What's in a name?

Maria Grishina warns of the Russian inheritance law issues that may arise when using structures with nominee shareholders

A nominee shareholder acting under a declaration of trust is still being used by clients for holding shares of offshore corporations. Clients may pick this option for various reasons, such as confidentiality and because local shareholders (most often provided by the local agent) provide certain flexibility and facilitate management of the company.

Nevertheless, the use of nominee shareholding structures by Russian clients can lead to various complexities when the Russian beneficial owner dies. Below are two colourful examples of how the nominee arrangement can complicate succession relations.

CASE 1

A Russian individual, Mr A, was the sole beneficial owner of a BVI company. A BVI service provider held the shares of the company under a nominee arrangement in Mr A's favour. The company held an account with a Swiss bank. Mr A and the directors of the company were authorised to give instructions to the bank.

Mr A passed away, leaving a will. The probate case was opened in Russia, and an executor was appointed in accordance with the will of the deceased.

There was a conflict between the heirs specified in the will and the forced heirs. To initiate negotiations, the executor had approached the service provider and the bank, asking to obtain information regarding the company and its bank accounts, but was denied access. The service provider was under the impression that beneficial rights cannot be inherited in the situation at hand under Russian law, and, therefore, the status and the powers of the executor to access information about the company were questioned.

KEY POINTS

WHAT IS THE ISSUE?
Russian clients may use simple structures with nominee shareholders. However, problems can arise when the Russian principal dies. How do Russian intestacy rules apply to these situations? What exactly is to be inherited?

WHAT DOES IT MEAN FOR ME?
There are practical issues related to Russian inheritance rules and implications for professional service providers, their clients and other persons involved.

WHAT CAN I TAKE AWAY?
Solutions to issues related to inheritance of Russian clients' nominee shareholding structures that can help to maintain the operation of the company in challenging circumstances.

SUCCESSION OF SHARES IN NOMINEE SHAREHOLDING

Under the provisions of Russian law, inheritance relations are governed by the law of the state where the deceased had their last place of residence. In this case, Russian law was applicable to inheritance.[1] Under Russian law, the composition of the estate includes the assets and other property belonging to the deceased, including property rights and responsibilities.

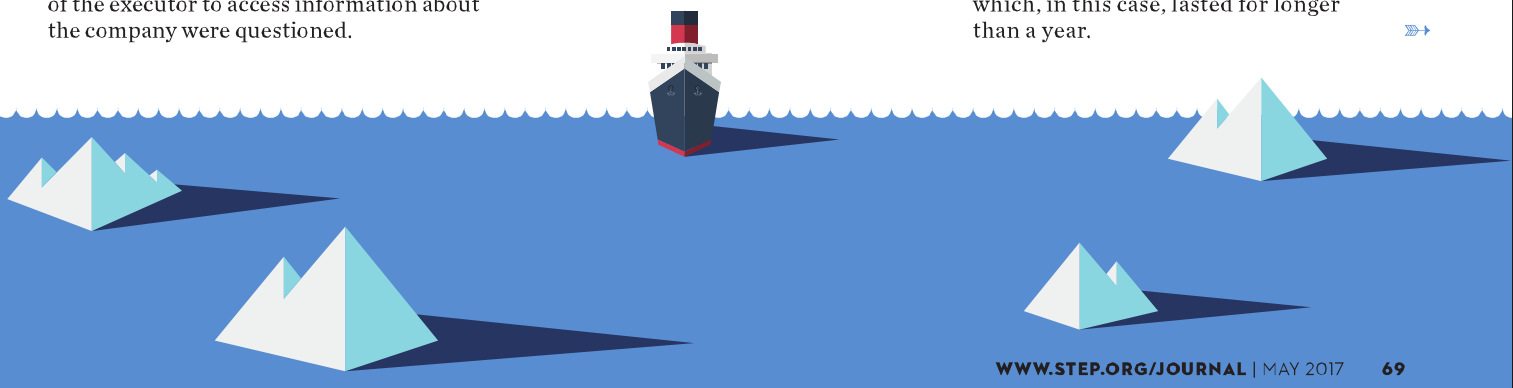
However, the concept of 'beneficial rights' is unknown under Russian civil law. Therefore, to establish the nature of beneficial rights, it is necessary to determine the applicable law.

It was concluded that the law applicable to determining the nature of the estate was BVI law, as a result of (i) the absence of conflict-of-laws rules regarding the beneficial rights arising from the nominee declaration in Russian law; (ii) complex analysis of Russian private international law; and (iii) application of certain internationally recognised conflict-of-laws principles. Under the applicable law, the beneficial rights can be generally treated as property rights, and thus included in the estate.

