RUSSIA

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INTERNATIONAL DEVELOPMENTS

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

Russian tax legislation and court practice has been developed regarding the tax consequences of M&A structures. The structures including debt push-down from the tax view was regarded by competent authorities as a strategy aimed exclusively at tax avoidance. The negative aspects in court practice arisen also regarding the debt financing, since in some cases interest were reclassified into dividends by analyzing the substance of the debt transaction even if formal thin cap rules were not applicable. Also rules regarding the capital gains on shares in companies with significant real estate assets were modified.

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?

New legislation has been implemented, including new CFC rules, residency criteria, the definition of beneficial ownership with regards to double tax treaties, CbCR rules, modified thin cap rules, and VAT on digital services provided by foreign companies.

Action 6. In Russia the concept of "beneficial ownership" has already been developed and is applied broadly by tax authorities to any kind of passive income transferred abroad in order to prevent the tax treaty abuse. Failure to meet such requirements may prevent a recipient of foreign income from receiving treaty benefits from a Russian perspective. Anti-avoidance clauses have already been implemented in some DDTs by additional Protocols.

Action 15. The Multilateral Convention to Implement Tax Treaty Related was signed by Russia in 2017. Nowadays the process is on the step of ratification. Russia is going to apply Convention to 66 Double Tax Treaties concluded regarding the following points: restrictions on appliance of DDTs (Russia has chosen the co-called simplified "LOB" clause); restriction of applying lower tax rate for dividends (the requirement of the minimum amount of investments established under the treaty should meet during 365 days); the definition of the PE is expanded (including the definition of the agent, limitations of the notion of preparatory and auxiliary activities).

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES BETWEEN AN ACQUISITION OF SHARES AND AN ASSET DEAL IN YOUR COUNTRY?

Sales of share are not subject to Russian VAT. In some cases, the tax authorities try to requalify share deals into sales of assets, and charge VAT on such sale; the courts support them, however, only when there is the clear evidence that the real intention of the parties was to sell the assets. Capital gains on share deals are subject to Russian CIT at the rate of 20% for both types of seller (i.e., the Russian company of the foreign company PE, unless an exemption is applicable). In shares deal the purchaser achieves not only the participation in the equity, but also a control over the company, consequently the credit liabilities as well as tax liabilities are "inherited" by the buyer.

In asset deal the purchaser acquires certain assets in the company, as a result only assets and risks related to them are transferred and not the risks related to the company itself. An asset deal is generally subject to VAT at the rate of 18%. Capital gains on the sale of assets are taxable at the general CIT rate of 20%. The gain is generally calculated as the amount of the sale price above the book value of the asset. The sale of land plots is always exempt from VAT.

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?

In statutory accounting the revaluation of assets could be used. Revaluation of assets is not a compulsory procedure and it is regulated by statutory accounting rules and not by tax legislation.

5. WHAT ARE THE PARTICULAR RULES OF AMORTIZATION OF GOODWILL AND SIMILAR INTANGIBLE ASSETS IN YOUR COUNTRY?

According to the Russian tax legislation goodwill is not qualified as an intangible asset. For tax purposes only the following assets could be regarded as intangibles: 1) patents on inventions/ industrial samples/ working models/ selective achievements; 2) know-how; 3) trademark/ tradename/ company name; 4) copyrights on computer programs or databases/ topologies of integrated microcircuits/ audiovisual works. Such assets in order to be recognized as intangibles have to generate income for the company and be justified by necessary documents.

An Intangible asset is subject to amortisation only if its initial value is not less than RUB 100,000 (approx. USD 1,600) and the period of use is more than 12 months. Amortisation of assets is deductible for profits tax purposes in Russia. Amortisation rates depend on the assets' useful life.

Goodwill is recognized in statutory accounting as the difference between the purchase price of an enterprise as a property complex and the net book value of its assets. The amortisation of goodwill is calculated only in statutory accounting.

