



## Russian “Deoffshorisation” Law

January 2015

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The new law, which is applicable as of 1st January 2015, introduces some significant changes to the Russian Tax Law.

### **Tax residency**

The new law introduces new criteria in determining tax residency. Foreign companies managed from Russia can be considered as Russian tax residents and consequently be taxed there.

If any of the following criteria are met then the company will be considered as a Russian tax resident:

1. More board meetings are held in Russia than in any other state
2. The executive (strategic/operating management) function is mainly performed from Russia
3. The day-to-day management of a foreign company is mainly performed from Russia

If the above test is inconclusive then the tax residency of the foreign company may be determined on the basis of additional criteria such as, whether the company's financial accounting or management accounting is performed in Russia, whether the company's documents are generated and processed in Russia, whether the human resource management is performed in Russia and so on.

### **Exceptions:**

The most important exceptions are the following:

1. The law allows strategic management of a foreign company to be performed to a certain extent by the shareholders from Russia without affecting its residency status.
2. Companies who conduct their commercial activities using their own qualified staff and assets in a treaty state are deemed as having their effective management in that state.
3. Foreign companies which are recognized as tax resident of a treaty state according to the double tax treaty.

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## **Controlled foreign corporations (CFC)**

A controlled foreign corporation (CFC) is a foreign organization or a foreign structure which does not involve the establishment of a formal legal entity (for example, funds, partnerships, trusts and so on). The law provides that Russian tax residents (legal entities or individuals) which control, either directly or indirectly, CFCs should pay tax in Russia on the retained earnings of these CFCs.

A Russian tax resident is considered to be a controlling person if they hold an interest of more than 25% in the CFC or more than 10% if the total participation of Russian tax residents in the CFC is more than 50%. The law has a transitional period ending on 1st January 2016 during which the threshold for both tests will be 50%.

Despite the above, the thresholds for notifying the Russian authorities about participations in CFCs are even lower, in most cases 10%, even though during the transitional period the applicable threshold is 50%.

### **Exceptions:**

While the obligation to notify the authorities is applicable in all cases, certain categories of companies are excluded from the obligation to pay Russian tax. The most important exemptions are:

- Foreign companies which are resident of treaty countries which are included in the list of countries that exchange information with Russia and (1) have an effective tax rate that exceeds 75% of the average weighted Russian tax rate, or, (2) their income from passive operations is less than 20% of their income
- Non-profit organizations
- Non-corporate structures when (1) their founders do not own their assets, and, (2) their founders' rights cannot be transferred to other parties except for inheritance / legal succession purposes, and, (3) their founders do not receive profits
- Banks and insurance companies domiciled in treaty countries

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## **Tax Rates:**

20% if the CFC is controlled by a legal entity and 13% if controlled by an individual for income in excess of RR 50,000,000 for 2015, RR 30,000,000 for 2016 and RR10,000,000 thereafter.

The profits of a CFC will be determined according to the audited financial statements of the CFCs which are domiciled in treaty countries which have mandatory audit requirements and under Russian tax law in all other cases. The taxable profit is reduced by the amount of dividends paid out of that profit and by the tax paid on the profit and the dividends paid out. There is also a distinction between active and passive (such as dividends, interest, royalties, income from sales of real estate and income from consulting and other services) income where the former is entitled to certain expense deductions.

The law permits carrying forward losses indefinitely.

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## **Beneficial ownership of income**

The Law introduces the concept of beneficial ownership of income for the purposes of applying double tax treaties. According to this provision, the person having the actual right to income is the person that has the right to independently use this income.

The Law further states that the applicable Double Tax Treaty (for example in the case of dividend, interest and royalty payments) is the one with the resident state of the beneficial owner of the income and not that with the resident state of the direct recipient of the income. This provision mainly affects back-to-back structures.

## **Real Estate**

Foreign companies (and structures that do not involve the establishment of a legal entity) which own real estate property in Russia will have to report submit information to the Russian tax authorities on their participants. Failure to do so will result in a fine equal to the tax assessed on the property owned.

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Foreign companies are currently under obligation to pay tax in Russia on their income from the disposal of their interest in Russian property rich companies. The new law extends this obligation to the disposal of interest in foreign companies if more than 50% of their assets comprise directly or indirectly of Russian real estate. The applicable tax rate is 20%.

Please note that certain exceptions apply, such as the disposal of shares of listed companies and of shares which are owned for over five years.

### **Our opinion:**

Cyprus is included in the list of countries that exchange information with Russia, however, the local income tax rate of 12.5% is below the effective tax rate which is required for exemption on the basis of effective tax rate.

Holding companies, whose income is mainly passive, will most likely pass the residency test, however, they will be affected by the law regarding CFC taxation in Russia.

Trading, and in general companies whose passive income is less than 20%, will be exempt from CFC rules. However, they should enhance their substance in Cyprus to pass the management and control test.

In general all structures should review the current situation and consider restructuring to reduce their exposure to the new legislation. The way that the control and the management of companies is exercised should be re-examined and their substance should be enhanced to help them pass the tax residency test. Specifically, it is strongly recommended not to use general powers of attorney and to manage bank accounts from Russia.

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