
CFC Rules of The Russian Federation

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18 November 2014

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Agenda

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- Legislative Agenda
- Key Definitions
- Exemption from Taxation
- Calculating the Profit of a CFC
- Tax Residency

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Part 1: CFC Rules

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CFC Rules Background

- Currently, there are no controlled foreign company (CFC) rules in Russia.
- The aim of the CFC Rules is that the taxes on the income of passive non-Russian companies and structures that are controlled by Russian resident companies and individuals are paid to the Russian budget.
- Disclosure requirements will likely also apply to uncontrolled participations of more than 10% in equity, as well as in relation to settlement of foreign structures that are not legal entities (e.g., trusts); the question of whether beneficiaries should file notifications is yet to be determined.

CFC Rules

Legislative Agenda

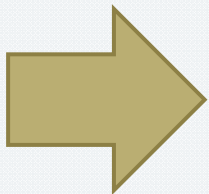
- A draft law on de-offshorisation, including Controlled Foreign Company (CFC) rules, has been submitted to the Russian State Duma on 22nd October and adopted in the first reading on 11 November.
- There are a number of yet-to-be published amendments for the second reading that will take place 18 November(!).
- The draft law is expected to be finalised and passed before 1 December 2014 and become effective as of 1 January 2015.

CFC Rules

Key Definitions - CFC

A CFC is:


- A foreign company that **is not tax resident** in Russia;
and
- Is **controlled by** organisations or individuals that are **Russian tax residents**.



All foreign companies controlled by Russian tax residents are treated as CFCs and must be disclosed as such, even though profits of certain types of companies are exempt from profit tax in Russia

CFC Rules

Key Definitions – Control Criterion

- A controlling person is:
 - A person whose direct and/or indirect participating interest in the company in conjunction with his spouse and/or minor-age children and other dependent persons is more than 25%.
 *During a transition period the threshold is **50%***
 - A person (as defined above) that directly and /or indirectly owns over 10% of a company, where all Russian tax residents (in conjunction with his spouse and/or minor-age children and other dependent persons) have an aggregated direct and/or indirect interest of over 50%.
 - Equity ownership is calculated taking into account participation held via structures, including trusts, in relation to which a Russian individual is a controlling person; courts may take into account other circumstances.

CFC Rules

Key Definitions – Control Criterion

Control Criterion with regard to a structure:

- A Russian person's control over a structure other than a company (i.e. funds, trusts etc.) refers to his influence on decisions adopted by the person who manages the assets of the structure with respect to the distribution of profit.
- Yet to be seen how foundations are treated i.e. whether foundations despite their legal personality are qualified as “structures”.

CFC Rules

Key Definitions – Control Criterion

Control Criterion with regard to a structure:

- According to the most recent amendments that are yet to be adopted, the question regarding the ability to exercise control and influence should be determined based on legislation of jurisdiction of the structure or its foundation documents.
- An additional criteria may be added in the final version of the law that a Russian person can be deemed as a controlling person of a structure only if he or she (a) both controls/influences the manager/trustee and has the right to receive income of the structure (i.e., is also a direct or indirect beneficiary) or (b) both is a settlor and a beneficiary, or (c) is a settlor and the structure is revocable.

CFC Rules

Key Definitions – Control Criterion

- Relevant for the control criterion are:
 - Voting rights;
 - Stake in the company's equity
 - Influence on decisions (e.g. through shareholder agreement).

Dividend rights should not be taken into account with regard to the control criterion (see structuring options in the case studies).

CFC Rules

Exemption from Taxation – Legal Entities (1/2)

Profits of a CFC are exempt from taxation in Russia if:

The CFC is a tax resident in a **treaty state** (except for those treaty states that do not exchange information with the Russian tax authorities);

and

If the **effective tax rate** is at least **75% of the average weighted rate** (operational corporate income tax rate: 20%; dividend income rate: 9% (in future: 13%))

or

If the company's share of **income from passive activities** is not more than **20%.***

*treaty state criteria for this active business exemption may be abolished in the final version of the law

CFC Rules

Exemption from Taxation - Structures (2/2)

Structures which are not legal entities (“corporations”) might be exempt if, in addition to other requirements, this structure **does not have the capacity to distribute profits among its participants** or other persons according to its personal law and constituting documents.

