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# Tax risks and advantages of creating a joint venture in Russia

16 February 2012



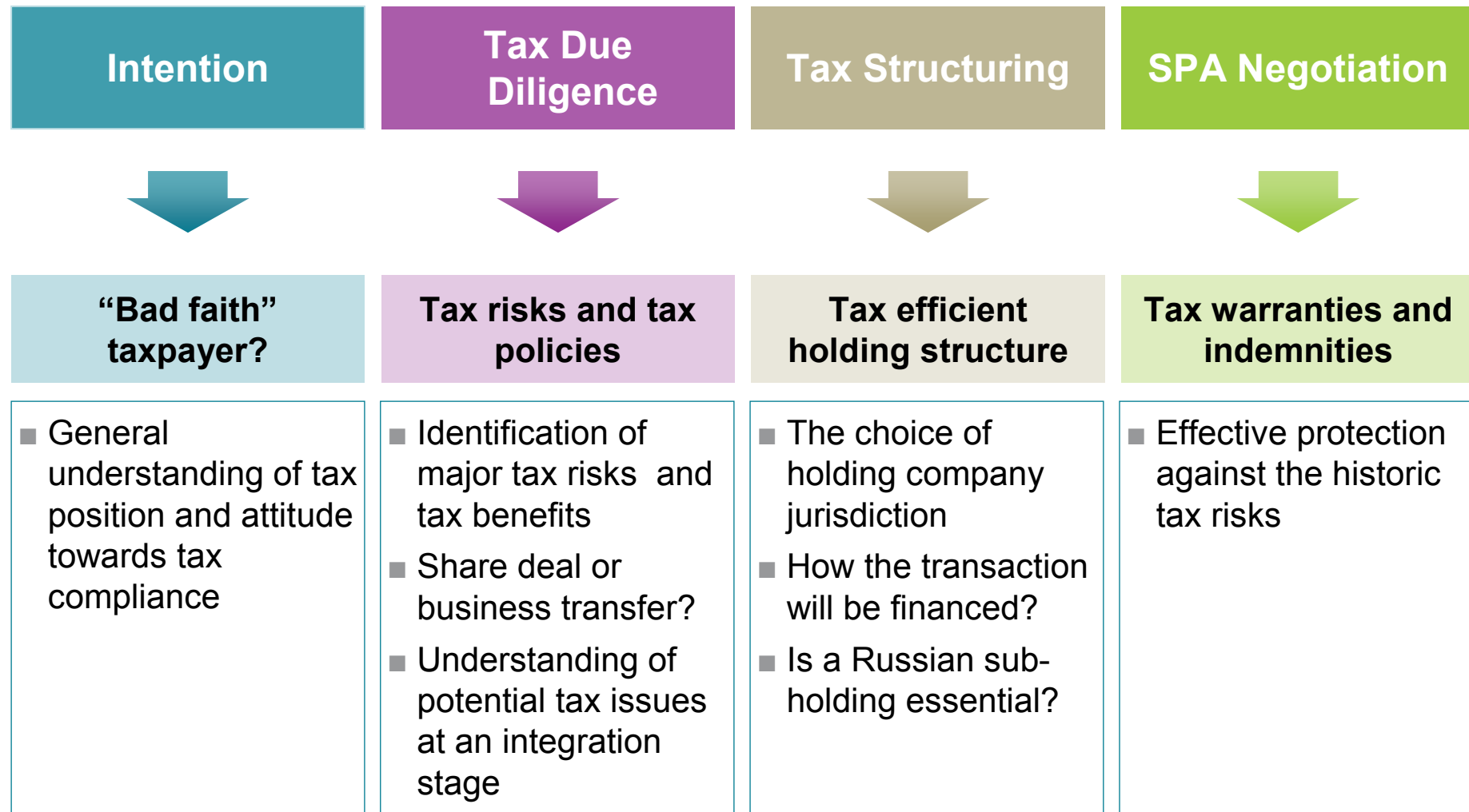