6. WHAT ARE THE LIMITATIONS ON THE DEDUCTIBILITY OF INTEREST EXPENSE? ARE THERE SPECIAL INTEREST LIMITATIONS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

Deductibility of interest expense is limited by thin cap rules in Russia. Thin cap rules are applied to interest on loans received from foreign shareholders (legal entities, individuals) holding directly/ indirectly more than 25% of the debtor capital or more than 50% in each next company in the chain. Interest expenses are deductible provided that the amount of debt does not exceed the debt/ equity 3:1 ratio (12,5:1 for banks and leasing companies). "Excess" amount of interest is deemed as dividends which are not deductible from the tax base and are subject to WHT at the rate of 15% (lower rates could be applied under the DDT).

The new rules have increased the sphere of application of the thin cap rules, including loans made from "sister" companies. Also in recent times the court practice has been developed on this matter. Despite the fact that under the law only fixed-ratio approach is established the tax authorities have started challenging the deductibility of interests even if the formal criteria are not met, courts support such approach and treat the debt as capital investments or equity financing if the real intention of the parties was to avoid taxes by disguising the distribution of profit with the appliance of artificial debt transactions.

Regarding the deductibility of interest during the acquisition and the following merger (debt push-down strategy), please see the answer to the question N 7.

7. WHAT ARE COMMON STRATEGIES TO PUSH-DOWN DEBT ON ACQUISITIONS?

Under general corporate and tax rules debt push-down strategies are not directly prohibited, so the companies are allowed to reorganize their assets in every possible legal manner. But the real court practice on this matter has been developed since recently two cases on debt push-down strategies have been regarded in courts. Both cases ended unsuccessfully for the taxpayers in cassation instance, so nowadays the appliance of the debt-push down strategies from the tax view cannot be safe.

Under the debt push-down strategy the acquisition of a target company are financed by debt provided from the foreign parent company. After the acquisition the buyer and the target company merge, so the interest accrued by the buyer are deducted from the target company income for profit tax purposes. Recent years courts determine such kind of M&A transactions as artificial and economically "unjustified", since they cause additional expenses to arise for the target company which were not associated with profit generating activities. As a result the deductibility of the entire amount of interest was refused.

The worst case-scenario could be if the court does not recognize not only the deductibility of interest, but also the entire debt transaction, which could cause the requalification of the entire amount of interest and the amount of loan paid to the foreign company into dividends. The situations described took place in recent cases, so there is a strong possibility that in the near future the tax authority will challenge the use of such structures.

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

According to Russian law equity financing is exempt from taxation. Contributions to the equity could be made in the form of money/ tangible or intangibles assets/ securities etc. Under general rules a contribution to the equity capital is not regarded as a sale of goods or services. Neither such contribution could be regarded as a donation of asset, since the equity-financing is accompanied by a transfer of company's share to the contributor of assets provided. As a result contribution itself is exempt from VAT. Meantime, contributing entity has to restore VAT on the book value of the assets. Such VAT may be deducted by the subsidiary in which these assets are contributed. Such contribution for the receiving company cannot be regarded as an income for the CIT purposes; for the contributor the amount of the contribution will not reduce the tax base.

The law establishes that the tax exemption for equity-financing is applied only if the contributor acts as an investor expecting to gain a profit in the future (for example, in the form of dividends) and does not use this type of financing only to avoid taxes. Otherwise the tax authority will challenge the tax exemption and requalify the transaction.

9. ARE LOSSES OF A TARGET COMPANY AVAILABLE AFTER AN ACQUISITION IS MADE? ARE THERE ANY RESTRICTIONS ON THE USE OF SUCH LOSSES?

After an acquisition all losses of a target company are still available. The losses may be carrying forward without any time limitation. There is temporary provision that the profit of the current year may be reduced on amount of the losses carrying forward not more than on 50 %. This rule is applicable until 2021.

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

As it was said before in share deals the buyer gains a control over the acquiring company, as a result all liabilities (including tax liabilities) are "transferred" to the purchaser. For this reason the thorough analysis of the historical/ current and future tax obligations must be conducted. So before the deal the buyer can request the documents issued by tax authorities from the target company at the latest day confirming the tax fulfillment. The buyer also should analyze the corporate structure, the current transaction and relations with clients in order to estimate correctly potential risks in the future, e.g. the VAT refund could be rejected by tax authorities from transactions with contractor who failed to perform its tax obligations, as a result such reject may cause significant financial expenses.

