



#### INTERNATIONAL DEVELOPMENTS

# WHAT ARE RECENT TAX DEVELOPMENTS IN YOUR COUNTRY WHICH ARE RELEVANT FOR M&A DEALS AND PRIVATE EQUITY?

Rules have been introduced for the taxation of the profits of controlled foreign companies (CFCs) and the income of foreign entities. A CFC is a foreign company which simultaneously satisfies the following criteria: the company is not a Russian resident and a controlling person of the company is an entity and/or an individual that is recognised as a Russian tax resident. A controlling person of a foreign company is: an individual or a legal entity holding more than 25% in the company; an individual (together with spouses and minors) or a legal entity holding more than 10% in the company, if all persons (if individuals, then together with their spouses and minor children) who are recognised as Russian tax residents hold a shareholding of more than 50% in the company.

If taxpayers that are recognised as Russian tax residents are found to have a controlled foreign company, such taxpayers must notify a tax authority of its membership in foreign companies (of having established unincorporated foreign structures) and of controlled foreign companies which they control.

A CFC's profit is equated to the profit of a person that controls such CFC and should be taken into account when the corporate profit tax base (for companies) or the income tax base (for individuals) is determined. A CFC's profits may be calculated based on the CFC's financial statements or by the rules for calculating corporate profit tax in the Russian Tax Code (the 'Code'). The Code provides for a definite exhaustive list of grounds for granting exemption to CFC's profits at the level of a controlling person.

If a foreign company is liquidated, provided the liquidation procedure is finished by 1 January 2018, a taxpayer will be entitled, when determining its tax base, not to record income such as the value of property received.

# 2. WHAT IS THE GENERAL APPROACH OF YOUR JURISDICTION REGARDING THE IMPLEMENTATION OF OECD BEPS ACTIONS (ACTION PLANS 6 AND 15 SPECIFICALLY) AND, IF APPLICABLE, THE AMENDMENTS TO THE EU PARENT-SUBSIDIARY DIRECTIVE AND ANTI-TAX AVOIDANCE DIRECTIVES?

BEPS action plan 3 provides for more stringent rules for the taxation of profits of controlled foreign companies (CFCs). In this regard, rules have been introduced in Russia for the taxation of profits of controlled foreign companies (CFCs) and of the income of foreign entities. Similarly, to the objective with CFC under BEPS, the above rules are intended to eliminate the deferral of taxation of profits and restrictions on passive income being artificially allocated to foreign low tax jurisdictions. Moreover, the CFC rules in Russia are also intended to combat offshore tax planning and tax abuses.

- \*\* Action 4 implies constraints on the opportunities for diluting profits by making interest payments and implementing other financial schemes. In the Russian Federation, a 'thin capitalisation' mechanism has already been implemented and is in effect. Starting from 1 January 2017, additional grounds have been introduced in the Russian Tax Code for recognising outstanding debt obligations as controlled debt. The Russian Tax Code defines the criteria of comparability under which debt to a Russian 'sister' company will not be considered controlled debt.
- \$\frac{\pmathbb{R}}{\pmathbb{E}}\$ Action 6 proposes measures to prevent tax treaties for the avoidance of double taxation from being abused. Starting from 2010, the Russian Government Resolution has adopted a standard agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and property, which included article 29 "Restriction of benefits". Specifically, benefits and preferences, for which existing international treaties to which Russia is a contracting state provide, should not be applied if:



- 1) in the opinion of competent authorities, if such benefits are provided, this will result in the abuse of the treaty from the perspective of its goals;
- 2) after the treaty is signed, one of the contracting states establishes a preferential tax treatment with respect to the offshore income;
- **3)** a shareholding of more than 50% in a foreign company is, directly or indirectly, owned by persons that are not residents of the state where the company carries out its operations (this provision, however, will not be applied if the owner carries out most of its business operations in the state where the foreign company is located, except for when it simply holds assets or carries out auxiliary operations).

The concept of a beneficial owner (a beneficial owner of income) has been undergoing brisk development in the Russian Federation. The concept of a 'beneficial owner of income' has been used in different wordings in early international double tax treaties which Russia concluded (e.g. in treaties with the US, Canada, France, Japan, etc.) Russian case law takes account of the Russian concepts of a beneficial owner of income, a business purpose doctrine and a bad faith taxpayer doctrine, which have been formulated by the supreme court in Resolution No. 53 of the Plenum of the Supreme Commercial Court. These doctrines enable tax authorities and courts to assess a taxpayer's business operations not only based on formal grounds, but primarily on the totality of circumstances in which such operations are carried out.

