The Inward Investment and International Taxation Review

Ninth Edition

Editor
Tim Sanders

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THE INWARD INVESTMENT AND INTERNATIONAL TAXATION REVIEW

NINTH EDITION

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PREFACE

There have been significant recent changes in the global tax landscape as highlighted in the OECD annual report on global tax policy reforms published on 5 September 2018. The report noted the impact of major tax reform in a number of countries, notably in the United States, Argentina and France. At the time the US tax reform became effective on 1 January 2018, Goldman Sachs estimated there was US$3.1 trillion of overseas profit kept outside the United States, which highlights the significance of this reform. One aspect of the US tax reform was lowering of corporate taxes, which reflects a global trend, with the average corporate income tax rate across the OECD dropping from 32.5 per cent in 2000 to 23.9 per cent in 2018. Other tax reform trends identified were the lowering of personal income taxes and new excise taxes, to deter harmful consumption, such as sugar taxes.

An area where coordinated tax reform has not materialised, despite being identified as a key area in the BEPS Action Plan in 2015, is in the taxation of the digital economy. The OECD produced an interim report in April 2018, with further work scheduled for 2019, with the aim of arriving at a 'consensus based solution by 2020'. Although there is widespread recognition of the need for change, consensus on how such change should come about has been limited. Some countries, including the UK, have decided to take unilateral action, pending an international solution. The UK's 2018 Autumn Statement announced a digital services tax (DST) to be introduced from April 2020. The proposal is that a 2 per cent tax will apply to the revenues above £25 million of certain digital businesses to reflect the value they derive from the participation of UK users, with consultation on the detail of the legislation to take place between now and the introduction of the tax in the Finance Act 2020. One may conclude that this reflects the UK's view on the likelihood of an OECD solution by 2020. The UK is not alone: Malaysia revealed plans in November 2018 to introduce a consumption tax on the supply of digital services to Malaysian residents from 1 January 2020; Quebec is introducing a digital sales tax in January 2019; and Chile, Uruguay and Colombia all have plans to tax foreign suppliers of digital services. Potentially, as more countries start to fill the vacuum with their own domestic digital taxes, the possibility of conflict with the regimes in other countries arises.

The potential for tax conflict, rather than competition, is not restricted to the digital economy and is much more likely than in recent years. It is possible that 2019 will see some nations retaliate to US tax reforms and also see the US and certain jurisdictions use tariffs and duties as weapons in their trade wars. Brexit is another potential source of tax conflict.

It is hoped that this volume will prove to be a useful guide to the tax rules in the jurisdictions where clients conduct their businesses. Each chapter aims to provide topical and current insights from leading experts on the tax issues and opportunities in their respective jurisdictions. While specific tax advice is always essential, it is also necessary to have a broad

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understanding of the nature of the potential issues and advantages that lie ahead; this book provides a guide to these.

I should like to thank the contributors to this book for their time and efforts, and above all for their expertise. I would also like to thank the publisher and the team for their support and patience. I hope that you find the work useful, and any comments or suggestions for improvement that can be incorporated into any future editions will be gratefully received.

The views expressed in this book are those of the authors and not of their firms, the editor or the publishers. Every endeavour has been made to ensure that what you read is the latest intelligence.

Tim Sanders
London
January 2019

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Chapter 29

RUSSIA

Oleg Konnov and Sergei Eremin[1]

I INTRODUCTION

In the past few years, the Russian government has taken various measures to reduce adverse consequences of sanctions introduced by the United States, EU and certain other countries and to encourage foreigners to invest in Russia. The measures included major reform of corporate law, simplification of the regulatory framework, subsidies and guarantees, as well as various tax incentives, for example, in relation to industrial R&D, tourism and operation of ports. As of the end of the first six-month period in 2018 direct inward investment into Russia was US$438 million, slightly exceeding investment in the first six months of 2017.[2] This is relatively small amount standing at par with inbound investments in Belgium.[3] The OECD forecasts the growth of the Russian economy to continue at a moderate pace.[4]

Tax incentives have been neutralised by a gradual overall increase in the tax burden, including an increase in the value added tax (VAT) rate (as of 1 January 2019) and introduction of various quasi-taxes.

