



# **Tax Directors Forum**

## **“Navigating through the financial crisis – Tax issues”**

### **Session 2: Debt restructuring**

14 May 2009

## Session 2: Debt restructuring



### Part I

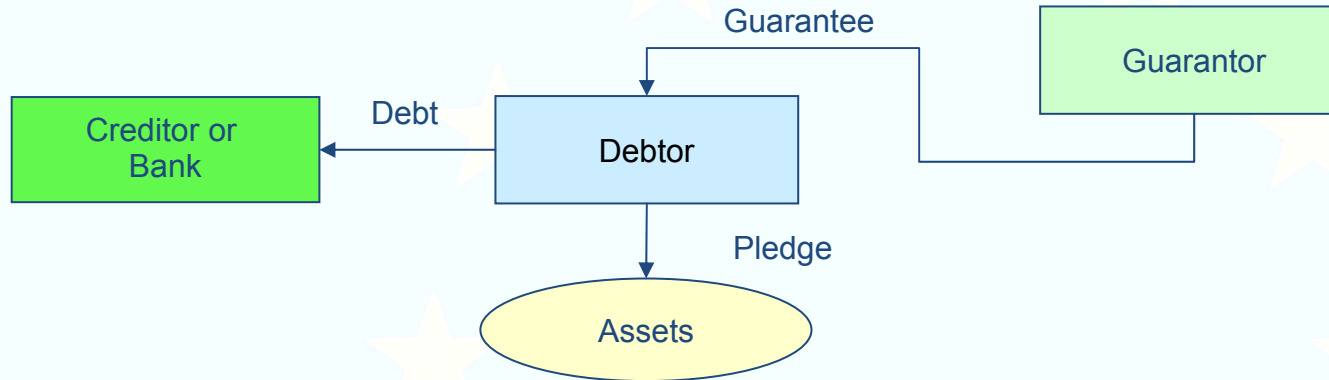
Assignment of Debts

Factoring

Termination fees

*Sergei Schelkalin, Partner, Noerr Stiefenhofer Lutz*

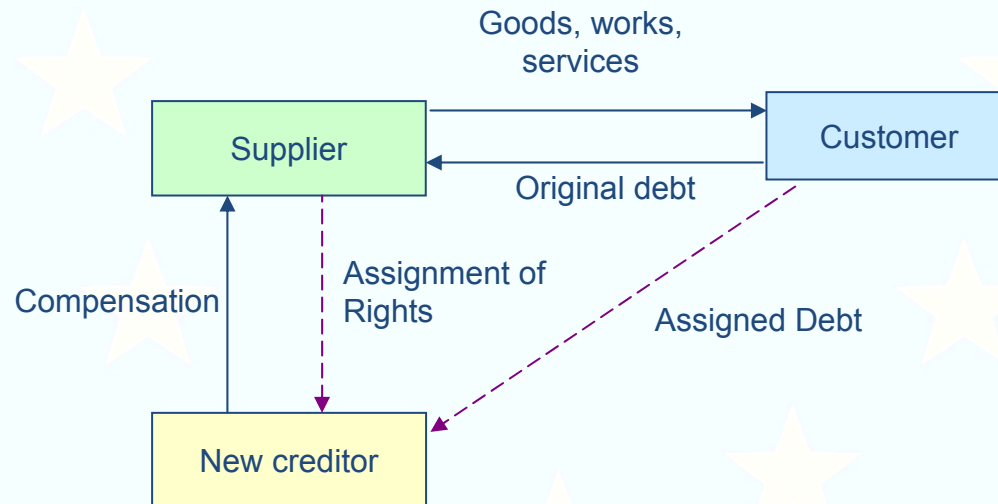
# Key issues for consideration



- Financial position of Debtor and Guarantor
- Financial position of Creditor / Liquidation of debt
- Security provided
- Debtor's Group consolidation issues
- Timing and court/ bankruptcy procedures

# 1. Assignment of Debts (1)

- Scenario 1: Assignment of Rights before date of payment under the terms of the contract
- Scenario 2: Assignment of Rights after the payment date



# 1. Assignment of Debts (2)

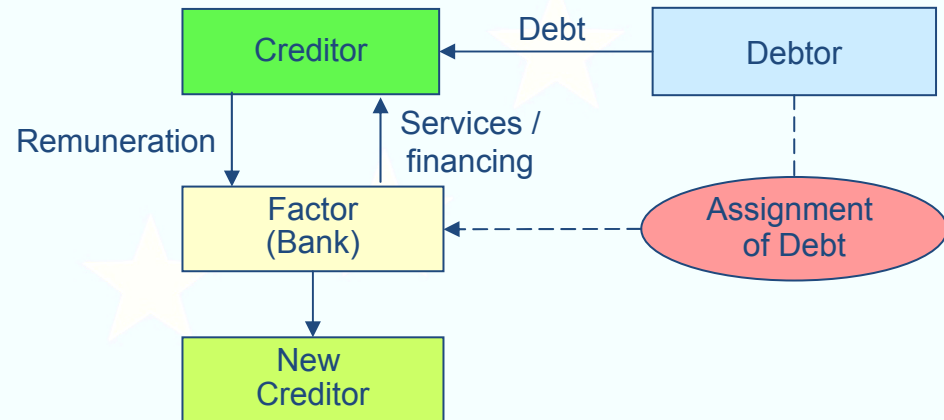
## Tax issues:

