

# New tax regime allows CFC owners to pay personal income tax on company's fixed profit

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Many changes to the rules of taxation of profits of controlled foreign companies ("CFCs") will apply starting from the 2020 tax year. In particular, individuals who are CFC owners will be able, provided they so choose by 1 February 2021, to pay personal income tax on the CFC's fixed profit. Previously, the Russian President mentioned this initiative in one of his [addresses](#)\* to the Russian people on anti-crisis support measures during the COVID-19 pandemic.

The [Law](#)\* that brings about these changes also modifies the deadlines for filing notifications on CFCs by individuals and substantially raises fines for violating the rules for submitting CFC reports. Other related issues, such as taxation of passive income distributed from CFCs, are not considered in the Law.

## Fixed tax for individuals who are CFC owners

### *Rationale behind the changes*

To pay tax on the profits of foreign companies, those controlling a CFC can now refer to fixed profit values, which have been set in the Russian Tax Code. Taking advantage of this is voluntary and not open to legal entities. Previously, individual taxpayers calculated their tax obligations taking into account the financial results of a CFC based on data from its reports.

For the 2020 tax period, the Law proposes establishing the amount of fixed profit at RUB 38,460,000 (EUR 430,738), and in subsequent tax periods at RUB 34m (EUR 380,787). If a controlling person switches to the payment of personal income tax from the fixed profit of a CFC, their tax for 2020 (taking into account the 13% personal income tax rate) will be RUB 4,999,800 (EUR 55,996), and starting from 2021 personal income tax will amount to about RUB 5m (EUR 55,998), depending on the size of the applied progressive personal income tax rate.

### *Procedure for switching to the new regime and conditions for its termination*

Taxpayers who decide to switch to the new regime must provide a special notification that personal income tax will be paid from a fixed profit. As a general rule, the notification is filed at the place of residence of the controlling person before 31 December of the tax period in which the taxpayer is ready to pay tax under the new rules. However, if one plans to switch to the new regime starting in 2020, the corresponding notification must be submitted to the tax authority by 1 February 2021.

Once individuals have switched to the new regime, they will be obliged to apply the new procedure for calculating personal income tax in relation to the CFC's fixed profit for at least five tax periods in a row (i.e. five years). However, for those who switch to payment of personal income tax from a fixed profit in 2020 and 2021, this period will be three years.

After the expiration of the specified periods, controlling persons have the right to return to the old regime for taxing CFC profits.

At the same time, the Law excludes the early termination of payment of personal income tax from a fixed profit at the initiative of the taxpayer. It is only possible to do so when the tax burden of the controlling person worsens due to the introduction of amendments to the Russian Tax Code which increase fixed income indicators.

### *Points to note*

At first sight, switching to the payment of personal income tax in relation to the fixed profit of a CFC could seem to be a simple and attractive solution. On closer inspection, however, the new alternative regime for taxing CFC profits will not be suitable for everyone.

Still, the new procedure for determining the tax base will significantly simplify the administration of tax for those controlling a CFC, since it makes it possible to abandon the complex calculation of the tax base of the CFC based on the indicators of the CFC's financial statements and special rules in the Russian Tax Code. At the same time, the

total fixed profit will not depend on the number of CFCs an individual controls and the profits received by these CFCs.

On the other hand, the application of the new regime for calculating personal income tax in relation to the fixed profit of a CFC makes it impossible for the CFC's controlling person to avoid double taxation. This means that if the owner of the CFC has paid taxes on the CFC's income according to the rules of a foreign state, they will not be able to set off this amount when paying tax in Russia. In addition, it will not be possible to offset personal income tax paid for the fixed profit of a CFC against the tax payable for dividends distributed from the CFC.

Importantly, individuals who indirectly participate in CFCs through Russian companies (when these companies fully reflect the CFC's profits in their income tax returns) will not be able to switch to the alternative CFC tax regime, as the tax rules for CFCs controlled by Russian companies remain the same.

In addition, switching to the payment of personal income tax in relation to the fixed profit of a CFC does not cancel the obligation of the controlling person to submit notifications to Russian tax authorities on CFCs and participation in foreign companies.

