

Russian “Deoffshorisation” Law – A Summary

December 2014

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BACKGROUND

Russia has introduced major changes to its tax code that will become effective on 1 January 2015 and which will have significant impact on Russian tax residents with an ownership interest in certain entities (including corporate entities and certain unincorporated structures such as trusts and partnerships) outside of Russia, entities that are judged to be managed from Russia (regardless of the location of ownership) and disposals of shares in companies holding significant Russian real estate assets.

The changes were introduced through the Federal Law No 376-FZ dated 24 November 2014 “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 Organizations)”, which is often called Russia’s ‘Deoffshorization’ Law and was signed by President Putin on 24 November 2014.

KEY CONCEPTS

The new Law introduces new concepts to the Russian tax code:

Technical Concepts

- *Controlled Foreign Companies (“CFCs”)* – profits of foreign organisations, companies or non-corporate structures controlled by Russian tax residents, will be attributed to those controlling persons and taxed accordingly.
- *Categorisation of Tax Residence of Legal Entities by Place of Management* – new tests have been introduced to judge if a foreign company is effectively managed from Russia. If a foreign company is deemed to be effectively managed from Russia, its worldwide income will be subject to tax in Russia.
- *Extension of Tax on Gains in Indirect Disposals of Russian Real Estate* – foreign companies already have to pay Russian income tax on the sale of non-exchange-traded shares/participation interests of a Russian company if more than 50% of the assets of the Russian company are Russian real estate. This rule has now been extended to include the sale of shares in foreign companies with more than 50% of their assets (directly or indirectly) comprising Russian real estate.

Administrative Concepts – Notification Requirements

Russian residents with interests in foreign entities will need to notify the tax authorities of those interests:

- Direct or indirect participations of more than 10% (25% until 1 January 2017) in foreign entities
- Interests in entities defined as CFCs

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CONTROLLED FOREIGN COMPANIES – KEY INFORMATION

Definition

A CFC is a foreign company or structure which is not a Russian tax resident but is controlled by a Russian tax resident (either a legal entity or an individual).

The definition of a “foreign company” includes both companies and certain unincorporated structures. A Russian tax resident will be deemed to be controlling the foreign company if their participation interest is:

- 50% or more during 2015
- 25% or more from 1 January 2016
- 10% or more if the participation is grouped with that of other Russian tax residents and the accumulated total of the participation of all the Russian tax residents exceeds 50% of the holding of the company

In addition to having a relevant participation interest, a Russian tax resident can be deemed to be controlling a foreign company if they exert a determining influence on decisions made by the person who manages the structure’s assets regarding the distribution of net profits to participants. In other words, a person can be judged to be controlling a foreign company even if they do not have any participatory interest in it.

Exemptions

A number of categories of companies and structures are excluded from the tax obligations of the new CFC rules, although the obligation to notify the tax authorities of participation in these exempted structures remains in place.

The following entities are exempt from the taxation requirements of the CFC rules:

- A foreign company that is resident in a treaty country included in the list of countries that exchange information with Russian state agencies and which has an “effective rate” of income (profits) tax (as defined by the Russian CFC rules) that exceeds 75% of “average weighted” Russian tax rate – in most instances this effective tax is 15%
- A foreign company that derives no more than 20% of its income from “passive” sources
- Non-profit organizations that under domestic law do not distribute profits to shareholders (members, founders) or other persons
- Companies resident of a member state of the Eurasian Economic Union (“EEU”)
- A foreign non-corporate structure which meets all of the following conditions:
 - its founder does not have ownership rights to its assets
 - the founder’s rights cannot be transferred to other parties (except for inheritance or universal legal succession)
 - the founder may not, directly or indirectly, receive profits of this structure

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- Banks or insurance companies domiciled in a jurisdiction included in the list of countries that exchange information with Russian state agencies
- Issuers of listed bonds or an organization authorized to receive corresponding interest income, if the interest on them is at least 90% of the issuer's income
- Companies that are involved in certain industrial projects (projects concluded at governmental level on matters such as oil and gas), the income from which is not less than 90% of their total income