CFC Rules

Calculating the Profit of a CFC

A CFC's profits are determined:

- In accordance with its financial statements subject to audit provided the CFC is located in a treaty jurisdiction (in this case, CFC will not have to recalculate its profits under Russian tax rules);
- According to Chapter 25 of the Russian Tax Code for all other instances.

Tax Residency Criteria

- The criteria used to determine a company's place of effective management have been revised.
- A foreign company's place of effective management is regarded as being in Russia if:
 - A relative majority of board meetings (more than in any other country) are held in Russia*; or
 - The company's executive body regularly conduct company-related activities in Russia (activities are not regarded as regularly conducted in Russia if they are carried on there to a substantially lesser extent than in another country or countries); or
 - The company's chief (executive) officers perform their executive management duties in Russia.

*Board meeting criteria may be abolished in the final version of the law to focus on day-to-day management tests

Tax Residency Exemptions (1/3)

- Several exclusions from tax residency have been introduced.
- Currently, four types of companies are excluded:
 - (1) Foreign companies incorporated in the jurisdictions that have tax treaties with Russia under which the companies are treated as tax resident in the jurisdiction of incorporation.*
 - (2) Foreign companies whose core activity involves participation in production sharing -/ concession-/ licence- or service agreements on a risk basis or other similar agreements with the government of the corresponding state or institutions authorized by that government.

* Exemption may be abolished in the final version of the law

Tax Residency Exemptions (2/3)

(3) Foreign holding companies subject to the following conditions*:

- Exemption applies even if the Russian shareholder has had at least a 50% direct (indirect) equity interest in the holding company for at least 365 calendar days, but
 - over 50% of the foreign holding company's assets consist of investments in foreign subsidiaries that receive primarily active income and are registered in countries not blacklisted by the Ministry of Finance; and
 - the holding company's equity interest in such subsidiaries is at least 50%; and
 - the holding company has no income (profit), or over 95% of its income (profit) consists of dividends from subsidiaries that are not tax resident in Russia nor in a blacklisted jurisdiction.

*The first “industrial subholding” exemption may become a CFC exemption in addition to this exemption from tax residency claims in the final version of the law

Tax Residency Exemptions (3/3)

(4) Companies in the field of hydrocarbon deposits.

CFC Rules

Liquidation Payments and Sales of Shares

- A foreign company is not a tax resident if a decision has been made to liquidate the company and the liquidation procedure is completed by 1 January 2017
- Similar to liquidation proceeds, the Draft Law exempts income that a CFC earns from sales of certain securities and/or property rights to a company that qualifies as a controlling entity or to its Russian related party.
- This provision applies if there has been a decision to liquidate the CFC and the liquidation procedure is completed by 1 January 2017. This is a transitional provision to provide an incentive for the restructuring of Russian groups to eliminate companies which would otherwise give rise to tax liabilities under the new CFC rules.

