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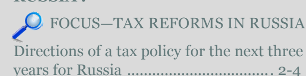

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FOCUS

TAX REFORMS IN RUSSIA

DIRECTIONS OF A TAX POLICY FOR THE NEXT THREE YEARS FOR RUSSIA

In brief

The Russian Ministry of Finance (MinFin) has published on its website the draft version of the Key Directions for Russian Federation Tax Policy for 2016 and the planned 2017 and 2018 periods*.

Although this draft policy document is subject to further discussion and approval by the Russian Government, even at this stage it's already possible to get a rough picture of what lies ahead taxwise for the next three years.

The MinFin stressed that it does not propose and would not support any major tax rule changes, but intends rather to wrap up those initiatives that have already been started. Its main focus will be on tax amnesty and anti-crisis measures.

* http://minfin.ru/ru/document/

In detail

The most important proposed changes in tax legislation:

- Tax amnesty for capital repatriation;
- Profits tax benefits for greenfield projects (new industrial enterprises) within the limits of their capital expenditures. The benefits will be structured in a similar way to those already in effect in the Russian Far East (i.e. a zero tax rate - federal part and a 10% tax rate - regional part, thus total tax rate of 10% instead of the usual 20%). There is also a proposal to make this benefit applicable on a Russia-wide basis beginning in 2016, but only for investment projects that meet specific criteria;
- Clarified thin capitalisation rules;
- Clarified rules for calculating output VAT on advance payments received by a seller and rules for the corresponding buyer to deduct the relevant input VAT. Simplified export VAT refund procedure and other measures to improve VAT calculation. Exemption for major taxpayers from excise duty on exported goods without bank guarantees;

Exemption for certain domestic Russian transactions from control under TP rules, including through raising the threshold amount for income earned from such transactions.

The MinFin also highlighted the following important areas with respect to tax administration:

- Introduction of tax rulings;
- Improvement of the consolidated group of taxpayers mechanism as regards the formation of a group and calculation and payment of group taxes;
- Combating tax base erosion in line with OECD initiatives (first of all, BEPS*), and the introduction of automatic exchange of information with other countries starting in 2018 ;
- Improvement of the CFC rules ;
- Improvements to TP rules according to OECD's proposals . Please note that this could mean the introduction of a three-tier TP documentation. Such documentation would allow the tax authorities to see all of, or nearly all of, the added-value chain and compare the contribution of each group company with its taxable margin.

* http://www.oecd.org/tax/beps.htm

Regarding **efforts to combat aggressive tax planning**, the MinFin indicated that the concept of an unjustified tax benefit would be codified. Indeed, a relevant bill has already passed its first reading in the State Duma.

The MinFin's draft tax policy document contains some proposals on taxation of natural resource users, but so far there has been no mention of replacing the Mineral Resource Extraction Tax (MRET) with a tax on additional income from hydrocarbon production (or a tax on financial results, as it is sometimes called) during the pilot projects.

Employers that make **insurance contributions** can relax for now as the current rates will not go up until 2018. At the same time, for some types of payers the benefits will gradually be discontinued.

The general direction of tax reform efforts (or, more precisely, enhancements to current tax law) is clear, thus allowing companies to make business forecasts that factor in the expected stability in tax matters.

The «Deoffshorization» Law – Initial Clarifications Issued

Federal Law No. 376-FZ of 24 November 2014 commonly referred to as the "deoffshorization" law has been in effect since 1 January.

The law introduced a number of key principles new to Russian tax law, including controlled foreign company ("CFC") rules as well as tax residency for legal entities.

The law contains some ambiguous provisions and there are certain aspects of the new measures which have yet to be fully addressed in the legislation.

Amendments to the law are therefore widely expected. In the meantime the Ministry of Finance is addressing taxpayers' concerns by means of clarifications.

Tax Residence of a Foreign Company

Letter No. 03-08-05/1599 of 22 January explains the tax residency concept in relation to a Maltese company. Per the question, the company belongs to a resident of Russia, the management is Russian, the activities it performs are outside Russia and it does not have autonomous divisions in Russia. The reply states that a Maltese company cannot unilaterally opt for recognition as tax resident in Russia if the company does not have any branches in Russia.