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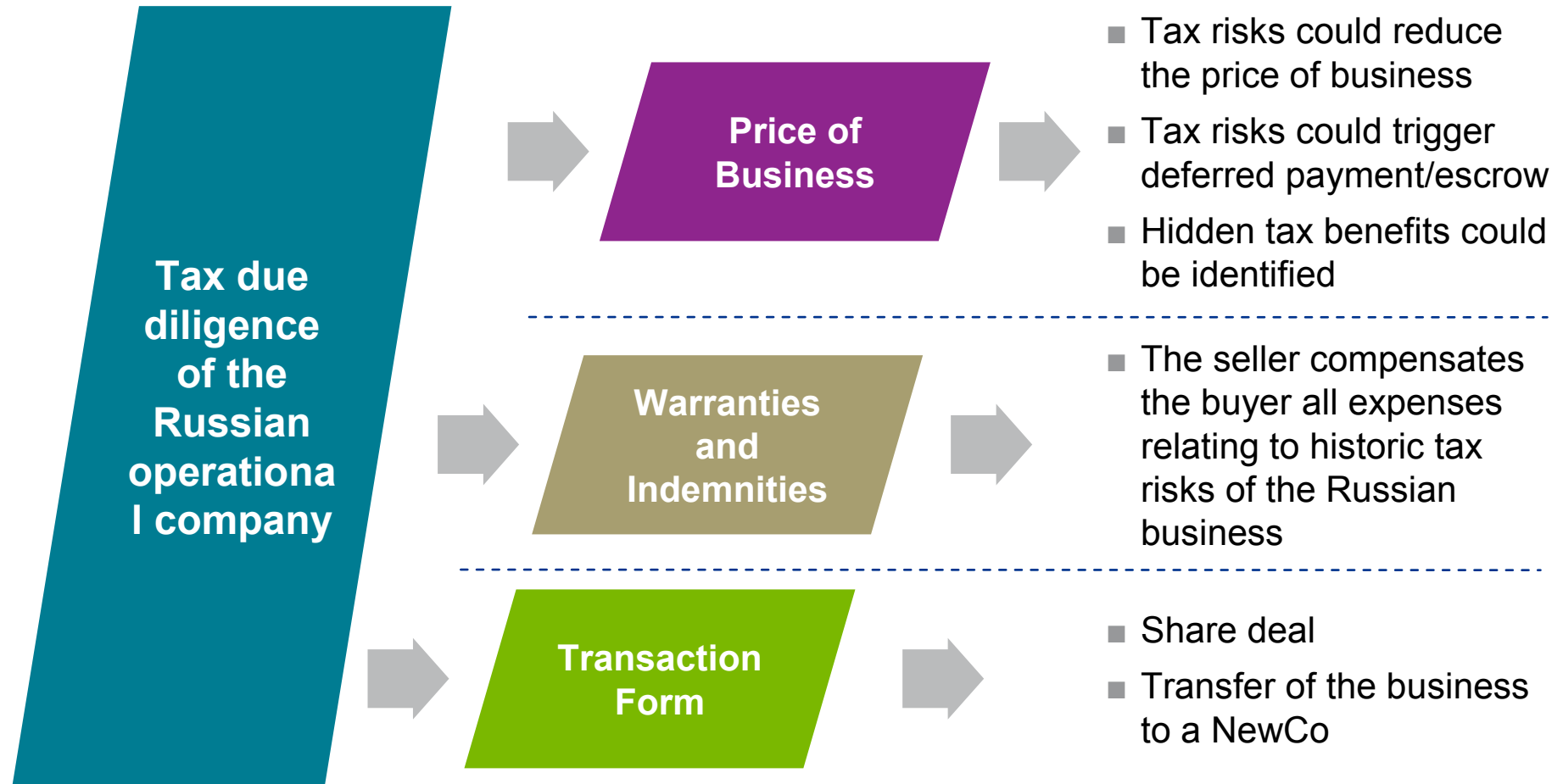
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# How to identify and address tax risks before signing? JV process milestones



