

client alert

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RUSSIA - FEDERAL LAW ON DEOFFSHORIZATION

Federal Law # 376-FZ dated 24 November 2014 (the “**Law**”) on deoffshorization, including Controlled Foreign Company (“**CFC**”) rules, tax residency rules for legal entities and beneficiary ownership concept comes into force from 1 January 2015 (subject to certain exceptions).

Please find below a brief on the key provisions of the Law.

- ✓ ***The Law adopted the Controlled Foreign Company (the “CFC”) rules. The CFC rules mean rules of application of Russian profit tax to profits of foreign companies and non-corporate structures controlled by Russian tax residents who can be considered as controlling parties;***
- ✓ ***CFC income will be subject to a 20% rate if the CFC is controlled by a legal entity and a rate of 13% if it is controlled by an individual;***
- ✓ ***In general there is no direct impact of Russian CFC rules on foreign groups;***
- ✓ ***Several types of additional notifications should be filed to the tax authorities within the deadlines established by the Law, in particular:***
 - ***Russian legal entities and individual entrepreneurs should submit notification on participation in Russian legal entities (subject to certain exemptions) if the share of direct participation is more than 10%;***
 - ***Russian taxpayers should submit notification on participation in foreign legal entities if participation is more than 10%, as well as on incorporation of foreign non-corporate structures or on control over such structures or actual right for income received by such structures;***
 - ***Russian taxpayers should submit notification on CFC, including cases when profits of a certain CFC will not be taxed in Russia;***
 - ***Foreign companies and structures owning immovable property located in Russia should report on their participants (foreign structures not having established a legal entity should report on their shareholders, beneficiaries and managers).***

Controlled Foreign Company Rules

- The CFC is defined as a foreign legal entity which (i) is not tax resident of the Russian Federation and (ii) is controlled by Russian tax residents (legal entities and/or individuals) who can be considered as a controlling party (the “**Controlling party**”);
- The Controlling party is defined as a Russian tax resident (individual or legal entity) who owns directly or indirectly (for individuals - jointly with spouses and minor children):
 - More than 25% (more than 50% before 1 January 2016);
 - More than 10% (more than 50% before 1 January 2016) if total participatory interest of all Russian tax residents in the CFC is more than 50%.

In addition, a Russian tax resident can be considered as the Controlling party in spite of the share of participation if such Russian tax resident controls (i.e. influences the decisions of such a foreign legal entity related to the distribution of profits, etc.) such a foreign legal entity in its own interest or in the interest of its spouse or minor children.

- The profit of the CFC is exempt from Russian profit tax *if at least one of the conditions listed in the Law is met*, in particular :
 - The CFC is a non-profit organization, which does not distribute its profits to shareholders (members, founders) or other parties;
 - The CFC is established in accordance with the legislation of states members of an Eurasian Economic Union;
 - The CFC is a bank or an insurance company domiciled in a country which has a tax treaty which is in force with the Russian Federation;
 - The CFC is an issuer of listed bonds, etc.
 - The CFC is domiciled in a country which has an international tax treaty which is in force and signed with the Russian Federation (except states which do not exchange information with the Russian federation for tax purposes), and the CFC's effective profit tax rate (*the Law establishes a rule for determination of the effective tax rate*) is not less than 75% of the average weighted Russian profit tax rate or if the CFC's “passive” income is not more than 20%; etc.
- The Law defines the rules for calculation of CFC profits;
- The CFC's profit is taxed in Russia only in case it exceeds 10 million roubles (50 million roubles in the year 2015 and 30 million roubles in the year 2016);
- If the CFC does not distribute profit due to an increase of the CFC's charter capital, such profit is not subject to profit tax in Russia;
- The CFC's profit may be reduced by the dividends paid from such profits;
- The Law establishes tax liability for violation of CFC rules, including penalties for not submitting certain required financial documentation, required notification, required information on shareholders, penalties for non-inclusion of shares of the CFC's income into the tax base (if applicable), penalty for provision of a notification containing non-reliable information, etc. At the same time, penalties established by the Law for not including CFC profits should not be charged in respect of profit tax periods 2015 - 2017;

- The Law adopts certain tax concessions within the transitional period, for example, a tax concession for Russian tax residents (controlling parties) which will decide to liquidate foreign structures falling under the CFC rules provided the liquidation procedure is finalized by 1 January 2017;
- Russian profit tax will apply only to the profits of CFCs for the periods starting in 2015. Such profits should be declared by Russian legal entities for the first time in the profit tax declaration for the year 2016 which should be submitted before the established deadline in the year 2017 (individuals should declare such profits for the first time in the personal income tax declaration for the year 2016 before the established deadline in the year 2017).

Tax residency

- The law defines the following legal entities as tax residents of the Russian Federation:
 - Russian legal entities;
 - Foreign legal entities which are treated as Russian tax residents in accordance with international tax treaties for the purpose of the application of such treaties;
 - Foreign legal entities managed from Russia. Basic and additional criteria for determining the place of management of a foreign legal entity are adopted by the Law. The Law also adopts a list of activities which by themselves cannot be treated as actual management in the Russian Federation of the foreign company, i.e. carrying out such activity in the Russian Federation by itself would not lead to the tax residency in Russia;
- *A Foreign legal entity has a right to obtain the status of a Russian tax resident on a voluntary basis* when a company is domiciled in a country with which a tax treaty is in force and has a separate subdivision in Russia, provided it meets one of the conditions listed in the Law, for example: a company is domiciled in a tax treaty country and is a tax resident of such a country under the international tax treaty, etc. *In such cases, a foreign legal entity must inform the respective tax authority at the place of registration of its separate subdivision in the Russian Federation and such a company will not be treated as a CFC;*
- The Law adopts a list of foreign legal entities which cannot be treated as Russian tax residents, for example: issuers of tradable bonds, etc.

Beneficial ownership concept

- According to the Law, a beneficial owner of income is a person having a right to independently use and/or dispose of such income, taking into account its functions and the risks it takes;
- If a Russian tax agent (a Russian legal entity which pays income to a foreign beneficiary of the income not tax registered in Russia and, according to the Russian Tax code, as a tax agent, must calculate, withhold and transfer respective Russian tax to the Russian budget) is aware of the actual beneficial owner of income originating from the Russian Federation:
 - if the actual beneficial owner is a Russian tax resident, the agent should inform the respective Russian tax authority about such a payment, however, the tax agent should not withhold tax;
 - if the actual beneficial owner is a non-resident in Russia, the agent may apply provisions of a respective double tax treaty signed by the Russian Federation with the respective state;

- The Russian tax agent has a right (not an obligation) to request a document from a foreign legal entity which confirms that such a foreign legal entity is a beneficial owner of income to apply lower tax rates under the applicable double tax treaty.

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