This is understandable based on the wording of clause 7 of Article 246.2 of the Tax Code. The company's earnings may therefore be part of the owner's tax base under the CFC rules. In practice the condition of having an autonomous subdivision may be quite easily fulfilled since an autonomous subdivision is deemed to be created if a company maintains workplaces during a period which exceeds one month.

It is noteworthy that the letter states that the issue of the recognition of foreign companies as Russian residents will be analysed in the course of improving tax legislation. We may therefore see further developments in this area.

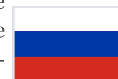
Can Profits of a Cypriot Company be Taxed?

Letter No. 03-08-13/65376 of 17 December, 2014 answers a question as to whether a Cypriot company should be recognised as a CFC for profits tax purposes. The answer is, as would be expected given the legislation enacted, that if the company: passes the "effective tax-rate test" or activities designated as "passive" generate less than 20% of its income, it falls under an exemption (in Clause 7 of Article 25.13 of the Tax Code).

So in either case the company's profits should not be subject to CFC taxation for Russian controlling persons. It is questionable whether any Cypriot company could in practice pass the effective tax-rate test given that the corporate income tax rate in Cyprus is 12.5% (meaning that it does not exceed 75% of the Russian profits tax rate, as required for the effective tax-rate exemption to apply).

Are a CFC's Russian-source Profits Included in the CFC Tax Base?

Letter No. 03-03-06/1/68300 of 29 December,2014 addresses a relatively straightforward question as to whether for profits tax purposes the CFC tax base should include all income (both from Russian and other sources) of organizations. The answer is "yes", as would be expected. In its conclusion the letter states that there is no necessity to amend the corresponding provisions of the law. It seems unlikely that the ministry intended this as a general statement meaning that no amendments to the CFC rules are required at all. Most likely, the ministry's meaning was that the provisions relevant to this particular issue regarding the scope of the CFC tax base do not require clarification.



CFC = Controlled foreign companies – As from 1 January 2015, a Russian corporation or individual is taxed on the undistributed profits of CFCs, at a rate of 20% or 13%, respectively.

What if a Controlling Person Who Has Been Tax Resident Spends Less than 183 Days in Russia in a 12-month Period?

Letter No. OA-3-17/87 of 16 January, 2015 addresses the situation in which an individual loses his or her tax residency status. The letter states that a person may still be considered a Russian tax resident even though he spends less than 183 calendar days in Russia over a period of 12 consecutive months (i.e. based on the domestic tax residency definition) if he has a centre of vital interests in Russia. In other words, the mere fact of being in Russia for fewer than 183 calendar days over 12 consecutive months is not decisive in determining Russian tax residency status.

This is a controversial position. It is likely to lead to more disputes on individuals' tax residency.

In addition, the letter states that there is no obligation to notify the tax authorities of the fact of ceasing to be Russian tax resident

The New Look-through Approach

Letter No. 03-08-05/69519 of 21 January explains the "look-through approach” to the application of tax benefits. When income is paid and the direct recipient does not have an actual right to receive this income, the provisions of Russian double tax treaties or the provisions of domestic law can be applied in relation to another person that is the beneficial owner of the income. So, for example, if a Russian holding company owns Russian operating companies through a chain of foreign intermediary companies, and the Russian holding company is the beneficial owner of income, the tax implications will be the same as they would be if the Russian holding company received the income directly from the Russian operating companies. In this case domestic rules for payments between a Russian company and a direct Russian shareholder can be applied, i.e. no tax is withheld at source, provided that the Russian tax authorities were informed and any other applicable conditions satisfied.

Adoption of an Anti-abuse Rule in the Parent-Subsidiary Directive: Potential Consequences for Russian Holding Structures

Companies Which Will be Affected by the New Anti-abuse Rule

The new anti-abuse rule will affect structures which include companies that have no business substance and were created solely for the avoidance of taxation. In line with general GAAR rules and the action plan on BEPS announced by the Organization for Economic Co-operation and Development (OECD) we may conclude that two main criteria could be applied by tax authorities prior to concluding that a group of companies should be refused benefits under the PSD:

- the company does not conduct any business activity; or
- the company does not have the right to determine the future destiny of dividends received.

