



Changes to anti-offshore legislation in early 2016

FEBRUARY 2016

VEGAS LEX

On the 15th of February 2016, Russian President Vladimir Putin signed Federal Law No. 32 "On Amendments to Parts One and Two of the Tax Code and the Federal Law – On Amendments to Parts One and Two of the Tax Code (regarding the taxation of profits of controlled foreign companies and income of foreign organizations). "

This law amends existing Russian anti-offshore legislation. We present here the most interesting amendments, which should be taken into account when working with affiliated foreign companies and non-corporate tax planning tools.

1. The concept of the "entity who has the actual right to income" (beneficial owner)

- In order to enjoy the benefits, under agreements for the avoidance of double taxation, foreign companies must provide proof that they are actually the entities that are benefitting from the income. Before these changes were implemented, the tax authorities had the right to ask for a confirmation from the party receiving the income.

- The provisions of Article 7 of the Russian Tax Code, in relation to the concept of beneficial ownership, now apply to foreign structures without legal entity status (trusts, foundations). This means that the actual owner of the income may be recognized as the entity in whose interests the other entity (structure without legal entity status) disposes that income.

- It codifies the position of the Russian Ministry of Finance in areas where the individual or legal entity receives payments from a foreign organization, the source of which was a Russian company, and has the actual right to them, and thus the Russian taxpayer does not need to pay taxes on such payments. For this to apply, the tax authorities must be provided with documentary proof:

(a) of the fact that tax was withheld by the Russian organization as a tax agent;

(b) of the existence of an actual right of the individual to the income (up to the date of payment of the income).

2. Controlled foreign companies

2.1. Notification issues

- The time limit for the submission of notifications about participation in international organizations (establishment of structures without legal entity status) has been increased – from one month to three months after the start of participation (change in the share size) in such a foreign company.

- The law abolished the obligation of submitting notifications on the control of foreign structures without legal entity status or the actual right to the income possessed by such structures (because information (in terms of structures) will be contained only in the notifications on controlled foreign companies). Thus, according to the new wording of paragraph 3.1 of Article 23 of the Russian Tax Code, taxpayers are obligated to notify the tax authorities – about participation in foreign organizations, about the establishment of structures without legal entity status, about controlled foreign companies, in respect of which control is exercised.

- The legislators have confirmed that shareholders of public companies, directly or indirectly participating in foreign companies, need not submit notifications of participation. This innovation corresponds to the already existing norm that control for the purpose of controlled foreign companies is not formed, and participation in a foreign company is carried out through a public company.

- Upon discovery by the tax authorities of the fact of undeclared control over a foreign organization (structures without legal entity status), the tax authorities send to the taxpayer a demand to provide an explanation or submit a notification. At this,

the period that the taxpayer has to provide a response cannot be less than 30 days from the date of receipt of such request.

- Taxpayers that are individuals may be exempted from the obligation in the form of 20% of the amount of the unpaid tax¹ and a fine of 100,000 roubles for failure to provide a notification about "control"². To do this, an individual submits an explanation and (or) documents proving that he/she was not aware of the fact that in the calendar year for which the corresponding notification was not submitted, the share of participation in the foreign organization of all entities, recognized as being tax residents of the Russian Federation, was more than 50%.

- For trust managers, who are considered as tax residents of Russia, an obligation has appeared to submit a notification on participation in foreign organizations or the establishment of foreign structures without legal entity status (trusts and foundations) in the event that into the charter capital of a foreign company or structure is transferred property that is the object of trust management.

- Recognition of being the controlling entity of a foreign investment fund (mutual fund or any other form of implementation of collective investment) by a tax resident of the Russian Federation, as well as the implementation by such a controlling entity of activities involving asset management of such a fund in the Russian Federation, alone in themselves, are not grounds for recognition of the fund as being a controlled foreign company.

2.2. Determining profits

- According to the new amendments, for controlled companies from countries

with which the Russian Federation has ratified agreements for the avoidance of double taxation and the efficient exchange of tax information, an audit to be used for financial reporting purposes is not formally required. At the same time, upon obtaining a positive audit report, one may use financial statements regardless if such an agreement exists between the Russian Federation and the concerned country.

