

Base Erosion and Profit Shifting (BEPS)

OR

Deoffshorisation in Russia

12 February 2015



Совершенствуя бизнес,
улучшаем мир

Agenda

1 **Controlled Foreign Company Rules**

2 **Determination of Tax Residency of a Foreign Company by Place of Management**

3 **Concept of “Actual Right to Receive Income” and “Actual Recipient (Beneficial Owner) of Income”**

What is BEPS and what are the goals of “deoffshorisation”?

BEPS and in Russia deoffshorisation is used to initiate a broad campaign against the use of foreign (particularly tax haven) companies by (Russian) businesses. It encompasses measures targeting both the understatement of Russian tax and a lack of transparency in ownership and transaction structures.

How the OECD sees BEPS:

Base erosion and profit shifting (BEPS) is a global problem which requires global solutions. BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid.

BEPS is of major significance for developing countries due to their heavy reliance on corporate income tax, particularly from multinational enterprises (MNEs).

Goals of Deoffshorisation in Russia:

- Reducing Russian tax base erosion
- Increasing transparency
- Increasing tax collection
- Reducing the use of tax haven entities (often referred to in Russia as “offshores” – see left)

How did the deoffshorisation campaign emerge?

Events

12 December 2013

President Putin in his message to the Federation Council asked for “*deoffshorisation*” of the Russian economy

18 March 2014

The Ministry of Finance issued a first draft of the law concerning amendments to the Tax Code “Concerning the Taxation of Profit of Controlled Foreign Companies and the Raising of the Effectiveness of the Tax Administration of Foreign Organizations)

27 May and 26 August
2014

Revised versions of the Draft Law were published

22 October 2014

The Draft Law was submitted to the State Duma

1 January 2015

The Draft Law was enacted/published in 2014, it is in force from 2015

Deoffshorisation measures: Tax vs non-tax measures

TAX MEASURES

- Controlled Foreign Company rules
- Tax residency
- The beneficial ownership concept

NON-TAX MEASURES

- The restriction of business opportunities of offshore companies, including participation in state programs, receiving budgetary funds etc.
- Increasing the criminal liability of the management of banks and other financial institutions for knowingly furnishing incorrect or incomplete data
- Criminal liability for non-payment of taxes due to a failure to provide proper information concerning CFCs

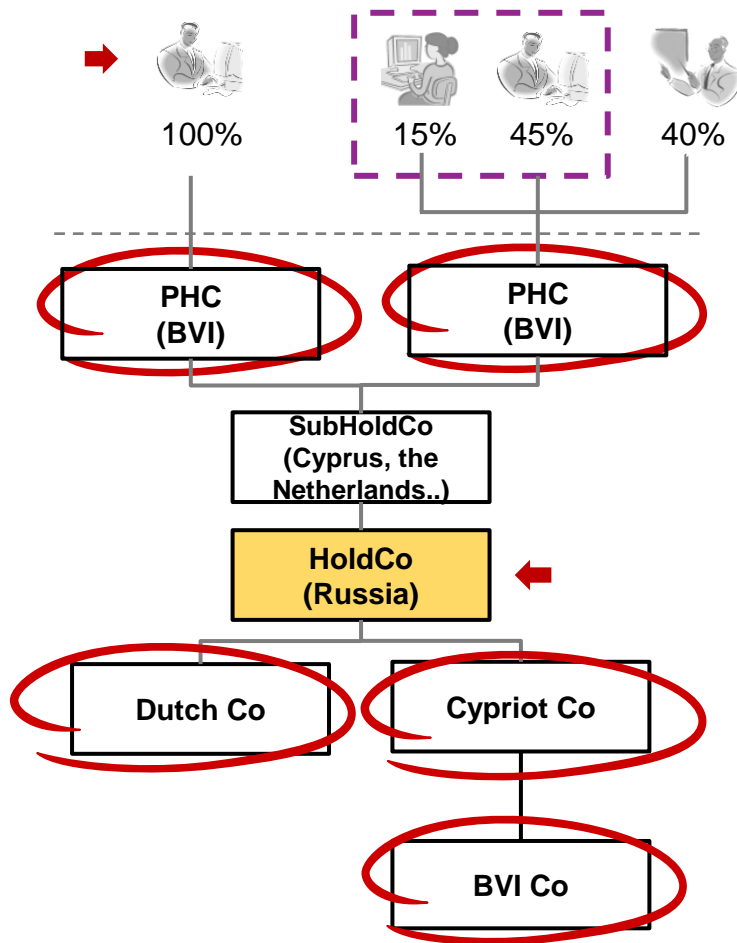
The new rules are effective from 1 January 2015

THE CONTROLLED FOREIGN COMPANY ("CFC") RULES

CFC rules

General provisions

Russian tax residents



Definition of control

- ▶ The ability of a Russian legal entity or individual to exert a decisive influence on decisions affecting a controlled company's distribution of profit and
- ▶ In case of structures that are not legal entities, the ability to influence the entity that manages such structure's assets as regards decisions on profit distribution