- Is initial assignment of debt a VATable operation? Further assignments may be subject to VAT
- Different terms of recognition of losses for profits tax purposes depending on the scenario above
- What is the starting date for determination of the term for recognition of loss?
- Application of Article 269 of the Tax Code

## 2. Factoring (1)

### Major problems:

- Economic justification of the operation for the initial creditor
- Terms of the initial contract
- Recognition of Factor's fee for tax purposes
- Intra-group operations are subject to precise control

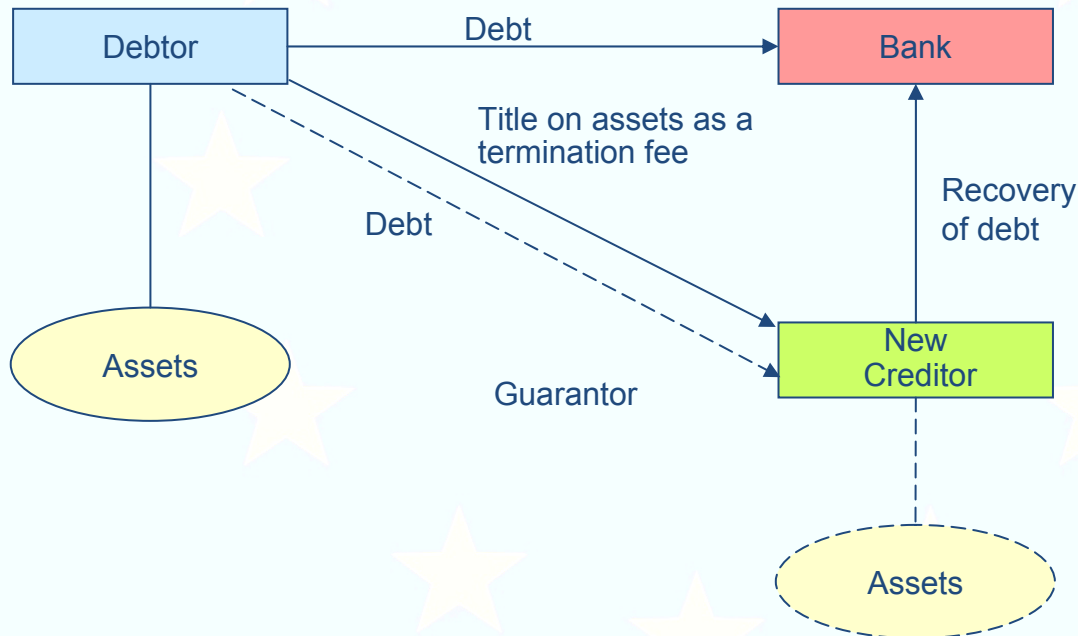


## 2. Factoring (2)

- Generally Factor's fees are tax deductible (art. 264 of Tax Code)
- Is it necessary to apply provisions of Art. 269 of Tax Code?
  - Contradictory court practice
  - Position of MinFin (Letter of Russian Minfin of 04.08.2008 N 03-03-06/1/437)
- Losses of the initial creditor
  - Economic justification of loss based on provisions of initial (sales) contract (Resolution of the Federal Court of Arbitration of Moscow region of 11.05.2007 N KA-A41/3646-07)
- VAT issues
- Factors' fees are subject to VAT
- Problems with offset of input VAT related to non-deductible portion of Factors' fee (Resolution of the Federal Court of Arbitration of North-Caucasian region of 08.11.2006 N F08-5694/2006-2366A)

# 3. Termination fees (1)

## Compensation for release from obligation:





## 3. Termination fees (2)

- Transfer of title on assets is treated as a separate operation for tax purposes
- Profits tax: margin between the amount of recovered debt (net of VAT) and tax value of asset forms either profit or loss. The loss is tax deductible.
- Tax value of assets for new creditor
- Output VAT: Art. 146 of Tax Code
  - is calculated based on the value of assets agreed by the parties, but not less than amount of recovered debt
- Input VAT – should not exceed actual expenses of new creditor
  - documentary support of input VAT (general procedure set up by Art. 171 of Tax Code is applicable)
- Application of Article 40 of Tax Code

