The latter would have an aim to increase the effective tax rate at the level of the foreign company. Listings and public investment funds may also be a workable route for certain cases.

2. Management and Control / Tax Residency

The relevant provisions of the Law provide that a foreign entity whose place of effective management is in Russia, shall be treated as a Russian tax resident. The result in such cases shall be that the foreign company's profits will be taxed in Russia according to Russian rules – irrespective of possible taxation in the other jurisdiction.

There are various criteria for determining the effective place of management, and these include - but are not limited to - the composition of the board of directors, where the board actually meets, who is actually "calling the shots" (officially or unofficially) - and can even extend to factors whether accounting, management and corporate records or even the daily human resource management are dealt with or kept in Russia.

Solutions to this matter mainly include to ensuring necessary relevant substance exists in the country of the foreign company, where necessary to reconsider the management structure and related functions and to have competent qualified people with relevant experience in the foreign country. It goes without saying that general or powerful Powers of Attorney issued to Russians should be avoided by all means.

3. Beneficial Ownership

The concept here is that in cases where a foreign company receives income (e.g. dividends, interest, royalties) is not considered to be the beneficial owner, then that company shall not be entitled to benefits provided in the relevant double tax treaty concluded with Russia – hence, no treaty benefits will be granted by Russia (e.g. reduced withholding tax rates or other tax benefits).

Within this context, in accordance with relevant OECD comments that can serve as guideline for the interpretation of tax treaties, one is considered to be the beneficial owner of income "when one receives for himself without any contractual obligation to pay (part of) the income to another party." Also, in practice, factors such as the bearing of related rights, associated risks and own decision making for the income received, can be taken into account.

Pure back-to-back arrangements as well as structures with no business rational other than tax reasons may no longer work after the bill is enacted to law.

In light of the above, it is advised – where necessary - to review existing arrangements and structures and if necessary to re-structure and modify these accordingly, so as to avoid the consequences of the law. Furthermore, branch structures, structures with tax refunds, use of hybrid instruments and structures with notional interest deductions should also be reviewed in light of these developments.

NOTES:

The above is intended to provide a brief guide only. It is essential that appropriate professional advice is obtained. P.G. Economides & Co Ltd will be glad to assist you in this respect. Please do not hesitate to contact us.

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