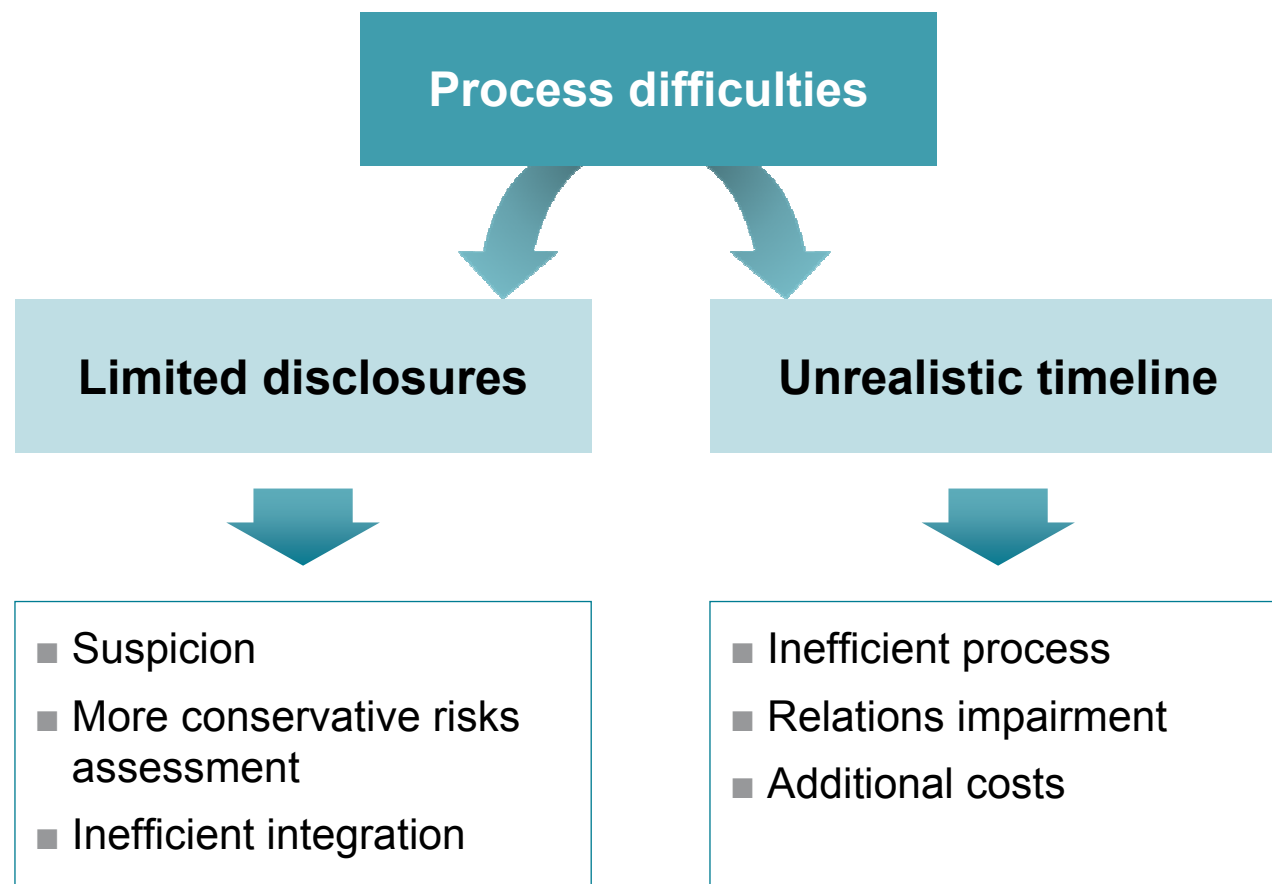
# How to identify and address tax risks before signing?