Although the role of the state in the Russian economy has been growing constantly, certain mega projects have been completed by private investors. For instance, Yamal LNG, a company majority owned by Novatek (Russia), with Total (France), CNPC and Silk Road Fund (China) as private investors, completed the LNG project well ahead of the plan. Major tax and customs concessions were secured through amendments to Russian law and an intergovernmental agreement was concluded by Russia and China.

Valuation of Russian companies remains low, making them an attractive target for investors willing to take on the risk in the current economic and political environment.

At the same time, Russia has been exercising control over investments in certain sensitive industries, such as defence, aviation and nuclear. Russian law also imposes foreign ownership limitations in certain sectors (e.g., transport infrastructure, aviation and space industry, cryptology, mass media). In some cases acquisition of real estate by, and issuance of subsoil licences to, foreigners may be subject to restrictions.

1 Oleg Konnov is a partner and Sergei Eremin is a senior associate at Herbert Smith Freehills CIS LLP.
2 CBR statistics http://www.cbr.ru/eng/statistics/?Prtid=svs.
3 https://data.oecd.org/fdi/fdi-stocks.htm#indicator-chart.
4 http://www.oecd.org/eco/outlook/economic-forecast-summary-russia-oecd-economic-outlook.pdf.

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II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

Russian law provides for a wide range of both corporate as well as non-corporate forms of doing business, however only a few are used in practice. Generally, tax rules do not materially differ depending on the types of corporate entities.

i Corporate

In most cases businesses prefer to invest through corporate vehicles. The two most commonly used forms of entities are the limited liability company (LLC) (shareholders in LLCs are called 'participants' and participants' stakes are called 'participatory interests') and the joint-stock company (JSC), which may be public or non-public.

Both vehicles, as a general rule, stand for limited liability of their members provided that the corporate veil may be pierced in certain cases, including bankruptcy. The major difference between these forms is that LLC capital is divided into participatory interests, which are proprietary rights and not securities, while a JSC issues shares. The title to shares and participatory interest is recorded differently, and the rules of the registration of their transfer differ as well.

An LLC is generally perceived as an entity where personal connections between participants matter more that in a non-public JSC. That triggers some other differences: unlike non-public JSCs, an LLC's charter may prohibit the disposal of participatory interests to third parties; an LLC's charter may subject the transfer of participatory interest to consent of participants without any time limitation while in non-public JSCs the lock-up period is limited to five years; in contrast to LLCs, where the right of first refusal is granted by default under statute, there is no such right in non-public JSCs unless the charter provides otherwise.

Taxation of LLCs and non-public JSCs is widely similar save for specific distinctions (e.g., application of the capital gains rules).

Generally, the following taxes would normally apply to legal entities: profits tax, VAT, social security charges, property tax, land tax and stamp duties. There is no separate capital gains tax, securities tax or capital tax in Russia. Depending on the type of business they perform, companies may also be subject to mineral extraction tax and various resources-related taxes, export or import duty, excise taxes, transportation tax and state duty. Employers are normally obliged to withhold personal income tax from wages they pay. Finally, corporates may apply a range of special tax regimes available for small enterprises and the like.

ii Non-corporate

While many unincorporated forms of doing business are recognised by Russian law, they are rarely used, except for real estate investments. Examples of non-corporate organisations include the simple partnership agreement, investment partnership agreement and private equity fund.

All three structures are transparent for profits or income tax and property tax purposes. Property tax and profits or income tax (depending on whether a participant is a legal entity or an individual) are payable only by the participant but not by the partnership. Some other taxes may be paid by the managing partner on behalf of the partnership.

The mutual investment fund enjoys profits tax deferral as its main advantage compared to partnership agreements. Thanks to that, private equity funds are commonly used for real estate investment.

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Apart from the mutual investment fund, non-corporate entities are not widely used in practice owing to lack of corporate protection of the participants in combination with somewhat ambiguous tax regulation.