The Russian Federation undertakes measures to streamline information exchange between different states to combat bad faith tax planning, the dilution of a tax base and the channeling of capital to offshore jurisdictions. In 2016, the Russian Federal Tax Service signed a multilateral Agreement of competent authorities regarding the automatic exchange of financial information. Starting as early as 2018, the Russian Federation will receive information from foreign tax authorities regarding foreign accounts of Russian tax residents. It is expected that in 2018 the Russian Federation will join the system of automatic exchange of information (Declaration dated 6 May 2014, Paris).

\*\* Action 13 proposes recommendations as to how transfer pricing documentation should be changed so that it complied with standardisation and disclosure requirements to different countries. At the moment, the Russian Finance Ministry has prepared a draft federal law on amending the Tax Code in terms of the preparation and submission of inter-country financial statements. The draft federal law provides for a mechanism for the collection by Russian tax authorities of information required in order to be shared with competent authorities of foreign states within the scope of the implementation of the Multilateral Treaty. For example, the draft federal law obliges taxpayers which are members of an international group to notify a tax authority of their membership in the international group and submit its inter-country financial statements starting from 1 January 2017.

### **GENERAL**

# 3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

#### A. Share deal

#### Tax advantages:

- 1) Under Russian tax legislation, share deals are not subject to Russian VAT;
- 2) A zero profit tax rate (if certain requirements for shares are complied with) is applied to the tax base determined based on sales or other disposals (including redemption) of shares of Russian companies (membership interests in the issued capital of Russian companies) provided that as at the date of sale or other disposal (including redemption) of such shares (membership interests in the issued capital) a taxpayer has continuously held an ownership title or any other proprietary rights to such shares for more than five consecutive years);



**3)** From a legal perspective, in a share deal, there is no requirement to re-sign contracts with existing contractors of the target or to obtain new licences. Share deals are a convenient way to acquire an enterprise without affecting its business processes, contractual obligations or clientele.

#### Tax disadvantages:

- 1) Adverse tax consequences may result from a deal for real estate by way of a share deal without any substantial business purpose other than a tax saving. There is some case law recognising a share deal as a real estate deal (if the real estate constitutes a base asset). However, the court has ruled against the taxpayer in a similar case, considering that the transactions were made with the sole purpose of avoiding VAT. As a result the tax consequences have to be the same as if the taxpayer sells immovable property. Additional VAT may be charged to the seller. In turn the seller has the right to demand payment of such additional VAT from the company;
- 2) Transfer of the title to the shares does not increase the value of the base assets.

#### B. Asset deal

#### Tax advantages:

- 1) The value of the base assets of the acquiring party increases;
- 2) An asset deal does not result in the transfer of any tax risks and tax obligations of the acquired business to the acquiring party.
- **3)** The expenses on the real estate acquisition form the initial cost of the property and may be deducted through depreciation (except for expenses on land);
- **4)** The process of registering a property right can take a long time but it does not entail tax risks (the company has the right to charge depreciation. The company also has the right to apply for a deduction of VAT before the time when the property right is registered).

#### Tax disadvantages:

- 1) An asset deal is subject to Russian VAT at the rate of 18%. This amount will be however recoverable as input VAT if the Company has a VAT-invoice and uses the property in industrial activities. Therefore, it will not result in an additional tax expense;
- 2) When property is transferred as a contribution to the issued (joint-stock) capital of business entities and partnerships, the amounts of VAT deducted in relation to goods, work, or services, including fixed assets, must be recovered.
- **3)** When a company is purchased as a set of assets and liabilities, such a transaction is complicated in terms of taxation. This transaction is possible only if a certificate of registration of the set of assets and liabilities as an enterprise has been obtained.
- 4) The tax base in the event of a sale of an enterprise as a whole set of assets and liabilities is determined separately for each type of asset of the enterprise. If the purchase price exceeds the value of the net assets, the buyer will be entitled to deduct this price surcharge not in one go but over five years, beginning from the month following the month of state registration of the buyer's title to the enterprise;
- 5) The Russian Tax Code does not stipulate a procedure for accounting for fixed assets purchased within the enterprise sold as a set of assets and liabilities, in view of the fact that the sale price is determined for the property as a whole.



