NEW AMENDMENTS TO THE "DEOFFSHORISATION AND REPATRIATION" TAX RULES ANSWER OLD QUESTIONS AND RAISE NEW ONES

For the attention of Russian companies and individuals who use in their activity foreign legal entities (companies) and structures which are created without a legal entity being established

Law firm Pepeliaev Group advises that new amendments have come into force to the tax rules regarding deoffshorisation and repatriation[1].

The new amendments answer certain questions regarding the procedure for applying the rules which were adopted earlier. However, some questions remain unanswered and new issues have arisen. It is expected that during the spring session the State Duma will adopt one more set of amendments (the third one). In the meanwhile, one year after the deoffshorisation rules have come into force, they still lack clarity and definition. This compels businesses to hold off adopting and performing specific decisions aimed at adapting to the new tax conditions.

Amendments that improve the position of taxpayers

A range of new amendments improve the position of taxpayers.

Timeframes have been extended for foreign companies to be liquidated as required for certain tax incentives (release of a foreign company from the status of a Russian tax resident and tax exemption of income in a form of a liquidation surplus or income from a CFC's sale of membership interests or shares for the purpose of repatriating them). The general timeframe has been extended for one year, until 2018. For certain special situations, when objective reasons (requirements of a foreign legislation, court disputes, etc.) prevent the liquidation, the liquidation may be performed within one year after such reasons cease to apply.

The timeframe for submitting notifications of membership interests in foreign companies has been extended from one month to three months. A time limit for submitting the notifications has been set for individuals who became tax residents (based on the results of a calendar year) after they had acquired membership: before 1 March of the following year.

A long-expected amendment has been adopted regarding the opportunity to calculate the profit of controlled foreign companies (CFC) in accordance with IFRS or other generally accepted rules. For CFCs incorporated in countries with which Russia has international double taxation treaties and for CFCs whose financial statements have been audited, such method for calculating profit becomes the primary one and applies "by default". A controlling party may adopt a decision that the profit will be calculated in accordance with the Russian Tax Code (the "Tax Code"). Such decision of the controlling party must have effect for a minimum of 5 years.

Foreign companies that have acknowledged themselves tax residents of Russia may apply the 0% rate to dividends they receive (provided that other requirements have been met as set out in article 283(3)(1) of the Tax Code). This opportunity may be used if a foreign company is needed for the purposes of applying foreign law to transactions or for other similar purposes which are not connected with obtaining tax advantages. However, if the status of a Russian tax resident was "forced" upon a company at the tax authority's initiative, the 0% rate will not apply.

More amendments have been introduced to eliminate inaccuracies which were identified while businesses adapted themselves to the new tax rules. Other new amendments apply to certain specific business areas. There is a considerable number of such amendments.

[1] Federal Law No. 32-FZ dated 15 February 2016.

All amendments, including those described above and others, should be carefully studied. Some earlier amendments turned out to be incorrect and were replaced with new ones. The new amendments may also contain shortcomings.

Amendments which impose an additional burden on taxpayers

The most obvious amendment imposing an extra burden on taxpayers is the change in the procedure for how Russian companies should pay certain types of income (dividends, interest, etc.) to foreign parties.

Starting from 2015, for a foreign party to use tax benefits (reduced rates or tax exemption) set out in international tax treaties, it should be a beneficial owner of the income.

The Russian payer of the income has a right to request from the recipient of the income a confirmation that it is the beneficial owner of the income.

Starting from 2017, this right will be replaced with an obligation of a foreign recipient of income to provide the Russian company with such confirmation.

At present, when the beneficial ownership of income is checked using the procedure that is currently in effect, tax agents can also incur tax risks. If the Russian company that is a tax agent exercises its right to request the appropriate confirmation, this can be treated as a practical example of due care. If, under the circumstances of the payment, the tax agent had grounds to doubt whether the beneficial ownership of income existed but did not send the appropriate request, the tax authority may attempt to raise claims against the tax agent. According to case law, the tax agent may be charged not only with late payment interest and a fine, but the tax arrears as well, in view of it being impossible to collect it from the foreign party[2].

Amendments that have failed to eliminate legal uncertainty for business

The greatest differences arise in the interpretation of article 309.1 of the Tax Code. They are connected with taxation of a CFC selling investment assets (shares or membership interests in a limited liability company) to a Russian controlling entity or one of its related parties.

On one hand, an obvious gap in legislation has been plugged: a tax exemption is now possible not only when these assets are sold to a Russian company that is the controlling entity of the CFC or to a related party of the controlling entity, but also when they are sold to an individual who is the controlling person.