## Tax due diligence (1/2)



# How to identify and address tax risks before signing?

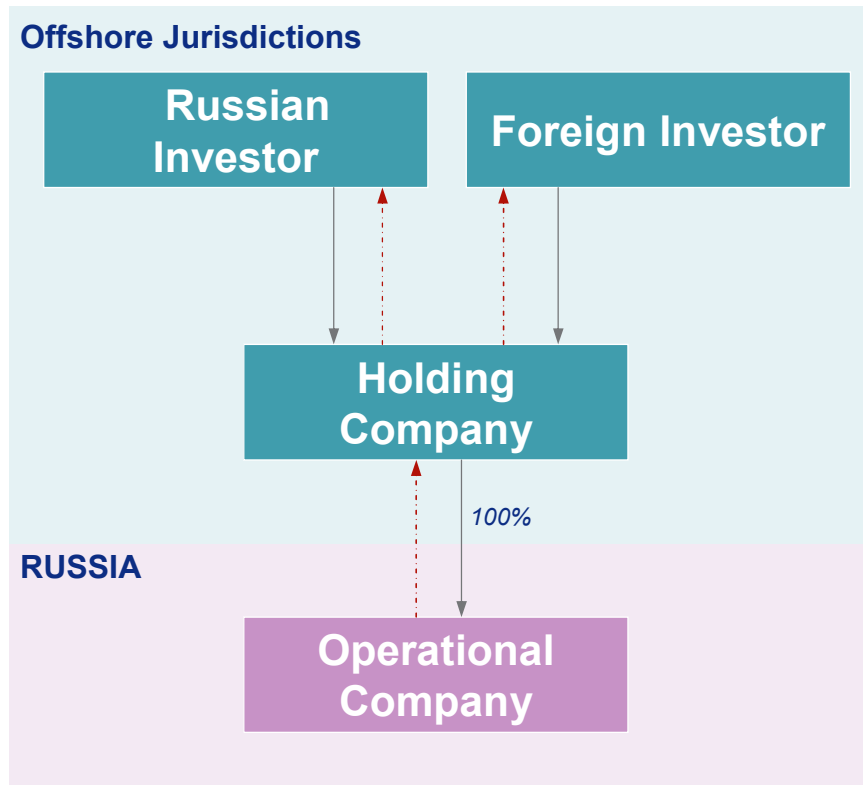
## Tax due diligence (2/2)