GAAR rules = General anti avoidance rules .Thus GAAR is a set of general rules enacted so as to check the tax avoidance.

BEPS= Base erosion and profit shifting - is a technical term referring to the negative effect of multinational companies' tax avoidance strategies on national tax bases. BEPS can be achieved through the use of transfer pricing, or, more correctly, "transfer mispricing".

Implications for Russian Holding Structures

Amendments to the PSD may have an adverse impact on Russian outbound investment structures which have used European jurisdictions as locations for holding companies for reasons including their favourable tax regimes. The Netherlands and Cyprus, for example, are often used for holding companies, Luxembourg and Ireland may have been used to establish financing centres, and Switzerland is often used in trading structures.

In the light of the amendments to the PSD, any structures in which an interest in an EU company is held via a holding company established in another EU jurisdiction should be reviewed to assess whether the structure remains effective and, if not, what the appropriate steps would be to mitigate the adverse impact of the amendments. In some cases it might be sufficient and reasonable to increase the substance of EU holding companies. In others it might be necessary to restructure because the costs of adding the required substance would outweigh the benefits or for other business reasons.

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Fax : +7 495 797 8775

www.rufaudit.ru

Your personal tax advisor:

Alexis RUF

Ask for him at :
ar@rufaudit.ru

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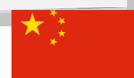
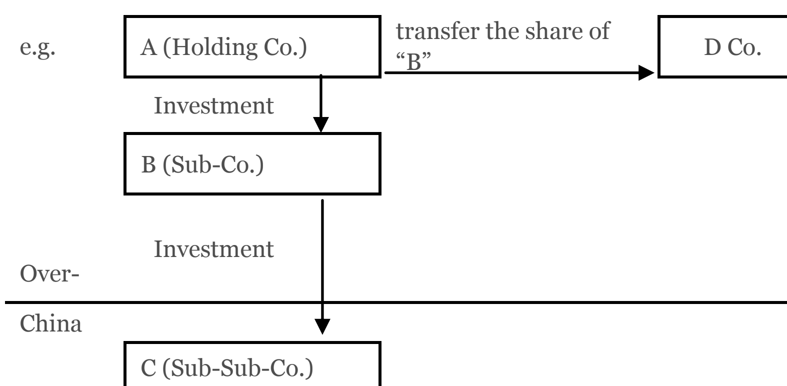


NEWS IN BRIEF

INTRODUCTION FOR REGULATING THE ENTERPRISE INCOME TAX ARISING FROM THE TRANSFER OF SHARES OF A RESIDENT COMPANY BY NON-RESIDENT COMPANIES

When the non-resident company transfers shares or other assets of a resident company indirectly by the arrangement which do not have proper business purpose, the nature of this indirect transfer transaction will now be re-determined and be identified as direct transfer of shares and other assets of the resident company. Then the Enterprise Income Tax (EIT) should apply in accordance with the tax law and the related regulations.



Notes: Company A transfer the share of company B to company D, Company A is the transferor and company D is the transferee.

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Ask for her at :

contactus@kzcpas.com.cn

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www.kzcpas.com.cn

Exemption item (comply with one of the below criteria) :

1.1 If company B is an overseas listed company, the gain from buy or sale B's share in the public share market.

1.2 If Company B sells Company C's share, the gain might be exempted from the Chinese EIT according to the appropriate tax agreement and arrangement.

2. Proper business purpose (shall comply with all the below criteria)

2.1 Relations between two parties: company A shall directly or indirectly hold more than 80% share of company D, or vice versa, or both A&D's more than 80% shares are held by a third party directly or indirectly.

2.2 Whether this transaction occurs or not, it will not reduce the Chinese tax liability in the next indirect transaction.

2.3 Consideration is shares (exclude the listed company) of company D or its related party which controls or is controlled by Company D.