III DIRECT TAXATION[5] OF BUSINESSES

Key Russian taxes and their general rates for businesses are the following:

a profits tax (20 per cent);[6]

b VAT (currently 18 per cent, but will increase to 20 per cent as of 1 January 2019);[7]

c social security charges (to the Pension Fund, 22 per cent for remuneration not exceeding 1.021 million roubles and 10 per cent for remuneration in excess of it; to the Medical Insurance Fund, 5.1 per cent; to the Social Security Fund, 2.9 per cent for remuneration not exceeding 815,000 roubles and zero per cent for remuneration in excess of it; and to the Social Security Fund for insurance for work-related injuries and diseases at rates ranging from 0.2 per cent to 8.5 per cent);[8]

d property tax (2.2 per cent);[9]

e land tax (may not exceed 0.3 per cent of the cadastral[10] value of agricultural and residential land and 1.5 per cent for other types of land);

f mineral extraction tax;

g excises;

h transportation tax; and

i stamp duty (relatively low in Russia).

i Tax on profits

Determination of taxable profit

Corporates that are Russian tax residents are liable for profits tax on their worldwide profit (calculated as gross income minus deductible expenses).

Non-resident foreign companies with a permanent establishment in Russia pay profits tax on the taxable profits attributable to that permanent establishment. Given that Russian attribution rules are not sufficiently clear, disputes with the Russian tax authorities as regards attribution are not uncommon. Certain other income deemed to derive from Russian source and not attributable to a permanent establishment may be subject to withholding tax.

Profit is calculated as gross income less deductible expenses. Most business expenses are deductible, provided that they are economically justified (i.e., aimed at receiving profit) and properly documented. Restrictions apply to the deductibility of certain expenses, such as certain advertising expenses and interest.

Generally, profits tax is calculated on an accrual basis subject to certain exceptions.

Special accounting rules apply for profits tax purposes.

5 Although VAT is an indirect tax, we have included it in this chapter due to its structure.

6 Special rates may apply, for example 13 per cent applies to dividends received by Russian shareholders.

7 Zero per cent applies to export (exemption with credit), 10 per cent applies to certain food, medical goods, goods for children, etc.

8 Thresholds subject to annual change.

9 Decreased rates apply for particular types of taxpayers.

10 Other statutory value used in certain cases.

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Capital and income

There is no separate capital gains tax in Russia. Capital gains are subject to the regular profits tax. A separate base may be required in respect of listed and unlisted securities.

An exemption is available for capital gains on the sale of participatory interests and specified in the law shares of Russian companies. In order to qualify for exemption, a taxpayer should have acquired shares or a participatory interest after January 2011[11] and have held them for more than five years.

Losses

Until recently loss carry-forward was limited to 10 years yet unlimited by amount. Now, loss may be carried forward indefinitely; however, such loss cannot reduce taxable profit in any year by more than 50 per cent. Loss included in the general tax profits base may be set off against received capital gain from non-negotiable instruments, but not *vice versa*.

Rates

Generally the profits tax rate is 20 per cent (that is shared between the federal (3 per cent) and regional (17 per cent) budgets). A zero rate applies to medical and educational institutions. In addition, the Tax Code lists certain categories of taxpayers eligible for profits tax incentives (for instance, residents of special economic zones). Until the end of 2018 regional authorities have the right to reduce, at their discretion, the regional portion of the rate from 17 per cent to 12.5 per cent. Starting from 2019, regions will only be able to reduce the rate in cases directly provided by the Tax Code, and the existing incentives will gradually fall apart.

Reduced rates also apply to certain types of income. For instance, dividends received by Russian companies from Russian and foreign subsidiaries are subject to a 13 per cent dividend tax. Furthermore, a participation exemption applies if the recipient has held at least a 50 per cent stake in the subsidiary continuously for at least one year. If the subsidiary is a non-Russian legal entity, it must also not be incorporated in a country that appears on the 'black list' of offshore jurisdictions published by the Russian government.

Dividends paid to non-Russian residents having no permanent establishment in Russia are subject to a 15 per cent rate unless a lower tax rate is available under an applicable tax treaty. Interest paid to non-Russian residents is subject to a 20 per cent withholding tax. However, this tax may be reduced (and even eliminated) under an applicable tax treaty. Royalties paid to non-Russian residents are subject to a 20 per cent withholding tax. Again, a reduction or full exemption may be available on the basis of a double tax treaty.