# How to identify and address tax risks before signing?

## The choice of holding structure

### Offshore holding



—> HOLDING  
-.-> PROFITS DISTRIBUTION

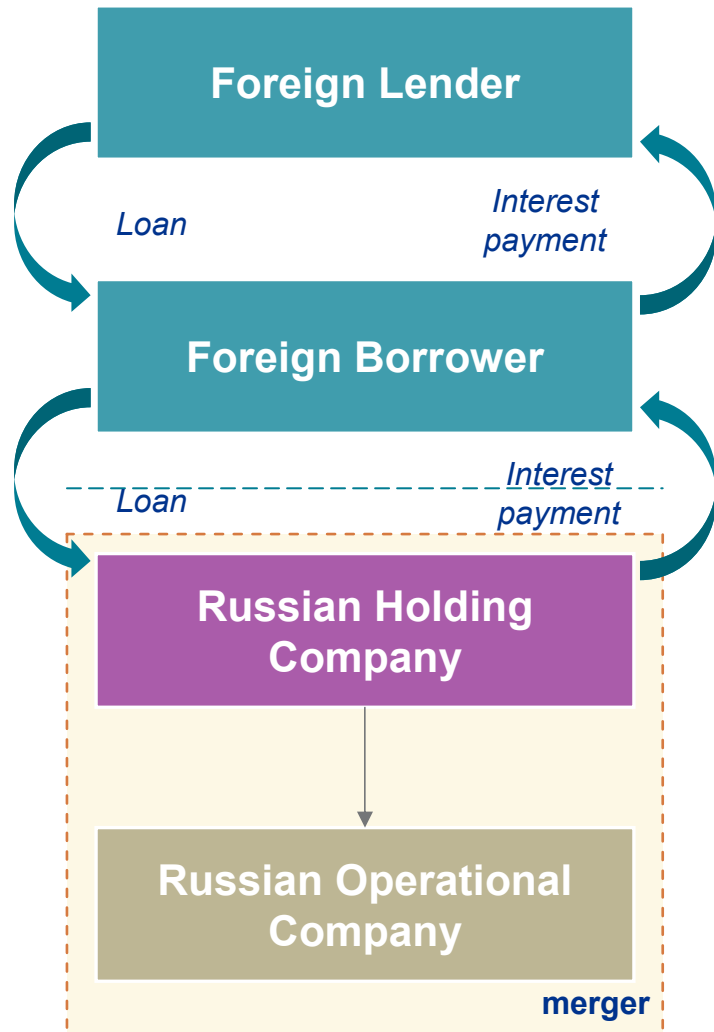
- Significant non-tax advantages: better legal protection, ability to effectively enforce court decisions
- Favorable income tax rates relating to profits repatriation under DTTs
- Favorable exit taxation (e.g. in case of Cypriot holding)
- No additional taxation of Russian source income at a holding level /no CFC rules
- Anti-treaty shopping rules are not sufficiently developed in Russia

## How to identify and address tax risks before signing? SPA negotiation positions

|                                      | <b>Seller</b>   | <b>Purchaser</b>  |
|--------------------------------------|---|---|
| <b>Tax definitions</b>               | Limited tax definitions   | Extended tax definitions  |
| <b>Tax indemnities</b>               | No or limited tax indemnities<br>No escrow coverage   | Extended or universal indemnities<br>Escrow protection  |
| <b>Tax reimbursements</b>            | Reimbursement of tax overpayments made prior to closing   | No reimbursement of tax overpayments made prior to closing  |
| <b>Tax warranties</b>                | Limited warranties  | Extended warranties   |
| <b>Procedures relating to claims</b> | The right to participate in any tax related disputes  | The right to ban the participation of the seller in any tax related disputes  |
| <b>Timing</b>                        | Limit the period covered by warranties and indemnities<br>Warranties and indemnities granted for a fixed period | Extend the period covered by warranties and indemnities<br>Warranties and indemnities granted for a period calculated as a fixed term starting from a trigger event |

# Tax aspects of debt financing

## Debt push down



### Purpose

Tax deduction of interest at the level of Russian Operational Company

### Steps

1. Foreign Lender lends money to Russian Borrower to finance an acquisition of shares in a Russian Holding Company
2. Purchase of shares
3. Russian Borrower lends money to Russian Holding Company with a minimal mark-up
4. Merger of Russian Holding Company and Russian Operational Company

### Risks and inefficiencies

1. Russian tax authorities pay special attention to significant interest payments to foreign group companies
2. If the overstatement of interest expenses at the level of Russian Operational Company is proven, additional profits tax and a 20% fine thereof could be imposed
3. Tax deductions in jurisdictions with higher profits tax rate could be more tax efficient