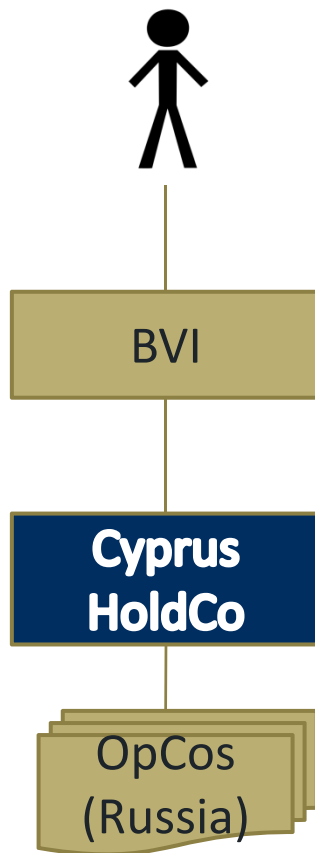
Part 2: Case Studies

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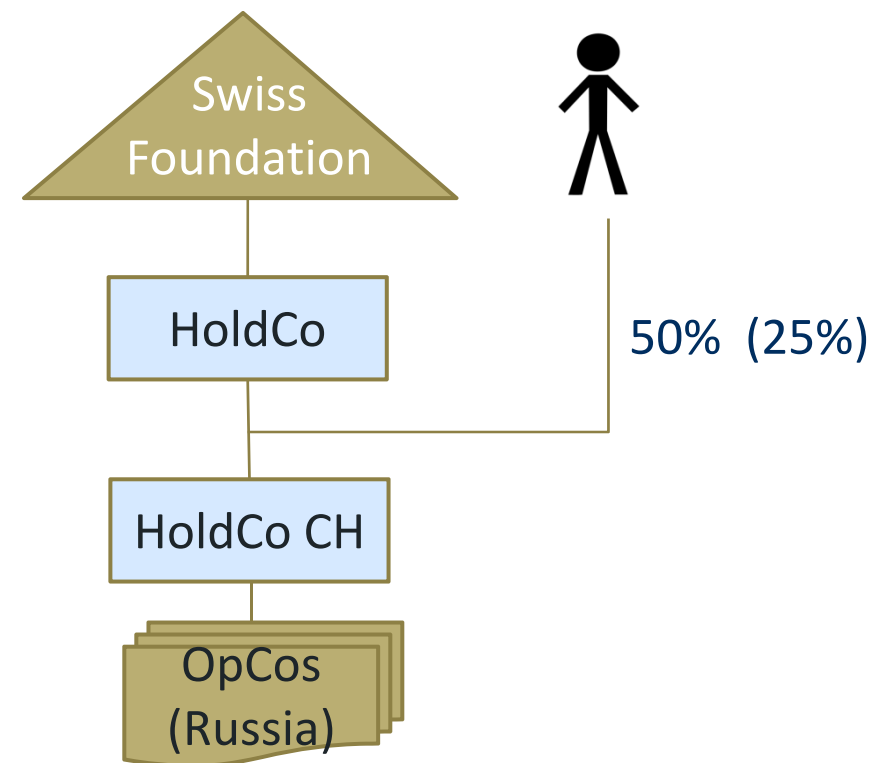
Case Study I

Reorganisation of an existing Structure

Current structure:

