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Tax residence of individuals: changes a-coming?

Changing the tax residence criteria for individuals – in particular, introducing the concept of the centre of vital interests – has been on Russian Ministry of Finance's agenda for several months.

Read on to learn more about the changes and whom they might impact.

Background

Changes at a glance

The Ministry of Finance expressed its intention to reconsider the tax residence criteria for individuals, in particular:

- to introduce additional criteria other than length of stay in Russia, e.g., the centre of vital interests in Russia
- to equalise the personal income tax (PIT) rate at 13 percent for residents and non-residents
- to reduce the qualifying time of stay in Russia from 183 to 90 calendar days over 12 consecutive months for those wishing to voluntarily assume Russian tax residence.

Similar proposals have been put forward before, but none have been implemented so far.



Importantly, the existing objective residency criterion (length of stay) may be supplemented with a somewhat looser concept of the centre of vital interests.

The concept is widely used in a number of jurisdictions and is based on the personal, social, and economic ties an individual has with the respective country: these criteria are always subjective and their interpretation depends on many factors.

In practice, it means that if the concept is formalised, many taxpayers that spend less than six months in Russia, but have strong ties with it, will have to drastically reconsider their approach to the Russian tax residence.



The new criteria will not affect the currency control residence rules.

Double taxation risks

Changes at a glance

If an individual assumes Russian tax residence voluntarily or is recognised as a Russian tax resident, it does not mean that his residence issues are fully settled with other countries, which may have other residence criteria.



This is important

If adopted, the changes will affect a large number of individuals, from frequent travellers or those travelling on business outside Russia to individuals who assumed tax residency by investment in a foreign jurisdiction. An individual may be recognised as a Russian tax resident simply based on having a business, family or real estate in Russia.

A closer look

In practice, such individuals can be treated as tax residents both in Russia and in a foreign state.

In a residence-based system, residents of the country are taxed on their worldwide (local and foreign) income.

To eliminate the conflicts arising from dual residence and avoid double taxation, the rules of international treaties (DTTs) signed between the jurisdictions of residence should be applied.

In the absence of a DTT between Russia and another state (for example, Liechtenstein or Monaco), personal income can be taxed in both states the individual is a resident of, based on the national laws.

Tax residence established by agreement of jurisdictions

If an individual qualifies for tax residency in two states at the same time, to determine his tax residence under the DTT, the following criteria should be consistently applied:

- 1) location of the permanent place of abode
- 2) location of the centre of vital interests
- 3) place of habitual residence
- 4) citizenship.

If these criteria are not sufficient, the competent authorities of the countries will settle the issue by agreement.

The practice of applying these provisions is currently limited; internationally, the focus is being made on analysing all circumstances in aggregate.

The greatest disputes arise around the centre of vital interests, since in most countries this concept is subjective and has no clearly established criteria.

The centre of vital interest test includes establishing the family location, social ties, positions held, participation in political and cultural events, places of business and management of family assets. Together with other circumstances, retaining any of the above in a particular country may evidence that the centre of vital interests has not been moved abroad.

If the concept is formalised in the Russian Tax Code without clear criteria, it may take years for the relevant regulatory practice to develop.

Important:

Some residency-by-investment programmes (like the one offered in Cyprus and requiring the annual stay of at least 60 days) do not apply if the investor is recognised as a tax resident of another jurisdiction.

Therefore, the introduction of the centre of vital interests test will directly affect the investors whose residence status has been already granted or is pending.

Recent developments

In October, Minister of Finance Anton Siluanov said the regulator was willing to postpone the reform if it was not supported by the big business¹.

“We wanted the ministry’s idea to be perceived as an additional opportunity for those wishing to assume Russian tax residence, not a coercive measure against those who are playing by the 183-day rules”, - Head of the Union of Industrialists and Entrepreneurs Alexander Shokhin later said².

“That is, we are keeping the 180-day requirement, but we want the stakeholders to know that it can be fewer than that, if one is interested [in assuming Russian tax residence]”, Anton Siluanov further explained³.

Yet, the minister did not elaborate on whether the ministry gave up on introducing the centre of vital interests test.

Initiatives to reduce the length of stay for individuals wishing to assume Russian tax residence have been declared before, but none of them resulted in any formal regulation. However, from 2019, the Russian Tax Code has a

provision to the contrary: a sanctioned tax resident can waive his Russian tax residence, if he has a tax residence in another jurisdiction. This is seen as a measure to eliminate double taxation.

The centre of vital interests test has been widely applied by many European countries.

At the same time, another initiative of the Ministry of Finance gained momentum, albeit after certain changes: Dmitry Medvedev tasked the relevant ministries with drafting a bill, enabling the 13-percent PIT rate for non-residents’ employment income, by 12 March 2020⁴.

Thus, the original proposal made by the Ministry of Finance to change the Russian tax residence rules for individuals has undergone a number of significant changes within just a few weeks. In what form it will reach the stage of a bill (if at all), remains unclear.

We are keeping track of how this initiative is evolving. We will be happy to assist you with assessing the impact of tax legislation changes on your business and to analyse the possible tax risks.

¹ <https://www.interfax.ru/business/679671>

² <https://ria.ru/20191025/1560196100.html>

³ <https://www.interfax.ru/business/682573>

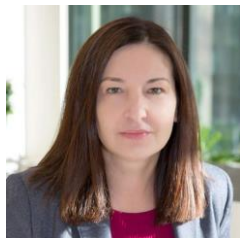
⁴ <http://government.ru/orders/selection/401/38219>

Contacts

We hope that you have found this issue to be both informative and useful. Please feel welcome to contact us at +7 (495) 787 06 00 for questions or comments.



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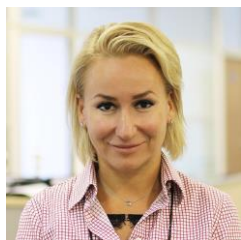
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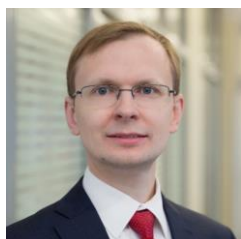
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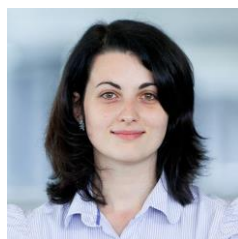
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