#### **BUY-SIDE**

# 4. WHAT STRATEGIES ARE IN PLACE, IF ANY, TO STEP UP THE VALUE OF THE TANGIBLE AND INTANGIBLE ASSETS IN CASE OF SHARE DEALS?

The step up of the value of tangible and intangible assets in the case of share deals is not allowed since the acquisition of shares does not increase the value of the underlying assets. In practical terms, the parties would usually arrange for an independent appraisal by an appraisal company. The appraisal, however, may be contested by tax authorities during a tax audit.

### 5. WHAT ARE THE PARTICULAR RULES OF AMORTISATION OF GOODWILL IN YOUR COUNTRY?

Goodwill is amortised in Russia over 20 years (but for no longer than the company's business operates) and only for accounting purposes. Amortisation for tax purposes in not stipulated by Russian legislation.

# 6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

There are no specific rules set by Russian tax legislation limiting the deduction of interest under borrowings in the cases of an acquisition of shares, and of assets. General rules have been established restricting a deduction under debt obligations (controlled debt).

### 7. WHAT ARE USUAL STRATEGIES TO PUSH-DOWN THE DEBT ON ACQUISITIONS?

Tax authorities have been actively fighting push-down strategies. Authorities may refuse to offset losses for transactions made between a loss-making enterprise and a profit-making enterprise where no business (economic) purpose of the transaction (except for saving on taxes) is determined. The refusal may be based not on statutory regulations but rather on the business purpose doctrine established by Resolution No. 53 of the Plenum of the Russian Supreme Commercial Court. Moreover, starting from 2017, restrictions are being introduced on decreasing the tax base of the current period by amounts of losses incurred in previous tax periods. For the period between 1 January 2017 and 31 December 2020 the base may be decreased by a maximum of 50%.

#### 8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

No.

# 9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

Russian tax legislation sets out a general rule for offsetting losses incurred in previous periods against the tax base of the current period. For the period between 2017 and 2020 the tax base cannot be decreased by more than 50%. A change in ownership of an enterprise (whether through a share or asset acquisition) does not have an impact on the possibility to offset losses. However, tax authorities can re-evaluate a transaction if they consider that it did not have any business purpose (if the only purpose of the transaction was tax saving by offsetting loss) and they may consequently refuse to recognise losses in the context.

# 10. ARE THERE ANY ITEMS THAT SHOULD BE INCLUDED IN THE SCOPE OF A TAX DUE DILIGENCE THAT ARE VERY SPECIFIC TO YOUR COUNTRY?

One of the specific features of performing due diligence in Russia is the need to check whether the taxpayer's counterparties are acting in good faith. This includes, without limitation, checking whether counterparties fulfil their tax obligations; checking what reputation counterparties have (market awareness, etc.). If any transactions between the taxpayer and counterparties acting in bad faith are identified, the amount of unpaid tax may be



collected from the taxpayer. In addition, special attention should be paid to intra-group services. Court practice in Russia over the past several years has not been evolving in favour of taxpayers. Tax authorities dispute whether such services are economically justified.

### 11. IS THERE ANY INDIRECT TAX ON TRANSFER OF SHARES (STAMP DUTY, TRANSFER TAX, ETC.)?

A statutory fee is set out for the state registration of the issuing (additional issuing) of securities by a competent authority. No other indirect tax is prescribed for transfers of shares.

# 12. ARE THERE ANY RESTRICTIONS ON THE CORPORATE TAX DEDUCTIBILITY OF ACQUISITION COSTS?

The expenses incurred by shareholders to acquire shares may not be taken into account to determine the tax obligations of the target company.

### 13. CAN VAT (IF APPLICABLE) BE RECOVERED ON ACQUISITION COSTS?

A sale of securities (including shares) is not subject to VAT. When property is transferred as a contribution to the issued (joint-stock) capital of business entities and partnerships, the amounts of VAT deducted in relation to goods, work, or services, including fixed assets, must be recovered. The amounts of the tax which must be recovered are not included in the value of property, intangible assets, and property rights; also, the tax deduction should be made by the receiving company. Moreover, when the core asset of the target company is immovable property, the transaction may be reclassified as a sale and purchase of property and be subject to VAT.

# 14. ARE THERE ANY PARTICULAR TAX ISSUES TO CONSIDER IN THE ACQUISITION BY FOREIGN COMPANIES?

No.