It also should be noted that if by the date of sale of shares the company does not have any tax arrears the tax audit can be performed for 3 years preceding the year in which the decision on the performance of the audit was made, therefore additional taxes could still arise.

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

No stamp duty/ transfer tax or similar taxes are imposed.

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

Acquisition costs for the share deal could reduce the tax base only at the moment of the disposal of shares. The following costs can be recorded: the acquisition price of those shares and the amount of expenses associated with the acquisition. For the asset deals acquisition costs are deductible in the form of depreciation.

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

VAT could be recovered on acquisition costs only for asset deal (except for land plots which are VAT exempt), since the share deals are not subject to VAT.

14. ARE THERE ANY PARTICULAR TAX ISSUES TO CONSIDER IN THE ACQUISITION OF A DOMESTIC COMPANY BY A FOREIGN COMPANY?

- The foreign company can acquire the shares in Russian company directly or through the local branch. If the branch constitutes the PE on the territory of Russia the capital gains from the sale of share will be taxed under ordinary rules, as for Russian legal entities. Without PE the capital gains is tax exempt unless the situation when more than 50% of the assets of the Russian company directly or indirectly consists of immovable property located in Russia.
- In case holding structure includes the intermediate foreign entities used in order to reduce of WHT on passive income, the foreign company should be aware that the tax authorities could challenge the WHT tax rates applied if the holding company was deemed as a "conduit" or basing on the approach that the recipient does not satisfy criteria of the beneficial owner.
- In order to achieve reduced WHT rate on dividends distribution instead of general 15 % rate the acquisition should satisfy requirements established in the applicable DTT.

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

The process of reorganisation is tax-neutral in Russia, no additional tax is arisen during this process. The tax rights and liabilities of the organised company are not affected by the reorganisation. The tax authorities may not charge penalties to the surviving company that were not presented to the company that ceased to exist.

Tax grouping is established in the Russian tax legislation only for the biggest enterprises which satisfy certain requirement s as amount of revenue, volume of the assets, amount of tax due. Non-Russian company may not be the member of the group.

16. ARE THERE ANY PARTICULAR ISSUES TO CONSIDER IN THE CASE OF A TARGET COMPANY THAT HAS SIGNIFICANT REAL ESTATE ASSETS?

In 2015 an important amendment was introduced regarding the tax consequences of sale of shares by foreign entities in companies with significant real estate assets located in Russia. According to this amendment capital gains is arisen for the foreign company from the sale of shares if more than 50 percent of the assets of a target company directly or indirectly consist of immovable property located in Russia. As a result since 2015 the "indirect" sale of Russian immovable property without taxation has been restricted. Before this amendments only sale of the Russian real estate company was subject to profit tax on the realized capital gain.

Meantime, tax is applicable only if the buyer of the target company is a Russian legal entity or the Russian PE of the foreign company. The sale of shares in a target company (even with significant real estate assets) between two foreign companies is still tax-exempt. But we cannot exclude the possibility that in the near future the legislation on this matter will develop.

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

Russian legislation provides an opportunity to create a consolidated taxpayer group ("CTG"). CTG is a formation based on a consolidation agreement for at least two years. Creation of such group is subject to registration with the tax authorities. CTG is availible only for big holdings since the minimum limits on consolidated revenues/ paid taxes/ assets are sufficiently high (not less than RUB 100 bn/ 10 bn/ 300 bn respectively). Members of the CTG are the legal entities holding, directly or indirectly, at least 90% in each of the other group member. CTG could be used only for calculating, paying and filing in reporting forms for corporate income tax with the consolidated tax rate of 20% (other taxes are paid independently by each of the group member). Members of the CTG cannot be in the process of liquidation or bankruptcy.

Benefits of the CTG: 1) Members of the CTG consolidate revenues and losses. As a result within one holding losses of the unprofitable entities can be considered and reduce the consolidated tax base; 2) Transactions between members of a consolidated taxpayer group are exempt from the transfer pricing control, except for transactions a subject of which is mining operations.