Controlling persons

- ▶ A person whose direct and/or indirect participating interest in the organization in conjunction with spouse, children or other related persons exceeds 25% and
- ▶ A person whose direct and/or indirect interest in a company (with spouse, children or other related persons) exceeds 10%, where Russian tax residents (with spouses, children and other interdependent persons) have a combined direct/indirect interest exceeding 50%

During a transitional period (until 1 January 2016), the threshold for both criteria is set at 50%

CFC rules

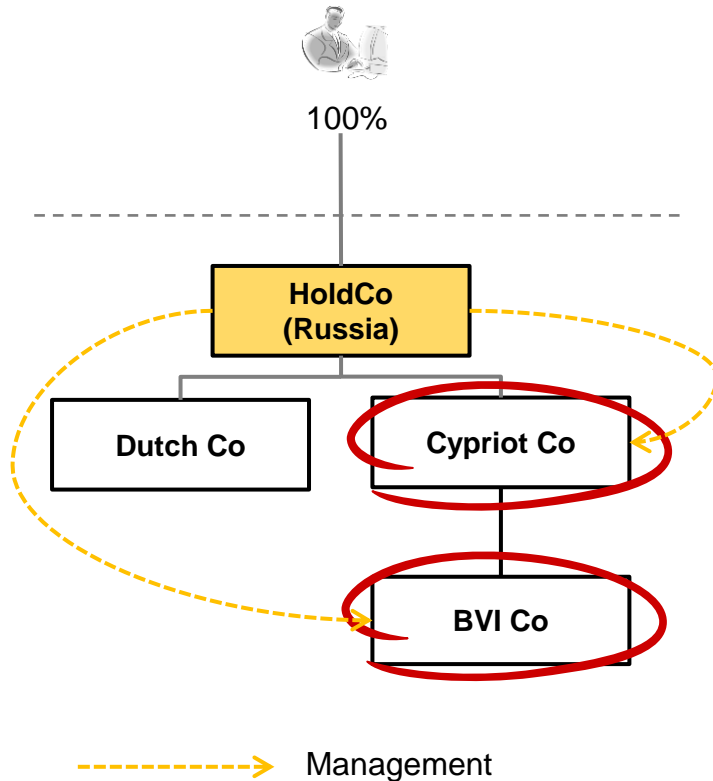
Exemptions

- Non-commercial organizations which do not distribute profits
- Companies in the Eurasian Economic Union
- Companies registered in jurisdictions that exchange information with Russia for tax purposes and impose an effective tax rate exceeding 75% of the blended tax rate
- Foreign companies involved in projects under production-sharing, concession and similar agreements in the “corresponding” country provided that over 90% of the company’s profit for the financial year is from such projects
- Foreign structures without a legal entity (e.g. trusts) are excluded only as long as they are unable to distribute profits to participants or beneficiaries by law or under their founding documents
- Banks or insurance companies operating in a territory that exchanges information with Russia
- Eurobond issuers, provided that the interest on the underlying loan is at least 90% of the issuer’s income
-  “Active” companies (where no more than 20% of income is passive income). The list of passive income includes dividends, royalties, interest, lease and rental income, capital gains, income from the provision of consulting, marketing, legal and other services. The list of passive income is open-ended
- Operators of projects on the continental shelf and their shareholders

DETERMINATION OF TAX RESIDENCY OF FOREIGN COMPANIES BY PLACE OF EFFECTIVE MANAGEMENT

Tax residency

General provisions



Definition

- ▶ A foreign company can be treated as Russian tax resident if:
 - it is tax resident in Russia under an applicable double tax treaty; OR
 - the place of management of the foreign company is in Russia

The introduction of the “place of management” principle would enable Russian taxes to be levied on worldwide income of foreign companies, if they are effectively managed from Russia

Tax residency

Determination of place of management

- ▶ Criteria for determining whether a company is actually managed in Russia:
 - The majority of the board of directors' or other analogous body's meetings takes place in Russia
 - Executive management of the company is regularly exercised from Russia
 - The company's chief (executive) officers perform their management duties for the company primarily in Russia
The "chief (executive) officers" means persons who are authorized to carry out and responsible for planning, management and oversight of an enterprise's activities
- ▶ If neither or only one of the first two criteria above are met, additional criteria should be considered

