

September 05<sup>th</sup>, 2014

Dear Sirs,

As we informed earlier, the Ministry of Finance of the Russian Federation (the “**MinFin**”) has published two versions of a draft law on proposed amendments to the Tax Code of the Russian Federation introducing the CFC rules, tax residency rules for companies and some other new regulations (the “**Draft Law**”).

On September 2, 2014 MinFin published an updated version of the Draft Law, which is submitted to the Russian Government. Below we outline most important aspects of the Draft Law.

## **1 CFC**

### *Notification on participation in foreign companies*

The Draft Law proposes to introduce an obligation for Russian tax residents to notify Russian tax authorities on direct or indirect participation in a foreign company of more than 25%. The penalty for failure to comply with the requirement is RUR 50 K (*approx.* EUR 1 K).

If Russian tax resident is recognized as a controlling person of a CFC, a special notification should be submitted. The penalty for non-submitting of the notification is RUR 100 K (*approx.* EUR 2 K).

### *Definition of CFC*

CFC is a foreign company or structure (trust, foundation, partnership, as well as other forms of collective investments / fiduciary management) controlled by Russian tax resident.

For example, a person is deemed to control a foreign company in case the person’s direct or indirect interest in the foreign entity, jointly with a spouse and/or minor children and other persons (if there are specific relationship between them) is more than 50 %.

In respect of foreign structures (trusts, foundations, etc.), a person is deemed to control the structure if a Russian resident influences or can influence a person, which is responsible for management of assets, in respect of distribution of profit or income.

The following companies / structures are not recognized as a CFC (i) entity, which is listed on Russian or foreign stock exchange included into the list of stock exchanges issued by the Central Bank of the Russian Federation jointly with MinFin; (ii) entity, which is a non-profit organization that does not under its governing laws distribute the profit (income) earned among its shareholders (participants, founders) or other parties; (iii) entity, which is a resident in a country included into the “white list” of jurisdictions exchanging tax information approved by the Federal Tax Service AND its income/profit is subject to taxation at the effective rate exceeding 15%; (iv) some others companies and structures.

### *Taxation of CFC's profit*

CFC's profit, which was not distributed in lieu of dividends in the year following the year when it was received, is recognized as income subject to tax in the Russian resident's hands. The profit is not taxable unless it exceeds RUR 50 mln. (approx. EUR 1 mln.) in 2015, RUR 30 mln. (approx. EUR 0,6 mln.) in 2016, RUR 10 mln. (approx. EUR 0,2 mln.) starting from 2017.

Taxable profit of CFC is calculated in accordance with the Russian Tax Code and reduced by dividends paid out of that profit. CFC's profit is taxable at the basic rates (13% for individuals, 20% for companies).

The amount of tax on CFC's profit may be decreased by taxes paid in respect of such profit in Russia and in other countries.

### *Transitional provisions*

The above rules are proposed to be introduced gradually. Thus, rules in respect of CFC are proposed to apply to CFC's profit starting from 2015. No penalties should be imposed in case of non-payment tax on CFC's profit in 2015-2017.

At the same time, starting from 2017 the threshold for recognizing a person as controlling one will be decreased to stock of more than 10%. The threshold for submitting a notification on participation in foreign companies will be also decreased to stock of more than 25%.

Moreover, the person will be also obliged for submitting a notification on participation in foreign structure if such person is a founder of such structure or is a beneficial owner (actual recipient) of income of the structure.

## **2 Concept of the actual right to receive the income**

The Draft Law proposes to tax agents transferring income to foreign entities to pay attention to whether such entity has actual right to receive the income, i.e. if the recipient of the income actually benefits from the income and can independently dispose of it.

If it is determined that the foreign entity does not have actual right to receive the income, it is impossible to apply reduced rates or exemptions established by a relevant double tax treaty.

Special rules are established for dividends. If a foreign entity, receiving dividends from Russian company, does not have actual right to receive the income, provision of the relevant double tax treaty is not applicable. However, another person having actual right to receive the income, can apply double tax treaty if such person is a resident of a country having a double tax treaty with Russia. If the person having actual right to receive the income is a Russian tax resident, regular dividend tax rates will apply to such dividends (0% or 9%).

## **3 Tax residence for companies**

Foreign companies may be recognized as Russian tax residents and taxed in Russia in respect of their worldwide income if they are managed from Russia. A foreign company is deemed to be managed from Russia if one of the below conditions is met:

- Meetings of the Board of Directors (or other governing body of the company) are particularly held (more than 50% during a calendar year) on the territory of Russia;

- Management of the company is usually performed from Russia (making decisions and other actions related to current activities of the organization);
- Chief officers of the company (which are responsible for planning the management and control over the company) carry out their activities with regards to the company in Russia.

If the above conditions are fulfilled in several countries, additional criteria are applied.

#### **4 Indirect sale of Russian real estate**

The Draft Law proposes to tax in Russia sale of shares of any companies, value of assets of which is comprised of Russian real estate for more than 50%. At the same time sale of the shares is tax exempt if they are owned by the taxpayer for more than five years. Other exemptions are also applicable for some other securities.

#### **5 Disclosure of the shareholders of foreign organizations**

The Draft Law requires that foreign organizations holding property, which is subject to Russian corporate property tax, notify the tax authorities about participants of such foreign organization having more than 5% direct or indirect interest. Failure to provide such information will result in a penalty totaling 100% of the property tax charged on such property.

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The Draft Law is submitted to the Government that should pass it over to the Parliament to undergo legislative procedures. We will monitor the process and keep you informed on any development in this regard.

Should you have any questions, please contact directly Maxim Alekseyev, Senior Partner at [malekseyev@alrud.com](mailto:malekseyev@alrud.com)

Kind regards,

**ALRUD Law firm**

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