

12 August 2014



On 11 August 2014, within the framework of additional discussions between the business community and the RF Ministry of Economic Development, the Russian Union of Industrialists and Entrepreneurs published its own version of the Federal Law "On amending Parts I and II of the RF Tax Code (in respect of the taxation of the profits of controlled foreign companies and income of foreign organisations)" ("the Draft Law") on its official website¹.

According to this version of the Draft Law, all of its provisions come into effect on 1 January 2019.

Please find below an overview of the key features of the Draft Law as proposed by the Russian Union of Industrialists and Entrepreneurs.

Key points:

Controlled foreign companies (CFCs)

- The definition of a CFC in this edition no longer includes foreign structures established in any form other than a legal entity (i.e. trusts, funds, etc.)
- The RF Ministry of Finance "blacklist" is proposed as the basis for forming a list of jurisdictions whose tax residents may be considered CFCs
- For an entity to be considered a CFC, the threshold of direct and indirect participation of the controlling party (in conjunction with related parties) in a legal entity must exceed 50 percent
- A foreign legal entity (and its direct/indirect subsidiaries) should not be considered a CFC if its shares or depository receipts are listed or have been admitted for listing on a foreign stock exchange included on the list approved by the Bank of Russia in coordination with the RF Ministry of Finance or are listed on a Russian stock exchange (in the official edition of the Draft Law prepared by the RF Ministry of Finance, depository receipts and listings on Russian stock exchanges are not taken into account when determining the list of excluded entities)
- Similarly, if the shares or depository receipts of the controlling party are listed or have been admitted for listing on a foreign or Russian stock exchange, a foreign entity controlled by that party should not be considered a CFC. In addition, a legal entity cannot be considered a CFC if it is controlled by a subsidiary/related party of an organisation with shares or depository receipts listed or admitted for listing on a foreign or Russian stock exchange
- A foreign legal entity is not considered a CFC if it performs certain types of activity (particularly if it is a party to a production sharing contract (PSC), concessional or service agreement, performs shipping by means of maritime transport or (sub)leases seagoing vessels, performs banking operations, operations for the exploration and extraction of natural resources, etc.)

¹

<http://media.rspp.ru/document/1/2/d/2def9e035c97de6a93f63b7ba3ecf34.docx>

- The tax base is calculated as the net profit of the CFC (confirmed by its financial statements, prepared in accordance with its own local legislation), less dividends paid during the accounting period. When determining the profits of the CFC, the revaluation of assets of the foreign legal entity at the market level is not taken into account. In addition, special rules are introduced for accounting for the revaluation of securities and financial instruments of term transactions for the purpose of calculating the profits of CFCs
- The profits of a CFC are reduced by the amount of share capital contributions made, or the cost to acquire shares of a Russian legal entity, provided the shareholding in that entity exceeds 25 percent (including relevant investment)
- Losses incurred within the previous 10 years (but no earlier than 1 January 2015) may be offset
- The Draft Law provides a mechanism to offset the Russian withholding tax paid by the CFC or its subsidiaries with direct/indirect ownership of no less than 25 percent if the respective income has been reflected in the CFC's financial statements
- The profits of a CFC are included in the tax base of a controlling party only if they exceed 10 million RUB (this threshold is set at 50 million RUB in 2016 and 30 million RUB in 2017)
- The Draft Law proposes reducing the requirements for providing notifications, requiring notifications only in regard of CFCs (the RF Ministry of Finance's edition of the Draft Law requires notifications to be filed in regard of all foreign companies with a minimum participation of 1 percent)
- As an additional transitional provision, this version of the Draft Law exempts taxpayers from fines in respect of calculation of the tax base and reporting on CFCs, as well as exemption from criminal liability until 2019

Tax residency of legal entities

- The Draft Law provides modified criteria for determining the tax residency of legal entities:
 - More than 50 percent of meetings of the Board of Directors (or any similar body) are held on the territory of the Russian Federation
 - The executive body of the legal entity usually conducts its activity on the territory of the Russian Federation
- Only one additional criterion is included: accounting and bookkeeping are conducted in Russia.
- A new provision is introduced, according to which a foreign legal entity is not deemed to be a tax resident of Russia if at least one of the following is true:
 - Its controlling party is a Russian company with shares or depository receipts listed on a foreign or Russian stock exchange
 - More than 50 percent of the income of the foreign entity is earned via its own commercial activities (operating, trading, etc.)

Concept of "beneficial ownership"

- If an actual recipient of income that differs from the legal owner of said income is a Russian tax resident, then income paid from Russia to a foreign legal entity is not subject to withholding tax in Russia in accordance with Article 309 of the RF Tax Code, but is subject to income tax in accordance with the provisions of the RF Tax Code applicable to relevant taxpayers. The Draft Law introduces the look-through principle when determining the status of the actual recipient of income.

Overall, the version of the Draft Law proposed by the Russian Union of Industrialists and Entrepreneurs represents a reasonable attempt on the part of the business community to soften the provisions of the Draft Law developed by the RF Ministry of Finance. We cannot exclude the possibility that the final version of the Draft Law, which should be prepared by autumn 2014, may represent a compromise between the harsher proposals of the Ministry of Finance and the more liberal ideas of the business community.

Contacts

If you have any questions regarding the information provided in this issue, please feel free to contact our Tax & Legal specialists:

Gennady Kamyshnikov Partner +7 (495) 787 06 00 ext. 2092 gkamyshnikov@deloitte.ru	Grigory Pavlotsky Partner +7 (495) 787 06 00 ext. 2102 gpavlotsky@deloitte.ru	Elena Solovyova Partner +7 (495) 787 06 00 ext. 2064 esolovyova@deloitte.ru	Svetlana Meyer Partner +7 (495) 787 06 00 ext. 2039 smeyer@deloitte.ru
Yulia Krylova Director +7 (495) 787 06 00 ext. 2461 ykrylova@deloitte.ru	Natalia Gluschenko Manager +7 (495) 787 06 00 ext. 1471 ngluschenko@deloitte.ru		

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms. Please see www.deloitte.com/ru/about for a detailed description of the legal structure of Deloitte CIS.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world class capabilities and deep local expertise to help clients succeed wherever they operate. Deloitte has in the region of 200,000 professionals, all committed to becoming the standard of excellence.

Deloitte's professionals are unified by a collaborative culture that fosters integrity, outstanding value to markets and clients, commitment to each other, and strength from diversity. They enjoy an environment of continuous learning, challenging experiences, and enriching career opportunities. Deloitte's professionals are dedicated to strengthening corporate responsibility, building public trust, and making a positive impact in their communities.