

October 27, 2014

Dear Sirs,

As we informed earlier, the Ministry of Finance of the Russian Federation (the “**MinFin**”) has published three 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 October 22, 2014 the Draft Law was submitted to the Russian State Duma. Even though the main aspects remained unchanged, significant amendments and additions were made to the Draft Law as compared to the previous version.

For example, “active” foreign companies are not subject to the CFC rules; in a contrary, public companies are not exempt from the CFC rules anymore; the threshold for submitting a notification on participation in foreign companies is reduced. Below we outline the 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 CFC and on direct or indirect participation in a foreign company of more than 10% (instead of 25% as it was in the previous version). Russian tax residents are also obliged to inform on establishment of foreign structures, on control over it as well as on having actual right on income of such structure.

The penalties for non-notification remain the same. Thus, the penalty for non-notification on a foreign company / structure 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).

The new provision on notification was added. Thus, if the tax authorities become aware of a CFC that was not reported by a Russian tax resident, the tax authorities will require submission of a clarification within 20 days or issue a notification within the prescribed deadline. In its request, the authorities shall provide detailed information on the company and describe the grounds for deeming it as a CFC. If documents and clarifications provided by the taxpayer do not persuade the tax authorities they may claim the taxpayer to be a controlling person. After that the taxpayer has three months to dispute this claim in the court. If there is no dispute, the taxpayer obtains the status of controlling person and is subject to all requirements with regards to the CFC.

### *Definition of CFC*

In general, definition of the CFC remains the same. However certain changes were introduced in the list of the companies that are not subject to the CFC rules.

Thus, the following companies / structures are not recognized as a CFC (i) entity, which is a resident in a country having a double tax treaty (the “**DTT**”) with Russia, excluding “blacklist” jurisdictions<sup>1</sup> AND its income/profit is subject to taxation at the average weighted rate exceeding 15%<sup>2</sup>; OR which share of incomes from passive activities (e.g. dividends, interest, etc.) is not more than 20% of total incomes; (ii) some others companies and structures.

Contrarily to the previous version public companies may be regarded as CFC.

#### *Taxation of CFC’s profit*

CFC’s profit is taxable at the basic rates (13% for individuals, 20% for companies) and is determined based on:

- Its financial statements, in case such financial statements are subject to mandatory audit, and if the CFC is a resident of a jurisdiction having a DTT with Russia; OR
- The Chapter 25 of the Russian Tax Code in all other cases.

CFC’s profit may be reduced by dividends (distributions in case of structures) paid from such profit. 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.

If, in certain cases, CFC does not distribute its profit because of increasing of its charter capital, such profit shall not be taxable in Russia.

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 of tax on CFC’s profit in 2015-2017.

No criminal liability should be imposed for non-payment of tax on CFC’s profit in 2015-2017 if the tax would be paid in full by the taxpayer.

## **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 a foreign entity, receiving income from Russian company, does not have actual right to receive the income (not only dividends as it was established by the previous version), provision of the relevant DTT is not applicable. However, another person having actual right to receive the income, can apply DTT if such person is a resident of a country

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<sup>1</sup>The “blacklist” will be approved by the Federal Tax Service and will include jurisdictions that do not exchange tax information.

<sup>2</sup> The Draft Law contains references to formulas for calculating the average weighted rate; however the formulas themselves are not listed herein.

having a DTT with Russia. If the person having actual right to receive the income is a Russian tax resident, regular tax rates will apply to such income.

### **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. Comparing with the previous version, the Draft Law clarifies criteria of “majority” and “regulatory”.

The Draft Law also clarifies which activities performed in Russia would not by themselves result a Russian tax residence (e.g. making decisions on matters within the competence of the general meeting of shareholders, strategy planning, budgeting, etc.)

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The Draft Law is submitted to the State Duma that would consider it in three “readings”. Draft laws are often amended after the first and second readings in the State Duma. Based on the information available in public sources the first reading is appointed on November 11, 2014. 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**

*Note: All information was obtained from publicly available sources. The author of this newsletter assumes no liability for the consequences of decision-making based on such information.*