OFFSHORE AMNESTY AND TAX REPATRIATION IN ACTION

For the attention of Russian entities and individuals who do business through foreign legal entities (companies) or structures created without a legal entity being established.

Pepeliaev Group advises that decisions have been taken which were needed for the law on 'tax repatriation' (in effect from 2015) to take full force:[1]

1) the procedure and the time frames have been set for the 'offshore amnesty';

2) clarifying amendments have been made to the law on 'tax repatriation';

3) a form of a notice of a participation interest in foreign entities has been approved. In respect of an existing participation interest, such notice was to be filed by 15 June 2015.

'Offshore amnesty'

The Russian parliament has adopted the federal law "On individuals voluntarily declaring assets and accounts (deposits) in banks ..." (the "amnesty law").[2] According to the amnesty law, individuals who have transferred their income to foreign jurisdictions or opened bank accounts abroad and have not notified tax authorities of this may submit a declaration which will relieve them from negative tax and other implications (including administrative and criminal liability).

The law extends to income transferred and accounts opened before the date on which law on 'tax repatriation' took effect, in other words before 1 January 2015.

Tax authorities may be notified both of the property for which the declarant is recognised as the direct owner, and of the property ownership title to which is held through a 'nominal owner' to the benefit of and/or on behalf of what the law calls the 'actual owner'. The same approach applies to accounts with foreign banks (both direct and beneficial ownership may be declared).

The amnesty law does not make it clear how control over foreign structures which are created without a legal entity being established correlates to the actual owner exercising its ownership title through a foreign nominal owner (for example, via establishing a trust). The ground on which a declaration is filed depends on this. Moreover, if a declaration is submitted in the latter of the above cases, a nominal ownership contract certified by a notary should be attached to it. No such contract is required in the former case. We believe that these doubts should be interpreted in favour of a declarant which is a taxpayer. This means that the declarant has the right to choose the ground on which it submits the declaration However, we cannot rule out that in practice tax authorities will require that the declaration be filed on the second ground or on both grounds.

The amnesty law sets a list of assets which may be declared:

1) ownership interests (participation interests, equity units of) and shares in entities, as well as control over a foreign entity or a structure on other grounds;

[1] Federal Law No. 376-FZ dated 24 November 2014 "On amending the first and second parts of the Russian Tax Code (to the extent of taxing the profit of controlled foreign companies and the income of foreign organisations)" dated 24 November 2014.
[2] Federal Law dated 8 June 2015 No. 140-FZ

2) real estate, transportation vehicles (vessels) and securities (other than shares);

3) accounts with foreign banks and money on them.

The fact that this list of assets is so limited can be explained by the lack of provision in Russian legislation for an obligation to disclose to tax authorities information about other assets. Other assets, including those purchased to derive income (such as items of cultural value, intellectual property and others), are not declared as such. However, income derived from them may be declared if it has been received in foreign bank accounts. The amnesty law does not provide for an opportunity to declare cash (paper money).

If a declaration submitted, this relieves the declarant from:

- any tax additionally charged or recovered;

- any liability for a shortfall in paying taxes and customs duties under the Russian Tax Code, Code of Administrative Offences and Criminal Code (to be relieved of criminal liability, one does not have to pay the outstanding amount, any default interest or fine);

- liability for violating the procedure for carrying out operations with cash and for violating currency legislation (articles 15.1 and 15.25 of the Code of Administrative Offences, and article 193 of the Russian Criminal Code).

The relief applies to operations which were performed before 2015 and which related to assets that were declared.

The declaration may specify that a legal entity took part in the purchase (forming sources for the purchase), use or disposal of the assets declared. In this case the relief will apply to parties who according to executive documents of such entity "performed organisational, management or administrative functions in it", i.e. not only to the declarant but also to employees who acted on its behalf.

As a rule, the relief is allowed whether the declared assets are returned to Russia or not. However, for the relief to apply, such assets must be returned if at the date when the declaration is submitted they are located:

1) in a state (within a territory) included in the FATF anti-money laundering list;[1]

2) in a state (within a territory) which does not ensure that information is exchanged with Russia for tax purposes. A list of such states has not been approved yet.

In both cases where assets declared are returned to Russia on a voluntary or compulsory basis, such transaction shall be exempt from tax. If repatriated assets are subsequently sold, the declarant may deduct as expenses their value as at the time when they were returned to Russia.[2]

The law directly establishes the form of and the procedure for filling in and submitting the declaration.

A number of formal requirements should be met (a declaration should be printed out on one side of the sheet only, the declarant is to sign each page, and similar). As for accounts with foreign banks, a notice on these accounts is to be submitted together with the declaration. It must be issued in the established form and contain information about the opening of and/or changes to such accounts.

The declaration is to be submitted to a local tax authority at the place where the declarant permanently or temporarily resides. If the declarant has no residence, or if the declarant so chooses, the declaration may be filed with the Russian Federal Tax Service.

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[1] http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions/documents/public-statement-february-2015.html

[2] According to amendments to the law on 'tax repatriation' as described in detail below.

The declaration is to be submitted by 31 December 2015.

It may be submitted only once, and no revised declarations are accepted. If any assets are not stated in the declaration, the above cases of relief will not apply to them. However if any omissions or any similar mistakes are made which do not prevent tax authorities from identifying the declarant and declared assets, such declarant will not be deprived of the right to apply the relief.

The relief is applied provided that the relevant authority has not initiated proceedings concerning any specific offence. If such proceedings have been initiated, such authority will at its discretion decide whether the proceedings should be terminated.

We recommend that when planning to submit the declaration you take into account all the above factors: the formal requirements and the prohibition on submitting a revised declaration, on the one hand, and the fact that you may lose the right to apply the relief if investigations are initiated before the declaration is filed, on the other hand.