Administration

Advance profits tax returns are filed quarterly (or monthly, in some cases); the final return is filed annually.

All taxes, including profits tax, are administered by the Federal Tax Service, including its regional and local departments. Special tax inspectorates exist (e.g., for major taxpayers, for foreign taxpayers, for IT).

Tax rulings are available only in limited instances in Russia. However, it is possible to obtain individual guidance from the Ministry of Finance. Action in accordance with such

11 A draft law is pending review that would expand the exemption regardless of when the shares were acquired.

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guidance may exempt the taxpayer from fines and late payment interest, but not tax arrears. A taxpayer or tax agent can also request such guidance from the local Tax Service, however it is unclear if it grants the same benefit. Letters of the Federal Tax Service and letters of the Ministry of Finance addressed to an indefinite number of persons are formally not mandatory, but reflect the general policy of the tax authorities.

Tax assessments may be challenged with the superior tax authority or in court; most decisions are to be challenged with the superior tax authority prior to filing a lawsuit.

Tax grouping

Tax grouping is only available to few major corporations in Russia.

Members of the group can count income and deduct expenses jointly, thus decreasing the tax and administrative burden. Transfer pricing rules are not applicable inside the group.

Currently companies are prohibited from joining the existing consolidated groups. It is expected that the existing consolidated groups will be terminated by 2023.

ii Other relevant taxes

VAT

VAT is charged on (1) goods, works and services 'supplied' in Russia, and also on property rights; and (2) imported goods.

Goods are deemed to be supplied in Russia if they are located in Russia and not transported or if they are located in Russia at the time of dispatch.

In respect of services the general rule is that they are deemed to be supplied in Russia if the seller of services carries out its activities in Russia. However, specific rules apply to certain types of services. For instance, consulting, legal, accounting, marketing, engineering and information processing services are deemed to be supplied in Russia if the purchaser or recipient of those services carries out its activities in Russia.

The standard VAT rate is 18 per cent. With effect from 1 January 2019, the standard VAT rate will be 20 per cent. A 10 per cent rate applies to certain food products, goods for children, certain mass media items (e.g., newspapers) and medical goods. The export of goods is zero-rated (exempt with credit). Certain VAT exemptions are available, for example the sale of land or residential properties and the import of certain technological equipment that has no Russian equivalent.

A company's VAT liability is generally calculated as its output VAT invoiced to customers minus input VAT invoiced to the company by suppliers or paid to customs upon the import of goods. Where the amount of input VAT exceeds the amount of output VAT, the difference is usually recoverable.

Personal income tax

Russian tax residents (generally individuals who, regardless of their citizenship or domicile, are physically present in Russia for at least 183 days in any consecutive 12-month period) are subject to tax on their worldwide income. Non-residents are only subject to tax on income from Russian sources.

In general employers are required to withhold personal income tax from wages. Personal income tax is withheld at a rate of 13 per cent from most types of income of Russian residents (special rates may apply) and at a rate of 30 per cent from Russian-sourced income

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of non-residents (although see below in relation to dividends). Employment-related income of non-resident individuals who are treated as highly qualified specialists is subject to 13 per cent personal income tax regardless of their residency status.

Social security charges

An employer is subject to social security charges payable on its employees' and individual contractors' remuneration. Employees are not subject to social security charges.

Employers are required to make contributions to different social security funds in the following amounts (assessed by reference to thresholds which are reconsidered annually):

a to the Pension Fund, 22 per cent for annual remuneration not exceeding 1.021 million roubles and 10 per cent for remuneration in excess of it;

b to the Medical Insurance Fund. 5.1 per cent; and

c to the Social Security Fund, 2.9 per cent for annual remuneration not exceeding 815,000 roubles and zero per cent for remuneration in excess of it.

Additionally, employers are required to make contributions to the Social Security Fund for insurance for work-related injuries and diseases at rates ranging from 0.2 to 8.5 per cent, depending on the types of activities carried out by the employer.