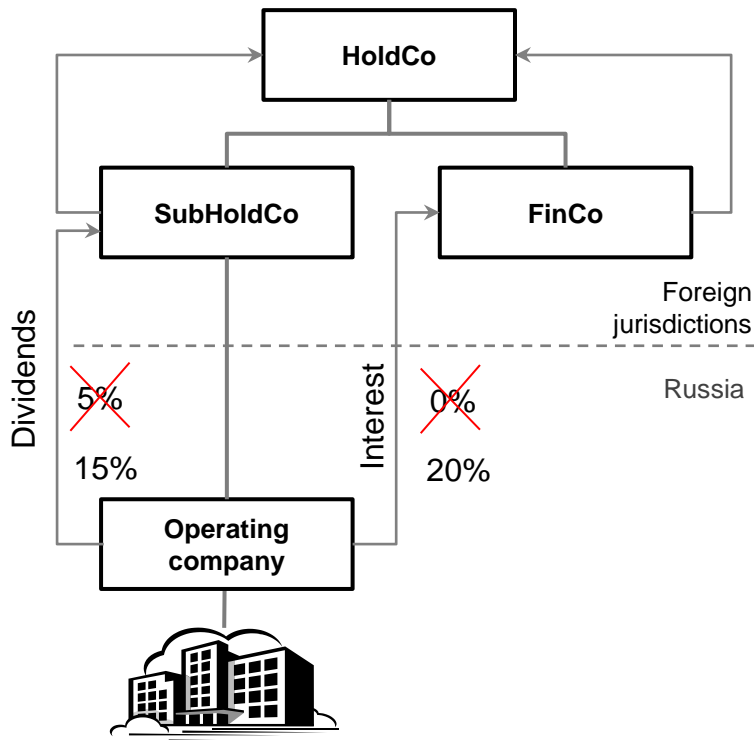
Place of management:

Meetings of the board of directors/other analogous body are primarily held in Russia	
Executive management is exercised from Russia	
The company's chief (executive) officers perform their duties mainly in Russia	
Accounting records or management accounts are maintained in Russia	
The company's corporate records are maintained in Russia	
Day-to-day human resources management takes place in Russia	

CONCEPT OF 'ACTUAL RIGHT TO RECEIVE INCOME' AND 'ACTUAL RECIPIENT (BENEFICIAL OWNER) OF INCOME'

Beneficial ownership

General provisions



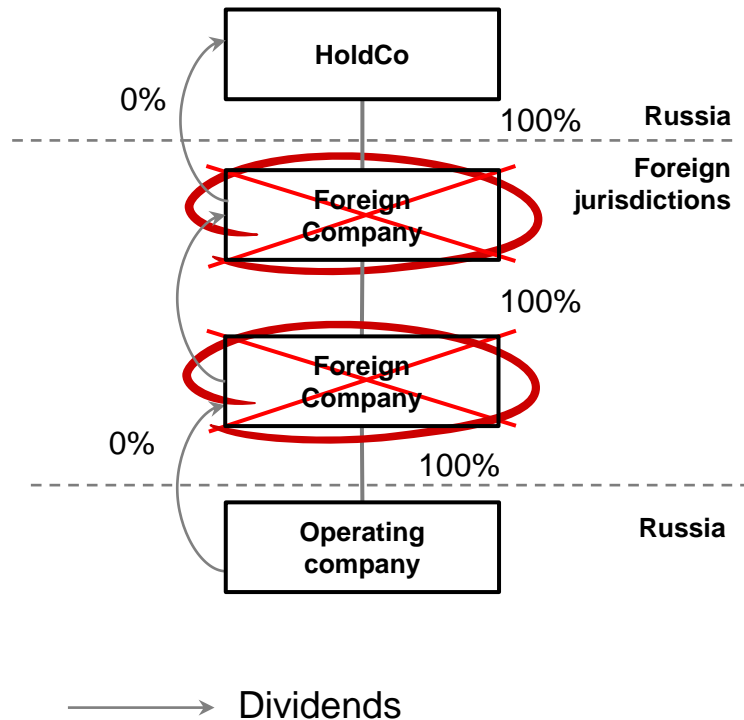
Definition

- ▶ A “beneficial owner” of income is a person who:
 - by virtue of participation (direct and/or indirect) in a company or control over a company, or by virtue of other circumstances, has the right to independently use and/or dispose of that income or
 - a person in whose interests another person has the authority to dispose of the income in question
- ▶ The functions performed and the risks assumed by that person will be taken into account

Under this concept, where a foreign company which receives income (for example, dividends, interest and royalties) is not the beneficial owner of that income, the company does not have the right to enjoy the benefits of a tax treaty’s provisions exempting the income from withholding tax or establishing reduced tax rates

Beneficial ownership

“Look-through” approach



- ▶ When income is paid (subject to certain conditions) and the direct recipient does not have an actual right to receive that income, the provisions of Russian double tax treaties or the provisions of domestic law maybe applied in relation to another person that is the beneficial owner of the income if the relevant conditions are met
- ▶ If a Russian holding company owns Russian operating companies through a chain of foreign intermediary companies, and the Russian holding company is the beneficial owner of certain income, the tax implications will be the same as they would be if the Russian holding company received the income directly from the Russian operating companies
- ▶ Domestic rules can be applied (no tax is withheld at source) provided that the Russian tax authority is informed

Beneficial ownership

Publicly available court case (first hearing)

- The tax authorities have challenged the application of the 5% withholding tax rate to dividends paid to one large foreign multinational company
- They claimed that the foreign recipient of dividends did not make the actual investment in the capital of the Russian company – the shares were contributed to its equity by another foreign company
- The tax authorities believed that the foreign recipient of dividends did not meet the monetary minimum capital requirement in the sense of the double tax treaty
- They argued that the foreign company did not meet the beneficial ownership criterion because the received dividends were immediately distributed in full claiming that the foreign company is the economic owner of the dividends in question
- This court case has been sent for consideration to the first level again

The speakers



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