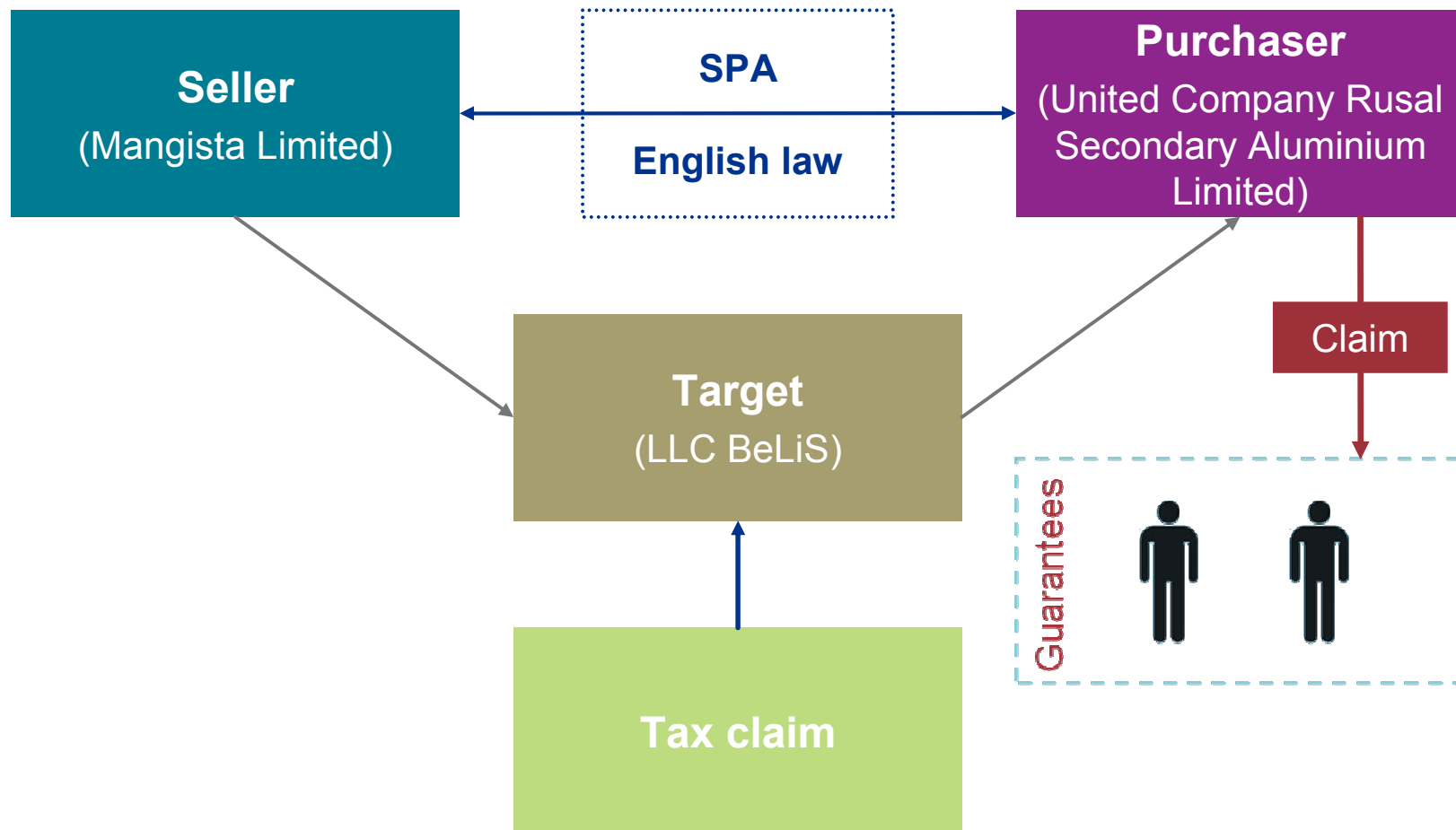
## Tax aspects of debt financing

# Deductibility of interest expenses

1. Generally, interest is a current deductible expense for profits tax in Russia
2. No restrictions to deduct interest on loans received to finance acquisition of shares
3. Interest is deductible within the limits, there are also thin capitalisation rules in Russia (debt to equity ratio =3/1)
4. Disputable application of DTTs provisions overriding Russian thin cap rules
5. Changes possible with regard to new transfer pricing rules introduced starting 01 January 2012

Deductibility of interest expenses on shareholder's loans could be limited under Russian thin capitalisation rules

# Claiming tax compensations in Russian courts



The court ruled in favour of Purchaser



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## Questions?

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