Property tax

As a general rule, Russian companies are liable to pay property tax on the average annual net book value (cadastre value for trade and business centres and non-residential premises) of the fixed assets on their balance sheet. However, movable fixed assets acquired after 1 January 2013 (other than those acquired from related parties or in the course of liquidation or reorganisation) are exempt from property tax. This narrows the application of this tax to immovable fixed assets and movable fixed assets acquired before 1 January 2013. As of 1 January 2019, the property tax on movable fixed assets is abolished.

The standard property tax rate is 2.2 per cent. However, regional authorities may reduce that rate or even provide a full exemption for all or certain categories of taxpayers.

Owned land is exempt from property tax and is subject to a separate land tax.

Land tax

Land tax applies to landowners at the rate determined by the municipal authorities. Land tax is assessed on the cadastral (other statutory values apply in some cases) value of the land, which is usually equal or close to its actual market value. Land tax rates may not exceed 0.3 per cent of the cadastral value of agricultural and residential land. With respect to other land plots, the maximum rate is 1.5 per cent of the cadastral value.

Municipal authorities may establish tax incentives.

Businesses leasing land are not subject to land tax. Instead, they are liable for the land lease payments established by federal, regional or local authorities or other landowners.

Mineral extraction tax (MET)

Companies and individual entrepreneurs that extract commercial minerals must pay MET. In particular, this tax is levied on the extraction of coal, peat, crude oil, gas, ferrous and precious metals and precious stones.

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Excise taxes

Certain activities with respect to alcoholic drinks, tobacco, transportation vehicles and oil products are subject to excise taxes payable by companies and individual entrepreneurs.

Transportation tax

Transportation tax is payable by persons in whose name a taxable transport vehicle is registered and is payable at the rate established for that type of transport vehicle. Regional governments are permitted to establish tax incentives for certain categories of taxpayers. Generally, transportation tax is not a great burden on businesses.

Stamp duty

Relatively small transactional fees apply to, among other things, the notarisation, registration and filing of legal documents and the issue of securities.

Other taxes

Other taxes include water tax and levies for the use of fauna and for the use of aquatic biological resources.

Certain specific tax regimes are available to small businesses.

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence

All companies incorporated in Russia are deemed Russian tax residents. Companies registered outside of Russia may be deemed Russian tax residents if they have a place of effective management in Russia.

ii Branch or permanent establishment

A foreign entity can establish its presence in Russia via a subsidiary, branch or representative office. Setting up a branch or representative office through which business activity is conducted regularly leads to permanent establishment in Russia unless the functions of such office are restricted to 'preparatory and auxiliary' activity.

In line with an OECD tax treaty, a 'dependent agent' may also lead to a permanent establishment.

As the test for permanent establishment in Russia is not formal but substantial, the only way to avoid its setting up in Russia is not to carry out regular business activity in Russia.

The profits received due to activity of a permanent establishment are attributed to this permanent establishment. If there are several permanent establishments, the taxable base for each permanent establishment is normally calculated separately, unless a specific rule allows the taxable base to be calculated on a consolidated basis (e.g., if several permanent establishments are involved in a single technological process).

Most of the double taxation treaties Russia is a party to are OECD-based, and so are the permanent establishment provisions.

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V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

There are no special tax regimes for resident operations outside the home jurisdiction. Worldwide income of residents is subject to taxation in Russia unless a double tax treaty applies.

However, various tax incentives are available for doing business in Russia. Some of them are granted for investing in specific territories (special economic zones, territories of advanced social and economic development) or participation in certain investment projects (regional investment projects, special investment contracts). Russian tax law also encourages investment in high tech. Reduced social security charges are imposed on certain IP companies. Profits tax benefits apply in relation to depreciation of assets used in technological activities. Exemption from capital gains tax applies to listed shares of high-tech companies though, as a general rule, such exemption does not apply to listed shares. Favourable tax regimes are available for small businesses.

i Holding company regimes

Dividends are not subject to profits tax if the participation exemption conditions are met. In order to qualify for this exemption, a Russian company must have held at least a 50 per cent stake in the relevant subsidiary continuously for at least one year. If the subsidiary is a non-Russian legal entity, it must not be incorporated in a country that appears on the 'black list' of offshore jurisdictions published by the Russian government.

