Changes in the legal background for foreign investments into Russia

The Law Firm Network Annual Meeting 2017

WESTSIDE
LEGAL SERVICES

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Foreign investments into Russia – 2012

- Top-3 countries to invest into Russia in 2012 are Cyprus, Netherlands and BVI, i.e. the countries commonly used for structuring of ownership for assets in Russia before deoffshorization
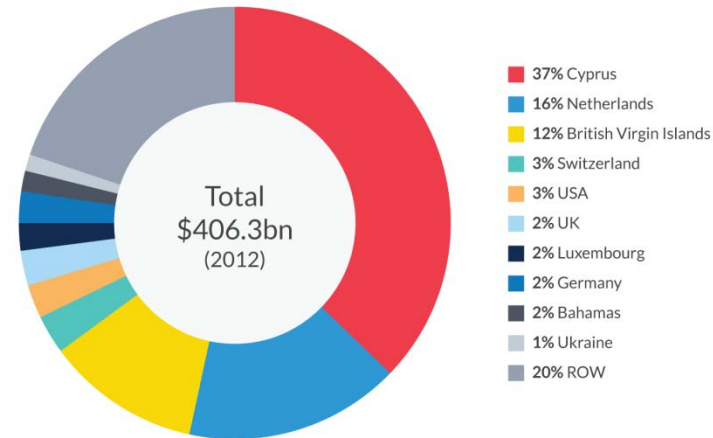
- Reasons for such structuring:

Total $406.3bn (2012)

- 37% Cyprus
- 16% Netherlands
- 12% British Virgin Islands
- 3% Switzerland
- 3% USA
- 2% UK
- 2% Luxembourg
- 2% Germany
- 2% Bahamas
- 1% Ukraine
- 20% ROW

- http://openeurope.org.uk data

  - Favourable taxation regimes
  - Non-disclosure of information on the beneficiaries
  - Legal systems allowing shareholders agreement
  - All together = comfort in structuring of the domestic investments via foreign entities
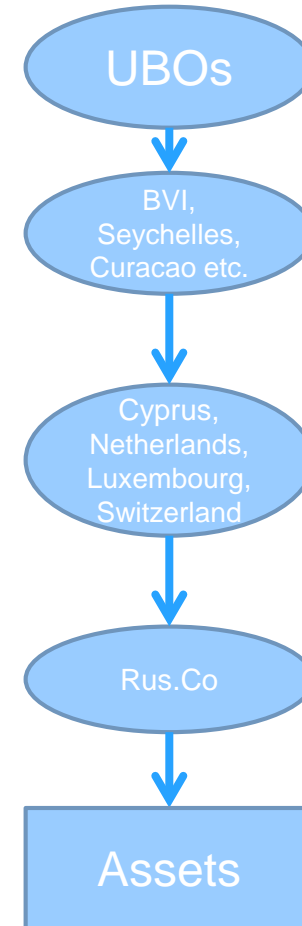
Commonly used investments structures (before "deoffshorization")