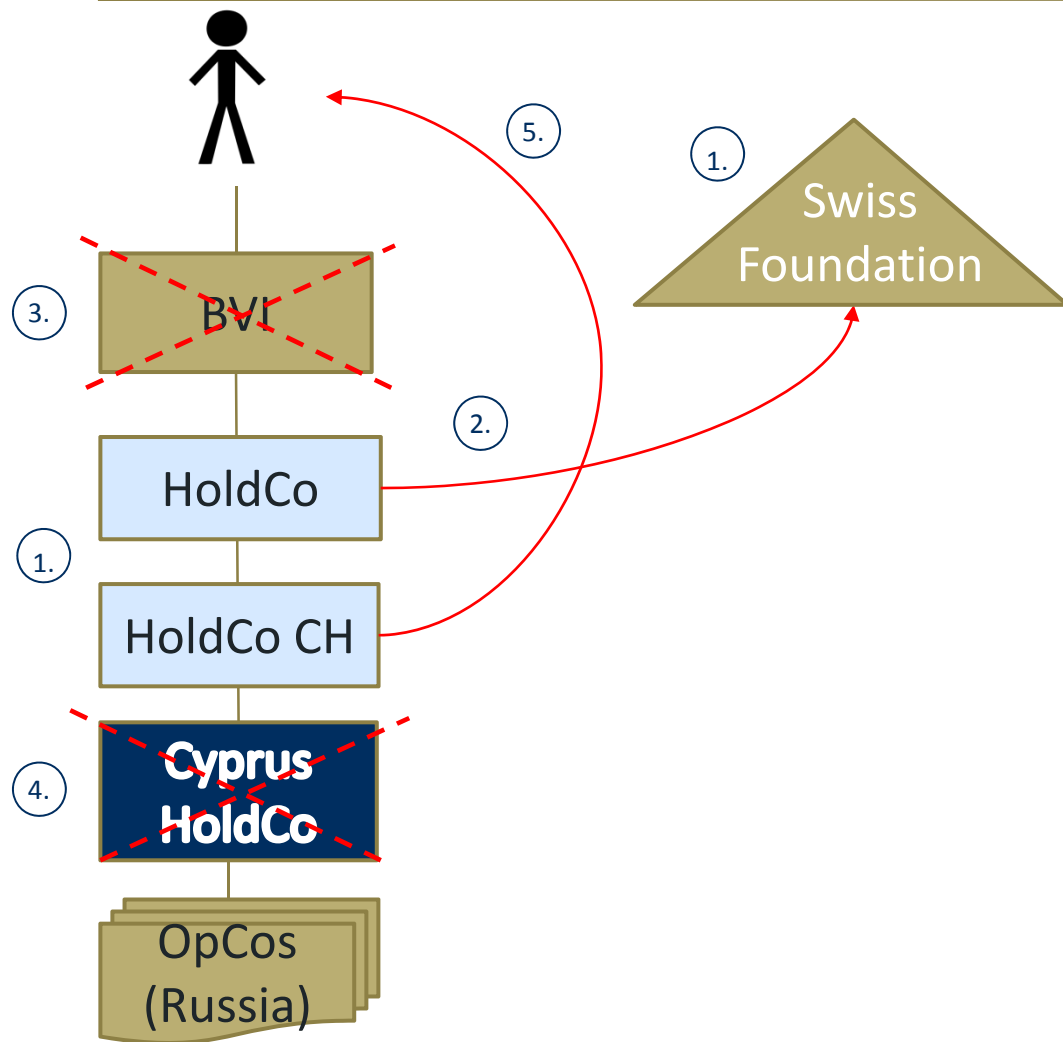


Target structure:



Case Study I

Reorganisation of an existing Structure



Restructuring steps:

- **Step 1:** Establishment of Swiss Foundation, HoldCo and HoldCo CH by BVI
- **Step 2:** Donation of HoldCo shares from BVI to Swiss foundation
- **Step 3:** Liquidation of BVI
- **Step 4:** Liquidation of Cyprus HoldCo
- **Step 5:** Transfer of 50% (25%) of the shares in HoldCo CH to Russian individual (?)

Case Study I

Corporate Foundations

- According to Swiss law, the foundation is a legally independent purpose fund. To establish a Swiss foundation an endowment of assets for a particular purpose is required. The foundation is established by public deed or by testamentary disposition. Further, an entry into the commercial register is required.
- Corporate foundations («*Unternehmensstiftungen*») are neither regulated nor mentioned in the Swiss foundation law but are a very common feature in practice.
- A corporate foundation is considered nonprofit provided that the interest in maintaining the company serves a nonprofit purpose and if the foundation does not carry out management activities.
- Participation exemption is not applicable but depending on the canton the effective tax rate is very low (e.g. 4.98% in the canton of Nidwalden or 7.7% in the canton of Lucerne).