Exemption from capital gains is also available (see above).

ii IP regimes

There is no special IP regime in Russia, although there are some incentives for R&D and high-tech companies.

iii State aid

No state aid provisions apply in Russia.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)

Russian residents are required to withhold tax on dividends, interest, royalties and certain other payments to non-residents.

No withholding tax applies on profit distributions by a permanent establishment to the headquarters.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

As a general rule, such exemptions do not apply.

iii Double tax treaties (DTTs)

Russia has a very extensive network of DTTs (at the time of writing, there are 83).

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DDTs may reduce local withholding on outward-bound dividends, and reduce or eliminate withholding on interest and royalties.

By way of example:

Party to DDT with Russia	Dividends	Interest	Royalties
Cyprus	5 or 10 per cent	Exempt	Exempt
Netherlands	5 or 15 per cent	Exempt	Exempt
Luxemburg	5 or 15 per cent	Exempt	Exempt
Ireland	10 per cent	Exempt	Exempt

Most of the DTTs Russia is a party to are based on the OECD model.

Russia is actively renegotiating its DTTs to accommodate recent trends such as source taxation of real estate shares and limitation on benefits.

iv Taxation on receipt

DTTs may provide for set off of tax withheld on outbound dividends in the source country. The same applies to other types of income. The set-off amount should not exceed the amount of tax due in Russia.

VII TAXATION OF FUNDING STRUCTURES

The most common way to fund business structures are loans, capital contributions and contributions to assets (financing by a shareholder with no capital increase).

i Thin capitalisation

Rules on thin capitalisation apply if a Russian company (A) obtains a loan:

a from a foreign company that is 'interrelated' with the borrower on the basis of a 25 per cent direct or indirect ownership interest in the charter capital of the borrower; or

b from an affiliate of a foreign company that is 'interrelated' with the borrower on the basis of a 25 per cent direct or indirect ownership interest in the charter capital of the borrower; or

c that is guaranteed in any form by the above foreign company or its affiliate.

In these three cases, the thin capitalisation rules only apply if A's debt-to-equity ratio exceeds 3:1 (12.5:1 for banks and leasing companies).

Interest attributable to the portion of the loan that exceeds the ratio is not deductible for A and is treated for tax purposes as a dividend that is normally subject to higher withholding tax under a tax treaty. The portion of the interest not taxed as a dividend is deductible up to the threshold set out in the Tax Code.

Thin capitalisation rules currently do not apply to permanent establishments of foreign companies.

ii Deduction of finance costs

Generally finance costs can be deducted. However, interest may only be deductible subject to thin capitalisation rules and interest transfer pricing rules.

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In relation to interest transfer pricing rules, if the loan is provided by a related party, interest may only be deductible if it is within the range set by the Tax Code. If the interest is higher than the threshold, only the interest up to the threshold can be deductible. This rule works for the assessment of profits tax to the lender as well: if the interest under the loan is lower than the threshold, the lender is subject to tax based on the lowest interest rate of the range provided by law.

iii Restrictions on payments

The right to receive a portion of distributed net profits (in the case of LLCs) or dividends (in the case of JSCs) arises only when the company makes a decision regarding net profit distribution or dividend payment. Profit and dividend distributions are subject to statutory solvency and certain other capital adequacy tests. In a number of situations profit or dividend distribution is prohibited, such as where the charter capital has not been fully paid up or where the company is close to being insolvent or may become insolvent as a result of the distribution.

iv Return of capital

Reduction of charter capital is allowed both in JSCs and LLCs. In some cases, such reduction may be obligatory (e.g., in case of insufficient net assets). Capital can be reduced twofold: by a decrease in the nominal value of the shares (participatory interest) or by a decrease in the number of shares (participatory interest). Share capital reduction may be either accompanied by return of capital or not.

When the reduction of share capital is not obligatory and is not followed by a capital return to shareholders then the company receives a taxable gain. Otherwise there are no tax consequences for the company.