3. Apart from the above exemption items and comply with proper business purpose, criteria which are regarded as non-proper business purpose are (simultaneously comply with the following items)

3.1 More than 75% value of company B's shares is, directly or indirectly, from the value of taxable property in China.

3.2 More than 90% of company B's total assets (excluding cash) belong to the investment in China at any time within one year before the transaction occurs or more than 90% of company B's revenue is generated from China directly or indirectly within one year before the transaction occurs.

3.3 Although Company B has the required organizational structure and registered according to the host country's law, but the function it performs and the risk it undertakes are restricted thus it cannot prove it has the economic nature.

REFUND OF FRENCH SOCIAL CHARGES & NON-FRENCH RESIDENTS

Since August 2012, non-French tax residents are subject in France to social security charges levied on real estate income (i.e. capital gain on the disposal of real estate in France and French rental income).

However, following the DE RUYTER decision rendered by the Court of Justice of the European Union (CJEU), the French Supreme Court ruled on 27th July 2015 that French social charges (CSG/CRDS) should not be levied on non-French residents affiliated to another EU country's social security system.

On 20th October 2015, the French Tax Authorities (FTA) released detailed guidelines regarding social charges refund process to be followed by non-French residents.

These guidelines confirm that individuals affiliated to another EU/EEA country social security system or in Switzerland can benefit from a refund of social charges paid/levied.

As a consequence:

- Individuals living in France and affiliated to an EU/EEA or Swiss social security system can claim a refund as regard social charges levied on all their asset related income as well as their income derived from investment products taxable in France.
- If not living in France, individuals affiliated to an EU/EEA or Swiss social security system can claim a refund as regard social charges paid on their French sourced real estate capital gains and French real estate income.

In practice, claims introduced before 31st December 2015 may lead to the refund of social charges paid and/or assessed (tax recovery notice issued) since 1st January 2013 on real estate and movable capital gains, real estate related income and income from investment products or other movable assets.

TRANSFER PRICING ANNUAL FILING REQUIREMENT & DRAFT FINANCE BILL FOR 2016

As per Section L 13 AA of the French Tax Procedure Code (FTPC) large companies exceeding the €400 M turnover or gross asset threshold or French affiliates of multinational groups with entity(ies) exceeding those thresholds must draft a transfer pricing documentation.

Since 2014 and new Section 223 quinquies B of the French Tax Code (FTC), these companies are also subject to a new requirement to communicate on an annual basis a Transfer Pricing disclosure form to the French Tax Authorities (FTA).

The FTA released on September 16, 2014 the final versions of the Transfer Pricing disclosure form (i.e. form 2257-SD) and guidelines with details as regard the general information about the group and the specific information about the disclosing entity to be reported in the tables of form 2257-SD.

Form 2257-SD must be filed within six months of the due date for filing the corporate income tax (CIT) return. As a consequence, companies whose fiscal year ends on 31st December must file form 2257-SD on 5th November at the latest.

Draft Finance Bill for 2016 proposed several amendments to the Transfer Pricing filing system in place with a view to having as from 2016 all Transfer Pricing documentation filed electronically.

In addition, as regard French tax groups, the Draft Finance Bill for 2016 provides that the head of the tax group would be in charge of the Transfer Pricing filing requirements for its subsidiaries.

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Your personal tax advisor :

Didier BREZILLON

Ask for him at :

Didier.brezillon@cabinetbda.com

BDA

10, Cours de Gourgue

33000 Bordeaux, FRANCE

Tel : +33 (0)5 57 14 26 70

Fax : +33 (0)5 57 14 26 73

www.cabinetbda.com

NEW „PLACE OF SUPPLY“-RULES SINCE 1.1.2015 AND EU-VAT-ONE-STOP SHOP (MOSS):

Since 1st January 2015, telecommunication services, television and radio broadcasting services and electronically supplied services are taxable in general at the location of the recipient of the service, regardless of whether these services are B2B or B2C services.

If the consumer who receives the service is located in more than one country or has his residence in one country and his habitual residence in another, that place becomes the place of supply, which better guarantees, that the tax is levied on the actual place of use. Until 31st December 2014 for this kind of services the place of supply-principle used to be effective only within the B2B-scope and within the B2C-scope (only) if the consumer was situated in a non-EU-country.

