

March 26, 2014

Dear Sirs,

Following Russian President's request to the Government to take measures that would discourage the use of offshore companies, on March 18th, 2014 the Russian Ministry of Finance (the "Minfin") published the draft law (the "Draft Law") on suggested changes to the Russian Tax Code.

The Draft Law is regarded as one of the main tools for implementing strategy on "deoffshorisation" of Russian economy. It may have considerable effect on Russian business structures and individuals having business assets or conducting transactions outside Russia.

According to the Draft Law Russian tax residents (both companies and individuals) will be obliged to:

- pay taxes on non-distributed income of their foreign controlled companies ("CFC");
- notify Russian tax authorities about participation in:
 - i. foreign companies being tax residents of the countries included into the of list countries, providing preferential tax treatment, established by Minfin (hereinafter – "List") or in foreign companies which tax residence is not known, in case of at least 1% shareholding;
 - ii. foreign companies for which the tax resident is the 'controlling person' (see below);
 - iii. structures established without incorporation of a legal entity (including, but not limited to fond, partnership, association, or other form of collective investments) under the laws of a country included in the List, and which under their personal law have the right to perform entrepreneurial activity aimed at gaining incomes for the benefit of their participants (beneficiaries, stockholders, principal and other persons), whereby the taxpayer is the person having actual right for the income (profit) of the structure in case of distribution or is controlling person over the structure.

The other main aspects of the Draft Law are as follows.

CFC

The Draft Law establishes the definition of CFC, which is a foreign company that is:

- (A) non Russian tax resident; *AND*
- (B) tax resident of a country included in the List; *AND*
- (C) has *controlling persons* - Russian tax residents (companies or individuals); *AND*
- (D) not listed on a stock exchange included into the list of stock exchanges which is issued by the Russian Central Bank together with Minfin.

Notably, the definition of the CFC also covers *structures* (“Structure”) without incorporation of a legal entity (including, but not limited to fond, partnership, association, or other form of collective investments), which:

- are established under the laws of a country included in the List,
- under their personal law have the right to perform entrepreneurial activity aimed at gaining incomes for the benefit of its participants (beneficiaries, stockholders, principal and other persons),
- are controlled by tax residents of Russia (companies and individuals).

Controlling person

Controlling person of a company / Structure is the person who independently or jointly with other persons exercises *control* over the company / Structure.

Inter alia, controlling person is the person who has direct or indirect participation (individually or jointly with spouse and (or) infant children and other persons in light of specifics of their relations) of more than 10%.

It is unclear what grounds the Russian tax authorities would use to argue that several persons’ shareholdings should be counted jointly to reach the 10% threshold.

The 10% shareholding triggers recognition of the shareholder as a controlling person. However, if a taxpayer owns only 10% of shares of a foreign company, its major shareholders may be opposed to distribution of dividends and the taxpayer will not have a chance to affect the decision on distribution. Thus the 10% shareholder may end up paying 13% or 20% tax on CFC’s profits instead of 9% on distributed dividends.

Control

The *control over a company* is defined as influence (or the possibility to influence) on decisions made by that company with regard to distribution of gained profit (incomes) after taxation in the view of direct or indirect participation in that company, participation in the agreement aimed at managing of the company or other specifics of relations between the person and company and (or) other persons.

The *control over a Structure* is defined as influence or a possibility to influence decisions of a person (managing assets of the Structure) on distribution of profit (income) after tax between the participants (beneficiaries, principals and other persons) based on foreign law or certain agreement.

Taxable profit of CFC

Taxable profit of CFC is defined as CFC profit calculated in accordance with the Russian Tax Code rules and reduced by dividends paid out of that profit.

The taxpayer is taxable in proportion to its share and ownership period. If it is impossible to determine the proportion of the share, the taxpayer is obliged to pay tax on total CFC profit.

As stated CFC profit should be calculated in accordance with the rules set up by the Russian Tax Code. Amount of the profit should be confirmed by foreign company financial statements and other documents. It seems next to impossible to make such calculation based on financial statements of a foreign company. Hence the taxpayer may have to request all the documents supporting transactions performed by the CFC and make separate calculation on their basis.

Fines

The Draft Law establishes quite significant penalties for violation of the new rules, e.g. for non-notification of the Russian tax authorities the fine is RUB 100 000 (approximately EUR 2 000); for non-payment or underpayment of the tax on CFC profit the fine is 20% of CFC profit but not less than RUB 100 000 (approximately EUR 2 000).

Exchange of tax information

The effective implication of the CFC rules would be possible only in case of well-established exchange of information with other countries. Currently, Russian tax authorities are limited in obtaining information from abroad; the procedure is mainly established by Russian double tax treaties.

Russia intends to ratify the OECD Convention on Mutual Administrative Assistance in Tax Matters that would enhance the exchange of information, including its exchange with low-tax jurisdictions. The draft law on ratification is expected to be passed soon to the Parliament. The officials of Minfin have also informed on start of negotiations with certain countries (including low-tax jurisdictions) regarding specific agreements on exchange of information.

Tax residence for companies

The Draft Law introduces a definition of *tax residence* for companies. Foreign companies are recognized as Russian tax residents and taxed in Russia on their worldwide income if one of the following conditions is met:

- (i) Meetings of the Board of Directors (or other governing body of the company) are held on the territory of the Russia;
- (ii) Management of the company is usually performed from Russia;
- (iii) Chief officers of the company carry out their activities in Russia
- (iv) Accounting of the company is conducted in Russia;
- (v) Archives of the company are stored in Russia;

A foreign company can voluntarily recognize itself as a Russian tax resident unless this contradicts an international treaty signed by Russia.

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Though the Draft Law is subject to further discussion and revision we believe that the existing structures should be reviewed in light of the Draft Law to understand its possible effect on Russian tax residents and their holding structures. New projects should be developed bearing in mind the possible changes in the legal framework. We will keep you updated on a status of the Draft Law.

For more information please visit our [web-site](#) or contact directly [Maxim Alekseyev](#), Senior Partner of ALRUD.

Kind regards,

ALRUD Law firm

Note: All information was obtained from publicly available sources. The author of this information letter assumes no liability for the consequences of decision-making based on such information.