Russia's new anti-offshore legislation

1 January 2015 in Russia an important bill of the law "On Amendments to Parts One and Two of the Tax Code of the Russian Federation (on the taxation of the income of controlled foreign companies and profits of the foreign companies") of 26/08/2014 entered into force. This piece of legislation, which modifies significally the Russian Tax Code, aims to prevent the cash-drain from Russia to off-shore places and struggles against the use of various cross-border tax evasion schemes. In another terms, the legislation deals with the taxation of profits received and held by Russian-owned businesses in non-Russian low tax jurisdictions.

The governing rules of a new law are the following:

- ✓ The undistributed profits of the controlled foreign companies, controlled by the russian tax residents (companies or individuals) will be taxed in Russia.
- ✓ The tax rate will be 20 percent for Russian corporations and 13 percent for Russian individual residents. Russia will allow, however, a foreign tax credit for withholding taxes incurred in the jurisdiction of the CFC.
- ✓ Allocation of profits (if CFC profit exceeds 10 million Rubles) with the controlling shareholder.
    - ➢ Threshold for recognition of control over the company or structure:
        - ▪ an individual or a company will be considered as a controlling in the cases, when a share of its direct or indirect participation (together with related persons) is more than 25% (50% till 1 January 2017);
        - ▪ the threshold of 10% is retained, if the share of direct or indirect participation of all persons (related) recognized as tax residents of RF exceeds 50%. (par. 4 of the Article 25 $_{13}$)
- ✓ For the first time, the definition of *controlled foreign companies* was introduced into the Russian law, which also covers structures (including, but not limited to, trusts, partnerships, associations and other forms of collective investments) that:
    - are established under the laws of a foreign country;
    - retain profits from the commercial activity for the benefit of their participants (beneficiaries, stockholders, principals and other persons); and
    - are controlled by Russian tax residents (companies and individuals).
        - ➢ Specific exemptions are previewed for the entity not to be considered as a controlled foreign company:
            - ▪ entities residing in a Member State of the Eurasian Economic Union (Russia, Belarus and Kazakhstan).

- entities which are resident in a country with an effective tax rate above 15% and which have concluded tax treaties with the clause of exchange of information.

- "White List" entities ((largely the countries which exchange information with Russia for tax purposes, though the list has not yet been published), like banks and insurance companies etc.

- in a case when a foreign company is recognized as Russian tax resident it won't be recognized as a controlled foreign company.

✓ Specific methods of the calculation of the amount of profits of the controlled foreign companies were created.

✓ The introduction of the russian tax residency rules and the beneficial ownership's concept, which limits the use of tax advantages under the Double Tax treaties concluded by the Russian Federation.

  ➢ The beneficial owner is a person that is directly or indirectly entitled to possess, use and dispose of any income gained, or a person for whose benefit another person can use and/or dispose of such income. Functions performed and risks assumed by the taxpayer are taken into account to determine if the taxpayer is the beneficial owner of the income.

✓ The widening of Thin Capitalization Rules which are now also applicable on loans from related foreign companies.

✓ Unlimited tax liability of foreign companies having a place of effective management in the Russian Federation, unless otherwise stipulated by an international tax treaty.

✓ General right of taxation of capital gains from the sale of shares in companies holding more than 50% of Russian real estate.

CONCLUSION:

The new rules are aimed at bringing capital back to Russia by imposing reporting requirements and tax liabilities on Russian residents who have established or who control or influence offshore companies, trusts and other holding vehicles.

The proposed changes to Russian tax law will inevitably affect artificial structures in which 'postbox' companies located in jurisdictions with favorable tax regimes are used without a sound business purpose, but purely to obtain tax benefits.

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