On the other hand, the range of new amendments not only fail to address the previous questions on the procedure for the application of the corresponding rules, but also give rise to new questions.

The initial version of article 309.1(10) of the Tax Code provided that the income and expenses of the CFC should be identified, as well as the acquisition cost of assets for the Russian company, equal to the documented cost of assets according to the accounting records of the CFC (but not exceeding their market value). No requirements were imposed regarding the price of the transaction.

The new version of article 309.1(10) of the Tax Code excludes from the profit of the CFC the income and expenses connected with the sale of the assets for the purpose of repatriation, but on condition that the price of the transaction is equal to the cost described above.

It is unclear what the purpose is of imposing requirements regarding the price of the transaction while taxes are calculated based on a fixed value that is independent on this price. Since this requirement did not previously exist, it imposes additional obligations on taxpayers. By virtue of article 5(1) of the Tax Code, it should not apply until 1 January 2017.

However, a risk exists that a harsher approach will be applied, because the legislature directly points out that the new version of the article should apply to relationships created after 1 January 2015. Further, it is important that these amendments are introduced before the timeframe expires for the tax for 2016 on the profit of CFCs to be calculated and paid.

Neither the old nor the new version of article 309.1(10) of the Tax Code directly prohibit the documented cost of assets from being identified taking account of revaluation in accordance with IFRS.

[2] Clause 2 of Resolution No. 57 of the Plenum of the Russian Supreme Commercial Court dated 30 June 2014 .

This procedure for identifying the cost of assets essentially opens up an opportunity for repatriating assets and exempting from taxation their market value as established before the repatriation, in the case of a possible future sale. Such an incentive for the repatriation of assets is in line with the expectations of the business community. However, the Russian Ministry of Finance has not yet provided a straightforward clarification that such interpretation of the law is correct.

Article 309.1(3)(1) of the Tax Code provides that if the profit of a CFC is calculated according to IFRS, it should not include revaluation of membership interests and shares.

At the same time, article 309.1(3.1) of the Tax Code provides that when membership interests or shares are disposed of, the profit or loss of the CFC calculated according to IFRS should be adjusted by the results of the revaluation of them.

It is unclear from the law whether such adjustment should be performed when membership interests or shares are disposed of in the context of being repatriated; in other words, if article 309.1(10) is a special provision for article 309.1(3.1) or, vice versa, if the adjustment taking account of the revaluation is a special rule for article 309.1(10).

Similarly, if the profit of a CFC is calculated under the Tax Code, it is unclear whether the Tax Code prohibits (i) records of assets being kept in accordance with IFRS when the profit of a CFC is calculated; and (ii) the "documented cost according to the accounting records" using the revaluation results (similarly to how accounting records are used when no direct instruction is given to apply taxation rules when the tax is calculated within the country) from being identified. Nor is it clear whether the revaluation results should be adjusted during a transition from IFRS to the rules of the Tax Code, etc.

Unresolvable doubts as to the content of tax regulations are to be interpreted in favour of taxpayers (article 3(7) of the Tax Code). However, a risk exists that tax authorities and courts will treat these doubts as resolvable to the detriment of taxpayers. Therefore, if it is possible in a specific situation to postpone the sale of assets by the CFC, we recommend doing so so until these discrepancies are eliminated in terms of interpretation of the amendments being reviewed.

An alternative way to repatriate assets is to receive them as a liquidation surplus. At the same time, while legal entities may exempt the liquidation surplus in any form from tax, individuals may not exempt from tax the liquidation surplus in a monetary form.

Additionally, the "offshore amnesty"[1] law provides that assets may be transferred from a nominal owner to the actual owner, and the previous amendments exclude such transactions from the concepts of sale and income. However, this is only possible if the tax return is filed within the framework of the "offshore amnesty" on the terms and conditions set out in this law.

What to think about and what to do

We recommend that in the nearest future, your business identify a list of the problems which are connected with the new deoffshorisation rules (including both the interpretation and application of law, and gathering together the necessary documents). It is still possible, as before, that these legal issues will be resolved by further amendments to legislation or clarifications of the Russian Ministry of Finance. However, it would be best to collect in advance the required evidence (auditors' and valuation reports, etc.).

Help from your adviser

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

With our partners in the international networks Taxand and Terralex, which bring together most competent teams of independent advisers all around the world, we draw up recommendations concerning how to use foreign jurisdictions. In doing so, we comply with the strictest confidentiality requirements.

[3] Federal Law No. 140-FZ dated 8 June 2015.

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