With a view to maintaining tax secrecy, declarations are kept in the Russian Federal Tax Service.

No other public or private authorities or organisations may obtain access to such information and documents.

However, the amnesty law lacks a clearly defined mechanism to ensure that the above requirements are met.

The above options are available only to individuals.

A Russian company that is a beneficial owner of foreign assets cannot directly apply these reliefs. Article 277 (2.2) and article 309.1(10) of the Russian Tax Code allow entities which have repatriated their assets to be exempt from profit tax at the time of such repatriation (when shares or ownership titles are bought back or when foreign entities are liquidated). However, there is still a risk that tax claims may be raised against such entities for even earlier periods when income was derived abroad.

When consideration is being given to whether to file a declaration in relation to assets, such assets may be owned by a foreign entity or structure which is created without a legal entity being established. Such entity or structure, in turn, may be co-owned by several individuals. In our opinion, if any foreign entity or structure is a nominal owner, the individuals may file a declaration stating the actual shares they hold in it.

Amendments to the law on 'tax repatriation'

The Russian Parliament has adopted a law[1] which irons out some drawbacks of the law on 'tax repatriation'. Such drawbacks result from the expedited adoption of the law in autumn 201 4. At that time the Russian Ministry of Finance proposed to pass a number of governmental amendments during the second reading, but these were rejected on the ground that they would be introduced later. To date most of the amendments have been adopted (their wording being somewhat adjusted).

The following amendments to the rules for a foreign company to be treated as a Russian tax resident were adopted:

- the criteria have been clarified showing that an entity is a resident. The criterion regarding the venue of the Board of Director's meetings has been removed; the criteria relating to activities of executive authorities have been kept. The second group of the criteria, including accounting, document management and HR management, has become optional and will apply if the main criteria are met for two or more states;

[1] Federal Law No. 150-FZ dated 8 June 2015

- the scope has been narrowed of the exemption from meeting the tax residence rules for companies which are residents of countries that are parties to an international taxation treaty; this exemption was excessively broad. Now companies will be exempt if they are not just tax residents of one such country, but if they provide evidence that they have qualified personnel and take decisions in that particular country.

For now, no specifics have been approved for foreign entities treated as Russian tax residents to register with tax authorities.

We believe that the management bodies of such entities operating in Russia may be treated as standalone business units of the entities in question and registration must be put in place with the Russian tax authority situated at their location.

Neither is it clear whether tax residence is determined as at the end of the tax period or as at the date on which income is booked according to the Russian Tax Code, or in a different way. This issue is important for foreign companies in which management procedures have been changed after the law on 'tax repatriation' took effect.

In the rules on controlled foreign companies ('CFCs') new exemptions from Russian tax have been introduced with regard to CFCs' profit:

- for active foreign holding and sub-holding companies through which Russian entities participate indirectly in active foreign companies (with share of the active business income being no less than 80%);

- if interest in such companies is held indirectly through Russian public companies;

- for irrevocable trusts;

- a CFC's profit may be reduced by the dividends from Russian companies, if the CFC is the beneficial owner of such dividends.

The amendments do not raise the 25-percent threshold for the participation interest which is considered to be a controlling interest and is to be applied starting from 2016. The 50-percent threshold is applied only in 2015. This may create a conflict between tax consequences and the relationship that actually exists in cases where in fact there is no corporate control.

However, the enacted amendments do not include a previously announced amendment under which a CFC's profit may be calculated based on laws of its country of incorporation (as a rule, such laws refer to the IFRS) if the CFC is subject not only to compulsory auditing but also to voluntary auditing.

The period for submitting a notice regarding a participatory interest in foreign entities was previously extended until 15 June 2015. A form of the notice was approved by Order No. MMV-7-14/177@ of the Russian Federal Tax Service dated 24 April 2015.

A failure to submit the notice if a CFC receives income may be treated as a ground for conducting a thorough tax audit. It may also serve as a factor aggravating any shortfall in tax paid if such is detected.

What to think about and what to do

The ways for companies to adapt to the new requirements remain as follows:

- a CFC's profit being distributed at a tax rate on dividends lower than the generally set rate; such lower rate will apply to the CFC's imputed profit, including a 0% rate (subject to conditions) if the dividends are received by a legal entity (these may include entities incorporated outside Russia which have recognised that they are Russian tax residents);

- structures which have no apparent business purpose to conduct their activities abroad, being 'repatriated'. As mentioned above, if assets are repatriated in the form of a participation interest being sold to Russian entities or a liquidation surplus being received by Russian entities, they are exempt from taxes provided that the liquidation of the foreign companies is completed before 2017. Individuals may deduct as expenses the value of such assets as at the time when they were repatriated. However, legal entities may in such case deduct only historical cost. They also may not directly apply the 'offshore amnesty' to previous periods.

Help from your adviser

Lawyers of Pepeliaev Group are ready to assist legal entities and individuals in the practical application of the 'tax repatriation' and the 'offshore amnesty' rules. This includes assessing implications and risks and drafting necessary documents

We prepare recommendations that relate to using foreign jurisdictions together with our partners in the international networks Taxand and Terralex, which bring together most competent teams of independent advisers all around the world. In doing so, we comply with the strictest confidentiality requirements.

Contact information

Petr Popov
Senior Associate
Pepeliaev Group
T: +7 (495) 967 00 07
P.popov@pgplaw.ru

Egor Lysenko
Head of Pepeliaev Group's
Siberian Office in Krasnoyarsk
T.: +7 (391) 277-73-00
E.Lysenko@pgplaw.ru

Sergey Sosnovsky
Head of Tax group
in St Petersburg
Pepeliaev Group
T.: +7 (812) 640-60-10
s.sosnovsky@pgplaw.ru