As for the shareholders (participants), generally, irrespective of whether they are legal entities or individuals only the share premium is subject to profits tax.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

Historically, a typical structure for acquisition involved an offshore company (often located in Cyprus, Luxembourg or the Netherlands) holding interests in Russian operating companies, with a shareholders' agreement governed by English law. The popularity of offshore vehicles was owing to the greater flexibility in structuring the relationship between investors and the benefit of tax treaties and bilateral investment treaties offered by other jurisdictions.

Reforms to Russian civil law in recent years have increased the availability of Western-style structuring instruments for onshore business structuring.

Typically, relations between co-investors in such entities are governed by a Russian law shareholders' agreement supported by an English law agreement containing anti-dilution and shareholder information provisions, and an English law deed of indemnity.

Traditional bank financing is the most common source of debt finance for Russian companies. However, sanctions limiting the debt- and capital-raising abilities of many state and state-backed companies have affected their ability to finance transactions. Further, international nervousness around sanctions has made many foreign banks generally cautious about lending money in Russia.

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Equity financing via contributions to assets or increases of the charter capital of the company are common, although EU sanctions may limit the ability of EU investors to participate in these. Shareholder loans are also commonly used and tend to be unsecured.

ii Reorganisation

Businesses can merge or demerge freely except for merging with or demerging from a foreign entity. Reorganisation itself is not taxed. All the tax duties are succeeded by the companies that resulted from reorganisation.

However, reorganisation requires completing administrative proceedings which take time. In addition, reorganisation can trigger special rights of creditors aimed at their protection (e.g., the right to demand early performance if the obligation is not duly secured) and an extraordinary tax audit.

iii Exit

Legal entities can freely relocate within Russia. In order to do so tax authorities should be notified and the charter amended. No tax penalties for relocation exist. Relocation to a foreign jurisdiction is generally not permitted under Russian law.

Recent amendments allowed redomiciliation to Russia from foreign jurisdictions. However it is only possible to relocate to two areas – the Russian Island (Vladivostok) and the Oktyabrsky Island (Kaliningrad). Special requirements are to be met in order for the redomicilation to become possible. If the redomiciled companies meet the 'international holding company' criteria, they may enjoy various tax benefits, such as the lower ownership threshold for participation exemption purposes (15 per cent as opposed to 50 per cent generally) and for the capital gains exemption; in addition 5 per cent withholding tax applies on outbound dividends to foreign shareholders until 2029 irrespective of application of a tax treaty, as opposed to 15 per cent generally. International holding companies are exempt from CFC regulation, including taxation of CFC profit, until 2029.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

GAAR have been developed in Russia by courts and applied for many years. In 2017 they were incorporated in the Tax Code, which provides that the following cases are considered tax avoidance:

a reduction of the tax burden by misrepresentation of tax accounting and financial statements;

b the main purpose of the transaction is reduction of the tax burden or receipt of a deduction from the budget; and

c an obligation under the transaction or other operation is not fulfilled by the taxpayer's counterparty or the person to whom this obligation was delegated.

The rule also describes circumstances that do not *per se* evidence tax avoidance (e.g., the possibility of the taxpayer reaching the same economic results with different means).

A taxpayer is presumed to act in good faith and the burden of proof rests with the tax authorities.

Notwithstanding the codification of GAAR, courts continue to apply the 'unjustified tax benefit' notion previously developed by the Supreme Arbitrazh Court.

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ii Controlled foreign corporations

CFC rules came into force on 1 January 2015. Under the CFC rules, a CFC is a non-Russian entity (including funds, trusts, partnerships and foundations) which is controlled by a Russian tax resident (a company or an individual). Limited exemptions exist. The rules set out how 'control' is assessed and there are certain circumstances in which 'control' will be deemed to exist, for example where a certain minimum level of participation exists. A controlling Russian resident is now required to:

a notify the tax authorities of the CFC; and

b calculate the CFC's profits and remit taxes to the state at the rate of 20 per cent (for Russian legal entities) and 13 per cent (for Russian individuals).