Concerning the determination of the location of the recipient, the following presumptions are applicable:

- If it is not possible to receive telecommunication services, television and radio broadcasting services and electronically supplied services at another than a certain place and if the reception requires the physical presence of the recipient of the service (e.g. telephone boxes, Wi-Fi hot-spots, internet coffee shops, etc.), then it is presumed that the recipient is located at this place.
- If the services are supplied via fixed phone lines, it is presumed that the location of the recipient is at the same place as the fixed phone lines are.
- If the services are supplied via mobile networks, the mobile telephone system country code of the SIM card is decisive.
- If the reception requires a decoder or a program or satellite card, it is presumed that the place of the recipient is where the decoder or card is located. Is this place unknown, it is presumed that the place of supply is located where the card was sent to.
- In all other cases: two not conflicting pieces of evidence (for example invoice address, IP-address, bank account data and other economical relevant information).

The respective tax rate of the member state of the place of supply has to be applied and the VAT has to be paid in that state. This would normally lead to an obligation for registration for VAT purposes in the respective state(s).

To reduce the entrepreneur's costs of registering in up to 28 EU-countries, a mini-one-stop-shop (so-called "MOSS") was introduced. MOSS offers the opportunity to avoid that obligation and allows the entrepreneur to register in only one member state (in the member state of identification - MSI).

Only services that are supplied within the EU member states, where the entrepreneur neither does run his company, nor has a permanent establishment, can be recorded via MOSS. In countries where the supplier runs his company or has a permanent establishment, the local turnovers have to be reported via regular VAT returns. Input VAT cannot be refunded via MOSS - the normal VAT refund procedure has to be applied.

Depending on the residence (permanent establishment) of the supplier of the service, there are two schemes for this procedure:

EU-scheme:

Example for an Austrian entrepreneur: Austria is the member state of identification for the entrepreneurs who have established their business or have a permanent establishment in Austria. Due to the application of MOSS, the entrepreneur avoids the obligation to register for telecommunication services, television and radio broadcasting services and electronically supplied services, which are supplied to consumers who are located in another EU-country.

Example for an "Austrian" entrepreneur:

- If the entrepreneur has established his business in Austria, then Austria is the member state of identification.
- Does the entrepreneur run his company in a non-EU-country

  - and does he have a permanent establishment in Austria, but no other one within the EU, Austria is the member state of identification again.

  - If that non-EU-entrepreneur does have another permanent establishment within the EU, he can choose one of the member states where the permanent establishments are located as member state of identification.

Non-EU-scheme:

A non-EU taxable person can register to use the Mini One Stop Shop if he

- has not established his business in the EU and
- has no permanent establishment in the EU and
- is not (by obligation or voluntarily) registered for VAT purposes in the EU (besides VAT refund).

The taxable person can choose any Member State to be the Member State of identification. That Member State will allocate an individual VAT identification number to the taxable person (using the format EUxxxyyyyyz).

Registration /Filings:

Registration and de-registration to the MOSS can be done by the start or ending of each quarter by prior notice. The MOSS-VAT returns have to be filed electronically until the 20th day of the month following the declaration period (=calendar quarter). Austria has been amongst the first EU-states to make this procedure fully electronically operable and we are at your disposal for any help needed in this field.

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Ask for him at :

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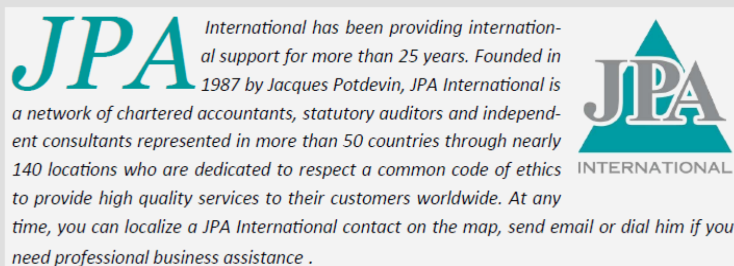

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