## 3. Termination fees (3)

- Initial obligation is ceased and replaced with a new one
- Practice: novation of liabilities under sale-purchase contract into loan obligation between same parties
- Determination of a taxable base for initial sale of goods, works, services
- Practical problems with offset of VAT for Buyer
  - terms of the loan agreement
  - actual expenses incurred by the Buyer
  - courts: Resolution of Supreme Court of Arbitration of 28.01.2008 N 15837/07

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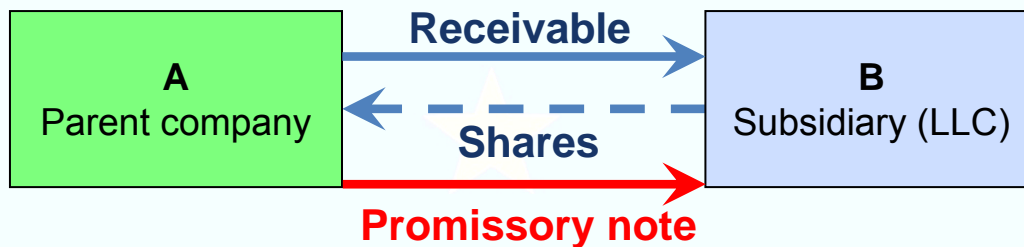
## Part II

### Converting debts into equity

*Stanislav Tourbanov, Partner, CMS*

## 4. Converting debts into equity (1)

- In principle, no right for capitalization of the debts
- Alternative arrangement

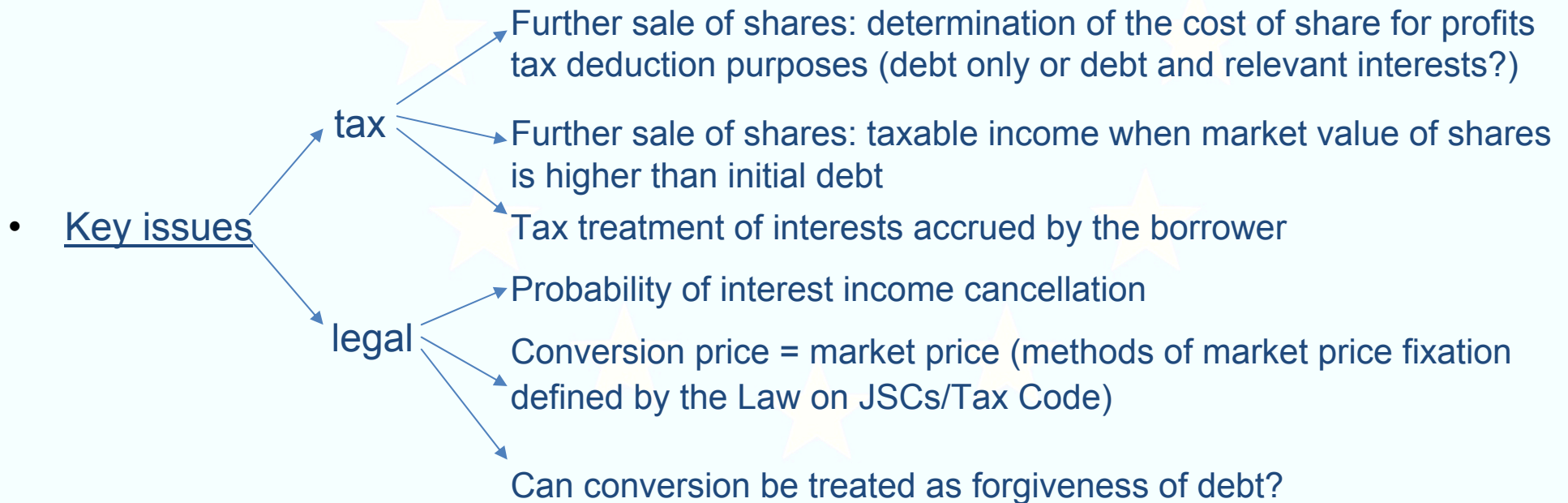


**A takes additional shares in B's capital, Respective Receivable / Loan are cancelled**

- Capital increase through incorporation of a bill of exchange (promissory note)
  - Legally allowed for LLC's
  - Stock companies: legally possible, but may be challenged by the Russian Financial Services for Financial Markets (FSFR)
- Possibility to mitigate against associated risks if the transaction takes place in foreign jurisdictions

## 4. Converting debts into equity (2)

- Conversion of bonds into shares
- Bonds initially issued as convertible by the decision of General shareholders meeting/ Board of directors (priority rights of shareholders to purchase such bonds)
  - Conversion into shares of JSC is possible
  - No conversion into shares of LLC



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