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Russian Deoffshorization law and its impact on contractors and subcontractors of the Sakhalin 1 and Sakhalin 2 projects



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Russian Deoffshorization law

Introduced by:

- Russian Federation Law No. 376-FZ dated November 24, 2014

Entered into force on:

- January 1, 2015

Purpose:

- to encourage Russian tax residents to suspend the use of offshore companies and non-corporate structures

Russian Deoffshorization law

Persons subject to new “deoffshorization” regulations:

- Controlled Foreign Companies (“CFC”)
- Controlling persons
- Non-Russian companies considered to be Russian tax residents
- Companies engaged in indirect disposal of immovable property located in Russia

Persons subject to new “deoffshorization” regulations

CFC characteristics:

- foreign company or non-corporate structure (foundation, partnership, trust or any other form of joint investment vehicle)
- non-Russian tax resident
- controlled by a Russian tax resident (either a company or an individual)

Persons subject to new “deoffshorization” regulations

Controlling person:

- Russian tax resident (company or individual), if the participating interest in the CFC exceeds:
 - 50% (25% as of January 1, 2016); or
 - 10% given that the total participating interest in this CFC owned by all companies and individuals, deemed to be Russian tax residents, exceeds 50%

- Person being a Russian tax resident, if he/she exercises control over a CFC (e.g., by having determining influence on making decisions on distribution of profits generated by this foreign company) in his/her own interests or in the interests of his/her spouse or minor children

Persons subject to new “deoffshorization” regulations

Non-Russian company, if the place of its actual management is in Russia

➤ **Principal criteria:**

- executive bodies carry out their activities in Russia on a regular basis (more frequently than in another country)
- chief (managing) officers perform their managerial functions mainly in Russia

Persons subject to new “deoffshorization” regulations

Non-Russian company, if the place of its actual management is in Russia

➤ **Additional criteria:**

- company’s bookkeeping or management records are maintained in Russia
- company’s records are maintained in Russia
- operating HR management is carried out in Russia

Persons subject to new “deoffshorization” regulations

Companies engaged in “indirect” disposal of immovable property located in Russia

➤ “Indirect” disposal of immovable property:

- disposal (sale, transfer) of shares (participating interest) of a company, if
- more than 50% of assets of such company directly or indirectly consist of immovable property located in Russia

Legal implications associated with “deoffshorization’ regulations

Disclosure/reporting requirements

- Russian tax residents shall be obliged to notify Russian tax authorities of:
 - participation in foreign companies if their participating interest exceeds 10%
 - formation of foreign non-corporate structures and exercising control over such structures or being actually entitled to profits generated by such structures
 - CFCs

Legal implications associated with “deoffshorization’ regulations

Disclosure/reporting requirements

- Foreign companies and non-corporate structures having in possession immovable property located in Russia shall be obliged to notify Russian tax authorities of their participants (founders, beneficiaries, etc. – for foreign non-corporate structures)
- Foreign companies qualified as Russian tax resident shall be subject to Russian tax reporting requirements

Legal implications associated with “deoffshorization’ regulations

Tax implications:

- Profits generated by CFCs will be attributed to the controlling persons and will be subject to taxation in Russia
- Foreign companies qualified as Russian tax residents shall be subject to taxation in Russia in accordance with the Russian Tax Code
- Profits generated by companies in connection with “indirect” disposal of immovable property located in Russia shall be subject to a Russian withholding tax at a rate of 20%

Legal implications associated with “deoffshorization’ regulations

Sanctions:

- Administrative fines for failure to observe reporting requirements (e.g. RUR 100,000 for failure to file a CFC notification)
- Administrative fines for failure to pay taxes in accordance with CFC rules (20% of unpaid taxes, however no less than RUR 100,000)

Legal implications associated with “deoffshorization’ regulations

Exemptions

CFC is exempt from Russian taxation requirements if:

- It is a non-for-profit organization which does not distribute profits;
- It is organized in accordance with the laws of a member state of the Eurasian Economic Union;
- It is an issuer of marketable bonds;
- It is a bank or insurance company acting under a bank or insurance license;
- amount of its profits is less than RUR 50 million (30 million beginning from January 1, 2016, and RUR 10 million from January 1, 2017);
- Etc.

Conclusions and recommendations

Conclusions:

- “Deoffshorization” regulations DO NOT provide for provisions restricting or limiting operations of contractors and subcontractors of Sakhalin 1 and Sakhalin 2 projects
- Contractors and subcontractors of Sakhalin 1 and Sakhalin 2 projects meeting criteria introduced by the new “deoffshorization” regulations may bear risks of tax exposure and additional reporting requirements

Conclusions and recommendations

Recommendations:

- Conduct due diligence of current corporate and management structure
- Assess relevant risks
- Make sure to comply with reporting and taxation requirements to avoid sanctions
- Take necessary measures (corporate and business restructuring) to avoid legal implications associated with “deoffshorization” regulations or minimize their negative effect

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