This is a relatively new area of tax law in Russia and there are still a number of questions about how it will apply in practice.

iii Transfer pricing

Generally, transfer pricing control applies to certain transactions between related persons and certain transactions that, for the purposes of transfer pricing control, are treated as being equivalent to transactions between related persons. In particular, all transactions between related persons where one of the parties is a non-Russian person are subject to such control.

Taxpayers are obliged to report to the tax authorities on all transactions that are subject to transfer pricing control. In addition, the tax authorities may conduct transfer pricing control audits.

If the price of a controlled transaction deviates from the market price and this deviation results in a reduction of taxes owed to the state, the tax authorities are able to assess the respective taxpayers for additional tax liabilities. That said, only profits tax, MET and VAT may be assessed as a result of the above control.

iv Tax clearances and rulings

See above.

X YEAR IN REVIEW

Unfortunately for businesses, the Russian government has taken certain measures resulting in the increase of the tax burden. The VAT rate will be increased by 2 per cent to 20 per cent effective 1 January 2019. Regions will lose the right to reduce the rate of profits tax payable to the regional budgets.

A new tax on additional income received from hydrocarbon production is being introduced. Taxpayers are legal persons that have licences specified by the law and satisfy certain requirements. The tax will also be applied to companies engaged in certain other activities in respect of hydrocarbon production. The tax rate amounts to 50 per cent from net profit received from hydrocarbon production reduced by expenses and the MET. The new tax will take effect from 1 January 2019.

Tightening of anti-abuse rules has been accompanied by the extension of the amnesty of capital rules. In 2018 the second stage of capital amnesty was proclaimed, which will continue until 28 February 2019. During this period, individuals who voluntarily declare foreign assets and accounts (deposits) will not be exposed to tax, criminal or administrative liability for certain categories of offences. Liquidation of their CFCs is exempt from tax. In

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addition, persons who have declared certain property in this course of this campaign can reduce the income tax base on disposal of such property in future by the documented value of property received by the ultimate benefical owner from the nominal owner.

XI OUTLOOK AND CONCLUSIONS

The main focus of the Russian tax authorities has been on challenging aggressive tax planning arrangements, including in the cross-border context. We expect that this trend will continue in the new year. In particular, the tax authorities have become very aggressive in applying the beneficial ownership concept when taxpayers claim treaty benefits.

Russia has been a strong supporter of the BEPS (base erosion and profit shifting) initiative and expects to further strengthen enforcement as a result of the introduction of automatic exchange of information.

The possible reform of taxation of the oil and gas industry remains on the agenda of the Russian government.

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Appendix 1

ABOUT THE AUTHORS

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Oleg Konnov has been practising law since 1993 and has developed a reputation as one of the best tax advisers in Russia. Oleg has been consistently ranked in the 1st tier by *Chambers Europe* for tax in Russia. He advises on national and cross-border corporate and individual taxation, and represents clients in all stages of disputes with tax authorities, including tax audits, and administrative and court appeals against tax inspection decisions.

Oleg frequently writes about international and domestic taxation matters for the leading publications. He is a member of the International Fiscal Association and lectures on international tax law and tax law of foreign countries at the Moscow State University.

In addition, Oleg has considerable experience in corporate matters. His corporate practice focuses on M&A and joint ventures in a variety of sectors including oil and gas, metals and mining, telecommunications and infrastructure.

Oleg graduated from the international law department of the Moscow State Institute of International Relations and received a Candidate of Sciences from the Institute of State and Law at the Russian Academy of Sciences. He joined the firm in 2007 as a partner. Prior to that, he worked at another international law firm and at a major consultancy firm.

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Sergei Eremin is a Russian-qualified lawyer specialising in national and cross-border corporate and individual taxation. Sergei's experience includes tax advice, tax litigation, international tax structuring and advice on FATCA matters. Sergei has significant experience in anti-corruption and anti-bribery matters, including FCPA and Bribery Act compliance and investigations. Also, Sergei has been involved in a number of high-profile aviation projects and frequently advises on sanctions matters.

Sergei graduated from the Moscow State Academy of Law. Before joining the firm in 2007 he worked at another international law firm and a leading Russian law firm. Sergei has been practising law for over 14 years.

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