# 15. CAN THE GROUP REORGANISE AFTER THE ACQUISITION IN A TAX NEUTRAL ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

N/A.

# 16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

The Russian Tax Code prescribes that income received from sale of shares (membership interests) of companies, more than 50% of whose assets are directly or indirectly comprised of immovable property located in Russia and also of financial instruments, which are derivatives of such shares (membership interests), save for shares which are recognised as shares traded on an established securities market, is considered to be a foreign company's income from sources in Russia and is subject to taxation. No other specific regulatory features are established for the sale and purchase of shares where the core asset is immovable property. Nonetheless, it is likely that such a share sale and purchase transaction will be reclassified as a sale and purchase of property and be subject to VAT. This approach is supported by court practice.

# 17. IS FISCAL UNITY/TAX GROUPING ALLOWED IN YOUR JURISDICTION AND IF SO, WHAT BENEFITS DOES IT GRANT?

Tax legislation in Russia prescribes the possibility for companies to unite as a consolidated group of taxpayers based on the corresponding agreement establishing such a group. The consolidated group of taxpayers calculates profit tax taking into account the financial performance of all taxpayers that are part of such group. This group may be



comprised only of Russian companies (with some exceptions) which comply with certain criteria including at least 90% mandatory participation in the equity of companies which are part of such group; the total amount of tax paid should be at least RUB 10 billion; the total amount of revenues should be at least RUB 100 billion; and the total cost of assets indicated in the accounting (financial) reports should be at least RUB 300 billion. Transactions between the members of the consolidated group of taxpayers do not fall under transfer pricing control.

#### **SELL-SIDE**

#### 18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

A zero profit tax rate is applied to the tax base determined based on sales or another disposal (including being redeemed) of shares of Russian companies (membership interests in the issued capital of Russian companies) provided that as at the date of sale or other disposal (including being redeemed) of such shares (membership interest authorised capital) a taxpayer has continuously held the ownership title or has had other proprietary right to such shares for more than five consecutive years.

The following income is not calculated for a company's tax base:

- 1) Investment obtained from foreign investors (foreign companies or Russian-based subsidiaries with 100% foreign membership) to finance capital expenditure of a production nature provided that such income is used within one year after it is obtained.
- 2) Property received by a Russian company on a free-of-charge basis:
  - **a)** from another company, if more than 50 percent of the receiving party's issued (joint-stock) capital (fund) was contributed by the transferring party;
  - b) from another company if more than 50 percent of the granting party's issued (joint-stock) capital (fund) was contributed by the receiving party and as at the date of transfer of property the receiving party has ownership of such contribution (share) in the issued (joint-stock) capital (fund). However, if the transferring company is a foreign company then such income will not be taken into account only if the state in which the granting company has its permanent location is not included in the list of states and territories granting a beneficial tax regime and/or not allowing for information to be disclosed and provided during financial transactions (offshore zones).

In this case the received property will not be classified as income for taxation purposes only if such property (save for monetary funds) is transferred to third parties within one year from when it was received.

# 19. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES ARE REINVESTED?

No.

## 20. ARE THERE ANY LOCAL SUBSTANCE REQUIREMENTS FOR FOREIGN HOLDING COMPANIES?

No statutory substance requirements have been established for holding companies but court practice always requires substance. Companies should have their offices at their registered address, own assets (property), employ staff, pay taxes in greater than minimal amounts; and they should have a business reputation. Tax authorities are entitled to go to court to collect tax arrears after an audit if such tax arrears have been pending for at least three months on affiliated companies (subsidiaries) or holding (controlling) companies if their accounts are credited with revenues from sale of goods (work, services) of such affiliated companies (subsidiaries) or holding (controlling) companies. Tax authorities are entitled to collect amounts if they establish that the revenues from sales of goods (work, services) were paid, the funds, or other property was transferred to a holding (controlling, participating) company or affiliated companies (subsidiaries) though a set of related transactions.



### 21. ARE THERE ANY SPECIAL TAX CONSIDERATIONS REGARDING MERGERS/SPIN-OFFS?

No

### MANAGEMENT INCENTIVES

# 22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

If the bonus (incentive) package is part of the employment contract then the payments made by the company may be deducted for tax purposes. If the bonus package is paid after dismissal, court practice allows for deductions for tax purposes only if the amount of the severance payment does not exceed five times monthly salary and if the economic justification has been confirmed.

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