### **Changes to the deadline and format for filing CFC notifications**

The deadline for individuals to submit CFC notifications has been postponed. Under the new rules, the deadline for submitting notifications will be 30 April (instead of 20 March). This change applies to all individuals, regardless of whether they pay personal income tax from the fixed profit of a CFC or in a general manner.

It is expected that the CFC notification form will be updated in line with the newly adopted Law and will allow controlling persons to indicate the CFC taxation regime they have chosen.

In addition, taking into account the amendments to Article 25.15(5) of the Russian Tax Code, together with a CFC notification, an individual must submit to the tax authority the financial statements of the CFC or other documents confirming the profit of the CFC, as well as an auditor's report in relation to these financial statements, if the preparation of this report is mandatory according to the law applicable to the CFC or its constituent documents, or if the financial statements of the CFC are audited on a voluntary basis.

### **Increased fines and new sanctions for failure to provide information on CFCs**

The Law significantly increases the fines for violation of CFC legislation. The fine for failure to submit a CFC notification within the specified time limit is increased from RUB 100,000 to RUB 500,000 (from EUR 1,120 to EUR 5,600) This fine will have to be paid even if the documents are provided on time, but contain deliberately false or inaccurate information.

A fine of RUB 500,000 (EUR 5,600) has been introduced for failure to submit reports (financial statements and auditor's report) that the individual controlling the CFC must attach to the CFC notification.

A fine of RUB 1m (EUR 11,200) has also been introduced in cases when, at the request of the tax authorities, an individual fails to provide financial documents confirming the exemption of the CFC's profits from taxation or documents (financial statements and auditor's report) that the individual controlling the CFC was required to attach to the CFC's notification. The tax authorities can request these documents for the three calendar years preceding the year in which the taxpayer received such a request. As for CFC owners who switch to the payment of personal income tax from the fixed profit of the CFC, these financial documents can only be requested for the periods in which the CFC's tax base was calculated or will be calculated according to the old rules.

### **Other points to note**

In addition to the key innovations described above, the Law introduces many other important adjustments, such as:

- It is no longer possible to adjust a CFC's profits by the income derived from the sale or disposal of derivative financial instruments and related expenses.
- The criteria for classifying a CFC as a holding or sub-holding company and the criteria for exempting CFC profits from taxation when a foreign holding or sub-holding company is recognised as an active holding or sub-holding company have been clarified.
- Tax on dividends received from Russian companies is excluded from the calculation of the effective and weighted average CFC rate, and the dividends are not included in the profits for this calculation.

### **Comments**

In light of the changes to the rules for the taxation of CFC profits, individuals who control CFCs need to analyse without delay their financial situation and the composition of the profits of the CFCs they control in order to:

- assess whether they should switch to the payment of personal income tax in relation to their CFCs' fixed profit; and

- properly prepare for the filing of CFC notifications (due by 30 April 2021) and ensure the preparation of financial statements and audit reports (when required).

Controlling persons who plan to switch to the payment of personal income tax under the new rules have a short time to take action. The Law does not provide for a transition period for CFC owners to assess the effect of the changes in a test mode. Taxpayers who switch to the payment of tax on the fixed profit of a CFC starting from 2020 are required to submit the relevant notice by 1 February 2021 and will only be able to return to the old tax calculation procedure in 2022.

Although there is no obligation to prepare CFC financial statements when personal income tax is paid on a CFC's fixed profit, we recommend that financial statements continue to be prepared on an annual basis. This is important for the correct calculation of the CFC's profit in the future after having switched to the previous CFC taxation regime. In addition, if a CFC incurs losses as part of the payment of personal income tax from a fixed profit, provided that financial statements are available, they can be carried forward to future periods if the controlling person reverts to the old procedure for calculating CFC tax.

In addition, if – under the new regime – a person controls several CFCs and loses control over part of the CFCs, fixed profit tax will have to be paid on the remaining companies, even if this turns out to be unprofitable. In such circumstances, the taxpayer will have to wait for the expiration of the minimum time frame for switching back to the old procedure or terminate their status as a controlling person calculating personal income tax on the fixed profit of the CFCs.

If you have any questions on this eAlert, do not hesitate to contact CMS Russia experts [Hayk Safaryan](#), [Yulia Smourova](#), [Anna Osmakova](#) or your regular contact at CMS Russia.

\* In Russian

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