- The law clarified the requirements for the preparation of financial statements of controlled foreign companies. In particular, it is possible to use non-consolidated financial statements, prepared according to the standards set by the governing law of the foreign company³. Moreover, if such standards have not been established – then according to the IFRS rules or other international standards. At the same time, financial statements must be audited of those foreign companies that are located in countries that do not have ratified agreements with the Russian Federation on the avoidance of double taxation.

- In determining the profits (losses) of controlled foreign companies, not considered is income (expenses) in the form of amounts of profits (losses) of subsidiaries (associated) companies (excluding dividends), recognized in the financial statements of the foreign controlled company, in accordance with its governing law.

- In determining the profits of structures without legal entity status, income of such a structure in the form of assets will not be considered, including cash and property rights received as a form of contribution from the founder of the structure and members of his/her family, close relatives⁴, as well as from a foreign company controlled by at least one of the said persons. It is important

¹ The tax base for the specified type of income of individuals is defined as the retained earnings of foreign companies (structures without legal entity status).

² This exemption applies to situations where an individual owns more than 10% of the foreign company, provided that the share of tax residents of the Russian Federation in the foreign organization is more than 50%.

³ Personal law of legal entities in accordance with paragraph 1 of Article 1202 of the Civil Code shall be the law of the country where the legal entity was established.

⁴ In accordance with the Russian Family Code, recognized as close relatives are: spouses, parents, children (including adopted children), grandparents and grandchildren, full and half (common father/mother) brothers and sisters.

to note that this

2.3. Taxation of profits

- Based on the share of passive income, the Law excludes foreign exchange differences, as well as income referred to in paragraph 3 of Article 309.1 of the Russian Tax Code (incomes from revaluation of securities and others).
- The Law introduces an exemption for dividends received from a controlled foreign company, if the controlling entity previously paid the tax in the Russian Federation with the retained earnings of the controlled foreign company.
- Exempt from income taxation is cash received by individuals, or in kind from foreign structures without legal entity status⁵, within the property (including cash and/or property rights), previously contributed into the structure by that person, his/ her family members and/or close relatives, except in cases when foreign entities without legal entity status, have retained earnings at the moment of the distribution of such income.

2.4. "Preferential" liquidation

- The benefit of tax-free liquidation of a foreign entity or entities without legal entity status has been extended for individuals and legal entities by one year – until 01 January 2018 (this period may be extended further, in particular if court proceedings take longer to complete).
- If an individual, who is the controlling entity of a foreign company or his/her Russian affiliated entity acquires from such company securities at the price at which these securities were previously purchased (but not higher than the market value), then for that individual is not attributed income in the form material benefits. For this, it is necessary that the controlled foreign

company be liquidated before 01 January 2018 (in certain cases this period may be extended).

- Upon further sale of securities received by an individual in case of liquidation of the foreign organization (structure), or purchased from a foreign controlled company, an individual may reduce his/her income by the lesser the following:

- (a) the value of securities according to the accounting records of a foreign company or
- (b) the market value of the securities at the date of transfer of ownership of such securities from a foreign company.

3. Tax residency of legal entities

- Benefits in the form of a 0% tax rate, in respect of dividends received, will be applied only to those foreign organizations that have voluntarily recognized themselves as tax residents of the Russian Federation.
- The law specifies the procedure for determining the first taxation period for foreign companies, voluntarily recognizing themselves as tax residents of the Russian Federation, whose activities did not give rise to the establishment of a permanent representative office in the Russian Federation at the time of such recognition (from 01 January of the year in which the application was filed or from the date of filing until the end of the calendar year; if the application was submitted in December, then from the date of submission to the end of the following year).

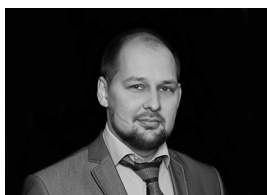
Entry into force

The main provisions of the Law apply to legal relations arising after 01 January 2015. However, some provisions concerning, in particular, the concept of the actual right to income, will come into force one month after the official publication of the Law.⁶

⁵ Including a legal entity, for which participation in the charter capital does not apply.

⁶ Law published on 15 February 2016

Контакты



YURIY IVANOV
Projects Manager
of Tax Practice

ivanov@vegaslex.ru



NIKOLAY RUDOMANOV
Associate of Tax practice

rudomanov@vegaslex.ru

For further information on the services of VEGAS LEX, please visit our website www.vegaslex.ru

The above information was provided for informational purposes only and it cannot be used as professional advice.

Where required VEGAS LEX recommends obtaining professional advice.