Another practical issue was obtaining a certificate of right to inheritance regarding these beneficial rights from a notary public in order to obtain a grant of probate in the BVI. Generally, to issue this certificate, the notary would request documents confirming that the deceased was the owner of the estate. In this case, the executor and the heirs only had scanned copies of the nominee declaration.

However, under Russian law, the certificate of right to the estate located abroad is issued without specifying the particular property. Therefore, the executor presented documents that confirmed that Mr A owned real estate abroad, and the heirs obtained certificates of right to all of the estate located abroad.

Even without the conflict between the heirs, a six-month succession period in Russia, followed by the probate procedure in the BVI, would have inadvertently led to a suspension in operational activity of the company, which, in this case, lasted for longer than a year.



> 'Russian law does not specify the exact term of validity of powers of the executor'

ACCESS TO INFORMATION REGARDING THE ESTATE

As mentioned, Russian law applies to the inheritance issues, including determining the status and powers of the executor. So, if an executor is appointed, what powers do they have? And what is the validity term of these powers?

In Russia, an executor is appointed in the will. Powers of the executor are set out in law,[2] but may be specified or extended in the will. In the case in question, the will contained the basic list of powers of the executor provided for in law. The scope of these powers is relatively wide, but the power to obtain information about the estate is not stipulated directly.

Another issue to consider was the term of powers of the executor. Russian law does not specify the exact term of validity of powers of the executor, nor a way to determine this term. It may be suggested based on the law's wording[3] that the powers of the executor cease upon expiration of the six-month succession period (unless otherwise expressly stated in the will); thus, time pressure is also an issue.

Based on the list of powers specified in law,[4] it was concluded that the executor had the right to request information from the bank, and the service provider acted accordingly.

However, it is necessary, in such situations, to confirm the powers of the executor in the relevant jurisdictions by providing all required documents or going through probate and obtaining a letter of administration.

CASE 2

Mr X, Mr Y and Mr Z were shareholders of an offshore company, holding 10 per cent, 45 per cent and 45 per cent, respectively. They all entered into the nominee services agreement with the same service provider. The annex to the agreement stated that one nominee shareholder would hold all shares on behalf of the three beneficiaries. The directors of the company were local corporate directors, employed by the same service provider.

Mr X died intestate with three heirs. Mr Y and Mr Z were interested in keeping the company functioning during the succession period.

POTENTIAL ISSUES

Mr Y and Mr Z assumed that they would be able to retain control over the company, given that they still had the qualifying majority vote. But how should the service provider act if they are appointed as a nominee shareholder for three principals and one of them dies?

The service provider refused to act upon the instructions of Mr Y and Mr Z, because the nominee agreement did not specify the proportion of beneficial interest/shares held on behalf of each beneficiary. Therefore, the nominee shareholder awaited instructions from all three shareholders, or, in this case, the heirs and the remaining shareholders.

The offshore company was the sole shareholder of a Russian operational company. Around the same time, the director of the Russian company resigned, whereas the shareholder (the offshore company represented by directors) refused to act without instructions from all beneficiaries, which led to losses for all parties involved.

POSSIBLE SOLUTIONS

To avoid such complications, careful structuring must be performed when Russian clients (or clients from other countries with similar legal systems) are involved.

The first possible option may be to avoid nominee arrangements. This may seem like the easiest solution. However, it is important to mention that succession of shares of an overseas company may still prove extremely time-consuming. A six-month succession period in Russia will most likely be followed by probate procedures in the relevant jurisdiction.

Should the client insist on engaging nominee shareholders, all the issues described above should be taken into consideration. It may prove useful to make prior arrangements with banks and/or service providers to let them know who will be the executor of the will, and to acquire the list of documents or conditions necessary to obtain information about the estate and give instructions to managers.

It is important to explore all available options in the jurisdiction where the assets are located. Still, even when drafting documents in the jurisdiction of the personal structure or company, Russian legal aspects must be taken into consideration when Russian citizens/residents are involved.

On a final note, it is worth mentioning that there is a bill currently being debated in the State Duma that provides for the establishment of private foundation-like structures, which will broaden succession possibilities for Russian high-net-worth individuals. I am positive that further Russian succession options will follow.

1 Under the provisions of Russian conflict-of-laws rules, Russian legislation is to be applied in this case. The respective conflict-of-laws principle with respect to inheritance is established in article 1224 of *The Civil Code of the Russian Federation, Part Three, No 146-FZ of November 26, 2001*
2 *Id*, article 1135
3 *Id*, articles 1110–1112, 1152–1154 and 1162–1163
4 *Id*, articles 1135 and 1171–1173

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