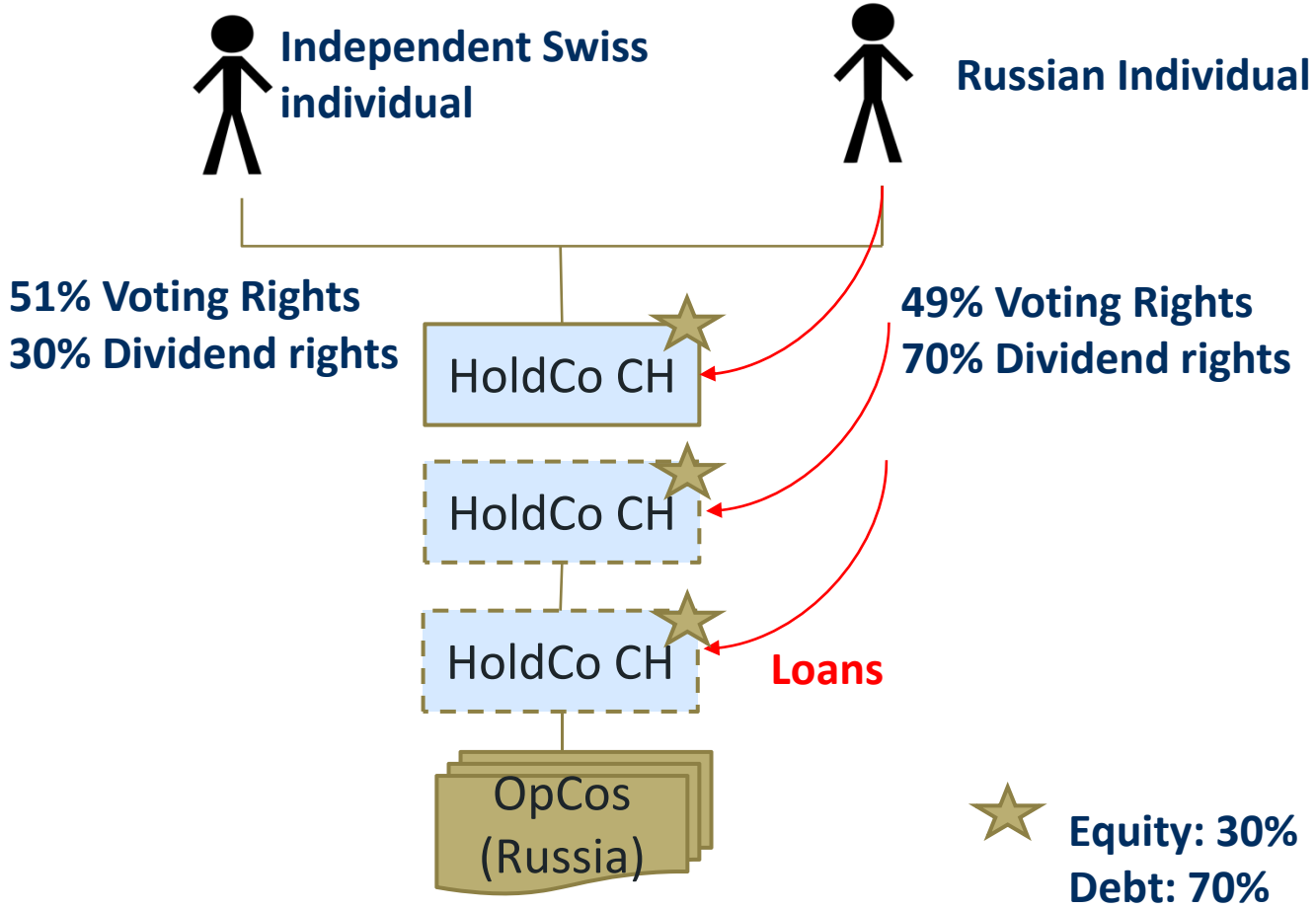
Case Study II

Set up of a new Structure

Current situation:



Target structure:



Case Study II

Shares with Privileged Voting Rights

- According to Swiss corporate law, a disproportionate voting power can be achieved via issuing two classes of shares with equal voting rights, but different nominal values (so called shares with privileged voting rights).
- The highest nominal value may not be more than ten times than the lowest.
- Each share grants to its holder a right to a portion of dividend and liquidation proceeds proportional to its nominal value.

Case Study II

Shares with Privileged Voting Rights

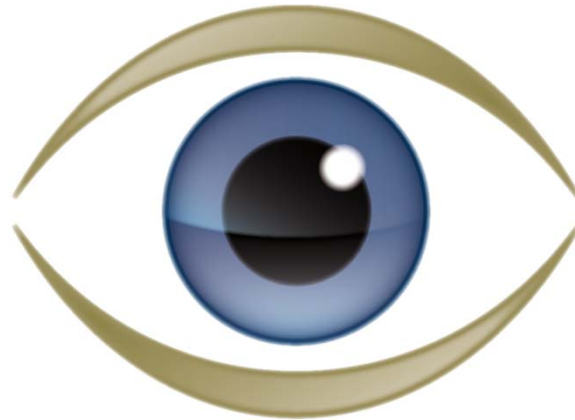
Example:

If a shareholder owns 100 shares with a nominal value of CHF 10.– and another shareholder owns 100 shares with a nominal value of CHF 1.–, they would each have the same number of votes (namely 100) at the general shareholders' meeting. They would also each have the same influence on the company, even if the second shareholder held a stake in the company's equity that was ten times smaller than the first shareholder. However, the dividend payment to the first shareholder is ten times higher than to the second shareholder.

Case Study II

Participation Certificates

- Swiss corporate law does not permit non voting shares, but participation certificates can be issued.
- In principle, the holders of participation certificates have the same financial rights as the holders of shares but no voting rights.
- The articles of association can, however, grant certain social rights to the holders of participation certificates (such as the right to call a general meeting or the right to information).
- The holders of participation certificates have the right to challenge the resolutions of the general meeting that violate the law or the articles of association and to initiate liability suits against the organs of the company for breach of their fiduciary duties.



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