18. DOES YOUR COUNTRY HAVE ANY SPECIAL TAX STATUS SUCH AS A PATENT BOX FOR COMPANIES THAT HOLD INTANGIBLE ASSETS?

No, the law does not provide such status for companies.

19. DOES YOUR COUNTRY IMPOSE ADVERSE TAX CONSEQUENCES IF OWNERSHIP OF INTANGIBLES IS TRANSFERRED OUT OF THE COUNTRY?

In some cases adverse tax consequences could emerge if ownership of intangibles is transferred out of the country within one holding to the parent/sister company without any compensation to the initial owner, especially if the expenses incurred by the initial owner associated with this intangible were significant. Such transactions could be treated as artificial and aimed at disguising the distribution of assets within holding at non-market prices and at creation unjustified expenses for the initial owner. But the consequences could be different depending on conditions of the transaction and the compliance of the compensation with the market value of this intangible.

SELL-SIDE

20. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY? WHAT, IF ANY, GAINS ARISING IN AN M&A CONTEXT ARE ELIGIBLE FOR SPECIAL TREATMENT?

In Russia there is no separate tax established for capital gains. Such gains arisen from the disposal of assets are regulated under ordinary corporate or personal income tax rules. The taxable base from sale of shares is calculated as the difference between the sale price under the transaction and the acquisition historical costs incurred (acquisition price plus additional expenses as legal/finance consulting services). For asset deal the tax base is equal to the difference between the sale price and their net book value (after amortisation costs).

Gains from the sale are subject to the 20 % CIT rate and the 13% personal income tax rate for residents and 30% for non-residents.

Nowadays the exemption from taxation is applicable for the sale of shares in Russian entities. It is available if the taxpayer held shares for 5 years prior to the date of sale and shares were acquired after 1 January 2011. Exemption is also applicable for the shares in Russian joint stock companies, if the shares are non-listed; if the shares are referred to the high-tech/innovation sector of economy or for the shares if less than 50 percent of the assets of a company directly or indirectly consist of real estate.

21. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES OR ASSETS ARE REINVESTED?

No direct advantages are granted by law.

22. ARE THERE ANY LOCAL SUBSTANCE REQUIREMENTS FOR HOLDING COMPANIES?

Tax authorities pay close attention to the matters of economic justification and the real purpose of transactions, and their context. In court practice the concept of “unjustified tax benefits” has already been used for many years (nowadays it is also incorporated into legislation), according to which taxpayers must record transactions according to its substance. Rules are applied in order to minimize the tax avoidance and determine the main purposes or transactions. This concept is a general rule and could be applied for debt financing (in order to reclassify interest into dividends) within holdings or for M&A reorganization purposes and etc.

Also tax authorities apply beneficial ownership rules by rejecting the appliance of lower beneficial rates under the DDT to transactions with “conduit” companies. For this reason the tax authority examines the substance of the foreign recipients.

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

The result of the merger process of several legal entities is the emerging of the new one, which becomes a legal successor of all tax liabilities of the former company, irrespective of whether such successor was aware of unpaid taxed (including penalties) prior to the reorganisation process. Along with it the successor has a right to reduce the tax base by the amount of losses made by former companies prior to the reorganisation (losses could be carried forward over the 10 years following the tax period in which the loss was made). Losses made from 2008 to 2017 could be carried forward in the full amount, for the period from 2017 to 2021 the reorganized company could reduce the income only by up to 50% of losses incurred.

Under the general tax rule for the reorganisation in the form of spin-off the new company does not become a legal successor, since the initial company does not cease to exist. Therefore no tax liabilities (unpaid taxes and penalties) are transferred to the spun-off company. There is a exemption if such form of reorganization was aimed exclusively at avoiding the fulfillment of tax obligations, then by court's decision the newly spun-off legal entity would be obliged to fulfill such tax obligations. The transfer of losses to the new company is not applicable for the spin-off process.

MANAGEMENT INCENTIVES

24. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES IN CONNECTION WITH SELLING OR BUYING A COMPANY?

NA.

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