Such structures allowed to use benefits from:
- beneficial taxation regimes of holding companies (including DTA treaties);
- Possibilities to decrease taxation base in Russia (royalties, interests etc.)
- English law shareholders agreements;
- nominal shareholders (no public registers on UBOs);
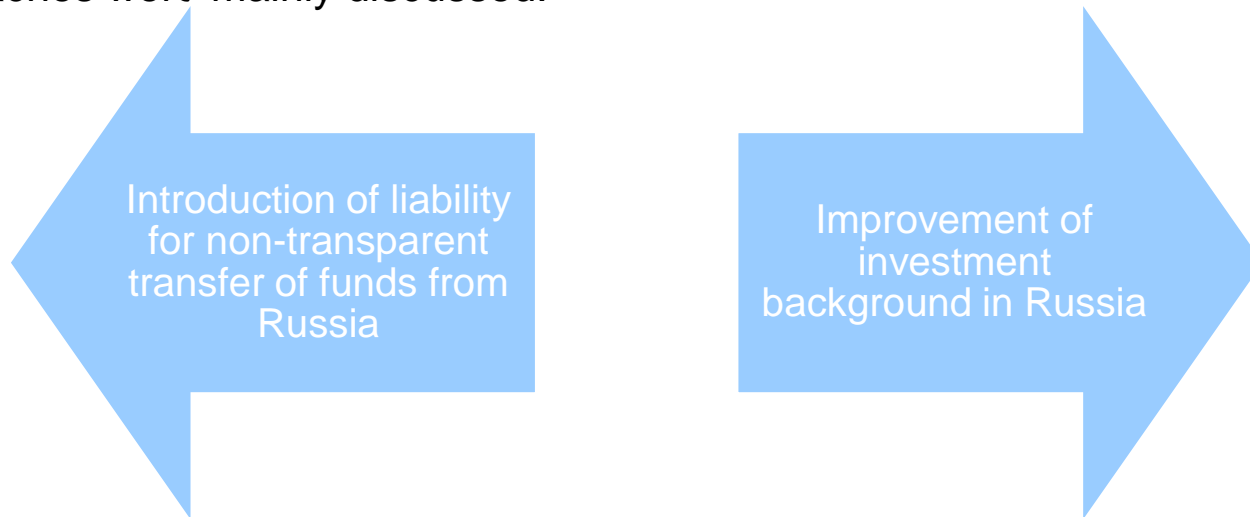- <u>Protection of assets</u> - ???

BUT caused the following issues:
- Non-transparency of ownership structure => difficulties in financing (from banks and professional investors)
- No real protection of assets (hostile takeovers possible at each corporate level)

UBOs
↓
BVI, Seychelles, Curacao etc.
↓
Cyprus, Netherlands, Luxembourg, Switzerland
↓
Rus.Co
↓
Assets

Launch of "Deoffshorization"

- In December 2012 the President of Russia invited the Government to make proposals on the complex of measures for deoffshorization of economy aimed to stop withdrawal of funds from the industry turnover
- Various projects were widely discussed during the years 2013-2014. Two approaches were mainly discussed:

Introduction of liability for non-transparent transfer of funds from Russia

Improvement of investment background in Russia

- In the end of 2014 the "deoffshorization package" was enacted

Controlled Foreign Companies (CFC) in brief

- ◉ Persons in control (starting from 2016):
  - Owning more than 25% of a foreign company
  - Owning more than 10% of a foreign company in case more than 50% of a foreign company is owned by Russian residents

- ◉ A Russian resident must:
  - Disclose ownership in CFCs and provide information on CFCs to tax authorities
  - File tax returns on CFCs

- ◉ CFC's non-distributed income is taxed at the rate of 20% (corporate income tax rate for Russian entities)

Localization of production

- Public tenders give priorities to local producers, which includes ownership structure with majority UBOs – Russian citizen and residents having no other citizenship / permanent residence permits
- Criteria of "local" producers vary depending on the sector of economy

Protection of investments measures

1. Notarial certification of transfer of shares in LLCs (since the year 2009)

2. Shareholders agreements (since 2009 and further improved)

3. Changes in the Civil Code (aimed at structuring of agreements between shareholders within Russian companies):
   - put and call option agreements
   - changes in the qualification of voidable transactions
   - more options for corporate structure of companies (two or more directors with co-signature rights or signing separately etc.)

4. New rules for minutes of the meetings of shareholders: to be notarized or certified by independent registrars unless signed by all shareholders

5. State registrar of legal entities check transactions for validity (since 2016)

6. Open online databases

https://egrul.nalog.ru/
https://pkk5.rosreestr.ru/
http://kad.arbitr.ru/

Results

- Investments from Russia tend to be structured in Russia

- Localization impacts outbound investments into certain sectors (telecommunications, oil and gas production equipment etc.). Such investments need to be carefully structured

- More warranties for protection of investments on the Russian level

- Some Russian businessmen change their tax residency

UBOs

BVI, Seychelles, Curacao etc.

Cyprus, Netherlands, Luxembourg, Switzerland

Rus.Co

Assets