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Russia

Russia Amends Tax Code to Impose New Requirements on Use of CFCs

Russian authorities revised provisions of the nation's tax code related to the taxation of controlled foreign companies (CFC).

According to a statement from the presidential press-service dated Nov. 25, President Vladimir Putin signed into law Federal Law No. 376-FZ to amend parts 1 and 2 of the Russian Tax Code to counter the use of tax havens for gaining unfair tax preferences.

According to the law, foreign entities controlled by Russian businesses become liable to the Russian profit tax if these CFCs are based in jurisdictions that have no tax treaties with Russia, do not share tax information with Russia, or where the profit tax rate is more than 25 percent below Russia's 20 percent profit tax.

Russian businesses and individuals are regarding as a ''controlling party'' if they control more than 25 percent of a foreign businesses, or more than 10 percent if Russian taxpayers control more than 50 percent of a foreign entity, said the statement. However, provisions of the new law do not apply to foreign banks and insurance companies; foreign businesses that concluded concession, license, and production sharing agreements (PSAs); and non-profit organizations, it said.

Penalties. The law set forth penalties for failure to report a CFC's profits to the tax authorities and subsequent incomplete payment of profit tax by businesses, the statement said. However, these penalties will not apply to the tax periods of 2015-2017, it said.

Vladimir Starkov of NERA Economic Consulting in Chicago told Bloomberg BNA in an e-mail that the ''concept of the 'controlling party' as defined in the law establishes a rather low threshold for ownership of a foreign entity's capital by the Russian tax residents,''

''This threshold can be as low as 10 percent in cases when Russian tax residents collectively own more than 50 percent of a foreign company's capital and 25 percent otherwise (although during the initial two-year transition period, the controlling ownership threshold will be set at 50 percent),'' he wrote.

This implies that even Russian minority shareholders of foreign companies will be subject to compliance requirements for the CFCs prescribed in this law, Starkov said. Such requirements include, for example, providing to the Russian tax authorities audited financial statements of the foreign companies, partnerships, trusts, or other entities, and in cases when audited financial statements are not routinely prepared, providing other documentation necessary to determine the taxable income of the CFC, he noted.

Passive Income. The law subjects to taxation in Russia companies and other entities—such as partnerships, trusts, and foundations—registered in foreign jurisdictions that have ''passive income'' accounting for more than 20 percent of their total income, said Starkov.

Oddly enough, the definition of the ''passive income'' adopted in the law includes, in addition to the ''traditional'' types of passive income—dividends, interest, and royalties—income from activities such as R&D and various professional services, he noted. Thus, for example, an Irish centralized services company or an Irish R&D company may become subject to taxation in Russia because even though Ireland has a double tax avoidance treaty with Russia, its corporate income tax rate is below 15 percent, said Starkov.

Federal Law No. 376-FZ was adopted on Nov. 18 by the State Duma, the lower house of parliament, and on Nov. 19 by the Federation Council, the upper house of parliament. The law takes effect Jan. 1, 2015, while some provisions become effective April 1, 2015, and Jan. 1, 2017.

The law states that in cases where Russia has entered a double tax avoidance treaty with a foreign country, the text of such treaty prevails over the domestic legislation. However, no functioning competent authority exists in Russia to date, Starkov warned.

Going It Alone on BEPS. Since the bill was signed into law before the end of the year, Starkov said, it became an ''unfortunate'' example of a country ''going it alone'' on efforts to combat base erosion and profit shifting, despite the efforts of the Organization for Economic Cooperation and Development to develop solutions in collaboration with a number of countries.

Under Action 3 of the BEPS Action Plan, the OECD has announced its intention to release a draft document on CFCs for public discussion in January 2015.

Starkov said the Russian government's lack of openness to considering other countries' experience on CFC legislation is further illustrated by the fact that the provision introduced by the business community stating that certain terms of the CFC legislation may be interpreted according to the laws of the relevant foreign countries did not make its way into the bill.

By Sergei Blagov

To contact the reporter on this story: Sergei Blagov in Moscow at correspondents@bna.com

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To contact the editor responsible for this story: Molly Moses at mmoses@bna.com

☐ *The statement is available in Russian at http://news.kremlin.ru/acts/47069. The law, dated Nov. 24, is available in Russian at http://publication.pravo.gov.ru/Document/View/0001201411250003.*

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