Russia proposes amendments to Tax Code regarding international taxation

The Russian State Duma has been presented with a bill proposing a whole range of amendments to the Tax Code. This Alert summarizes the changes relating to international taxation:

Tax rules for controlled foreign companies (CFCs)

The bill proposes to exclude dividends and the corresponding withholding tax from the calculation of the effective tax rate for profits of a CFC where the beneficial owner of the dividends is a controlling person with Russian tax residency. According to the explanatory note, the reasoning behind this change is that the CFC does not have the right to dispose of the dividends in carrying on its business activities and therefore should not bear the tax burden connected with their receipt.

There is an adjustment to the rules for treating foreign holding and subholding companies as active entities. Specifically, it is provided that the calculation of the proportion of passive income of such companies should not take into account income from sales and other disposals of shares/ownership interests in active foreign companies, active foreign subholding companies and other companies that satisfy the criteria in subsections 1 to 3 and 5 to 8 of clause 1 of Article 25.13-1 of the Tax Code, and other income for which the effective tax rate was not less than 75% of the profits tax rate (i.e., 15% or higher).

Deduction of expenses when selling property rights (ownership interests or units)

The bill proposes to allow income from the sale of property rights (ownership interests or units) to be reduced for taxation purposes by the amount of a contribution made to an organization's assets. This is a long-awaited initiative for participants that are limited in their ability to make a decision to increase a subsidiary's charter capital and are compelled to make investments by means of a contribution to assets. Similar amendments are proposed regarding the taxation of income arising from the distribution of the assets of an entity undergoing liquidation. It is unclear, however, whether these rules will apply to joint stock companies.

Adjustments to the rules for the application of tax treaty benefits

A number of tax treaties concluded by Russia (as amended by the OECD[1] BEPS[2] Multilateral Convention) make the application of reduced rates of withholding tax for dividends dependent on certain criteria being met, namely a minimum period of ownership of shares/interests and a minimum amount of investments.

The bill proposes to simplify the application of these criteria in situations where a taxpayer, as an indirect shareholder, declares its beneficial ownership of shares/interests and claims the application of the look-through approach for taxation purposes in relation to income received from the company concerned. Specifically, it is proposed that the applicability of the look-through approach should be determined solely by whether the criteria are met by the immediate shareholder/participant in a Russian company.

If the criteria are met by the direct shareholder, they will also be considered to be met by the beneficial owner of the income for the purposes of applying reduced treaty rates.

Tax residence rules for individuals in relation to COVID-19

The Ministry of Finance has announced a plan by the Government to make it easier for individuals who have been stranded outside Russia as a result of the pandemic and border closures to preserve their Russian tax resident status in 2020.

The option will be available to individuals who have spent from 90 to 182 days inclusively in Russia from 1 January to 31 December 2020. The retention of Russian tax resident status will be granted on a voluntary basis. To obtain that status, the individual concerned will need to submit an application to the tax authority.

The text of the bill has yet to be published. It may be concluded from the context that the right to apply the reduced timescale for recognition as a Russian tax resident will be available only to individuals who had a similar status in 2019. Meanwhile, the basic rule whereby individuals are recognized as Russian tax residents if they spend more than 183 days in Russia over any 12 consecutive months remains in place.

Endnotes

1. Organisation for Economic Co-operation and Development.
2. Base Erosion and Profit Shifting.

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