In addition, profits from a qualifying CFC are exempt from Russian income tax if they fall below the following monetary thresholds:

- RUB50 million in 2015
- RUB30 million in 2016
- RUB10 million from 1 January 2017

Obligations and Penalties

Profits of a CFC controlled by a Russian tax resident (as defined above) will be subject to the following tax rates:

- 20% where the controlling person is a legal entity
- 13% where the controlling person is an individual

In addition, a Russian tax resident controlling a CFC must notify the Russian tax authorities of relevant participation interests in foreign companies and structures one month after the grounds for such notification arise.

- The deadline for notifying a CFC is 20 March of the year following the tax period in which a share profit of a controlling person of a CFC arises (i.e., with the Law entering into force on 1 January 2015, the first notification deadline is set at 20 March 2016).

The following sanctions apply for breaches of the new rules:

- Failure to notify the tax authorities of an interest in a CFC, or misstatement of information about an interest in a CFC – RUB100,000 per CFC
- Non-payment or partial payment of a tax liability arising from a participation interest in a qualifying CFC – either 20% of the amount of unpaid tax or RUB100,000, whichever is higher
- Non-payment or partial payment of tax on a qualifying CFC's profits will not entail criminal liability until 2017, provided that the tax is paid in full to the tax authorities

TIMINGS

With the Law entering into force on 1 January 2015, the following deadlines apply:

- 1 April 2015 – notification on participations in any foreign entity or structures set up prior to 1 January 2015
- 20 March 2016 – first CFC reporting date
- 31 December 2017 – end of the transition period in which criminal liability is waived for late payment of tax or failure to declare relevant entities/structures

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TAX RESIDENCE OF LEGAL ENTITIES BY PLACE OF MANAGEMENT – KEY INFORMATION

Under the new Law a foreign company managed from Russia can be recognized as Russian tax resident, with its worldwide income subject to tax in Russia.

A foreign company is regarded as effectively managed in Russia if:

- Meetings of the board of directors (or other executive management body) are predominantly held in Russia (over 50% of meetings in a year)
- High-level executive management is predominantly performed in Russia
- The Chief (Executive) officers (persons authorized to perform and responsible for planning, management and control over the entity’s activities) operate predominantly in Russia

If these three tests do not provide a conclusive answer, three additional tests are applied to the company to determine if it is tax resident in Russia:

- The accounting or management records are maintained in Russia
- The company’s records are managed in Russia
- The place from which operating and administrative procedures (HR management) relating to the company’s operations (as opposed to any group operations) are issued in Russia

TAX ON GAINS IN INDIRECT DISPOSALS OF RUSSIAN REAL ESTATE – KEY INFORMATION

Companies which derive capital gains from the disposal of shares in Russian and foreign companies with assets consisting (directly or indirectly) of 50% or more of immoveable property situated in Russia, will be subject to Russian withholding tax of 20%.

There are three primary exemptions from this withholding tax:

- Disposals of shares of listed companies in any recognized stock exchange
- Disposals of shares of companies/interest in non-corporate structures with at least 50 shareholders/participants, provided that each of them holds not more than 5%
- Disposals of shares (interest, units) in companies owned continuously over five years

In addition, any exemptions applicable to the relevant income under certain double taxation treaties (such as that between Russia and the Netherlands, Russia and Cyprus until January 1, 2017) will prevail.

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REQUIRED ACTION

This summary memo does not constitute legal and tax advice and is not a substitute for it. Affected individuals and entities should review their current structures in detail and take specific legal and tax advice to determine the appropriate course of action.

HOW TRIDENT TRUST CAN ASSIST

Trident Trust is able to:

- Make introductions to appropriate legal and tax advisors
- Assist individuals who wish to relocate to another tax jurisdiction
- Assist with the implementation of structures that are deemed to be compliant with the new rules, as determined by specific legal and tax advice

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