



Now you are a Russian tax resident, aren't you?

Potential amendments to Russian tax
legislation
October 2019



Summary

The Russian Ministry of Finance (MinFin), as part of their routine budgeting process, has published a plan to change the definition of tax residency for individuals. Specifically, they want to replace the 183-days test with a 90- days test and introduce an additional test on the centre of vital interest.

The plan has no binding effect and merely represents what the MinFin's legislative proposals may be over the next three years. To become law, it would have to go through the Duma.

In theory, this could happen before November 31 this year, which makes the law effective from 2020. If so, many individuals would become Russian tax residents in 2020, pay Russian income tax on their worldwide income and pay Russian tax on CFC income earned in 2019. This would leave only two months to revise the CFC profit position for 2019, which may be hard to do.

The Minister of Finance, however, has said that the proposal will be discussed with the business community before it is submitted to the Duma. It is more likely, therefore, that the new rules will be introduced from 2021, taxing individual income for 2021 and CFC income for 2020.

What you need to do:

- Stay informed of developments by following our newsletters
- Analyse your facts and circumstances to understand whether you may be recognised as a Russian tax resident
- Analyse the double tax treaties available to you and their tiebreaker clauses to understand what can be used as proof of your non-resident status in Russia
- Carefully plan any activities of your CFCs from January 2020
- Think of becoming Russian tax resident
- If you think of Russian tax residency in the medium term, try to formalise the tax basis in your assets before you come back to Russia



What has happened

- Russian legislators have been talking of changing the definition of tax residency for individuals for many years. No specific actions have been made though, until late September when the Government mentioned this topic in the budget law for 2020-2023.
- The budget law contains an overview of the Government's plan in the area of taxation for the next three years.

How it works

- Usually, countries have rules to recognise individuals as their tax residents and to tax all worldwide income of such residents. For many years, the Russian rules were straightforward: those individuals who spend 183 or more days a year in Russia are Russian residents and those who do not are non-residents:
 - Residents pay 13% personal income tax on all their annual income, whether earned in Russia or abroad, and pay personal income tax on undistributed profits of their controlled foreign companies.
 - Non-residents pay 30% (which will likely go down to 13% from 2021) on their Russian-sourced income (salary, sale of Russian real estate, shares, other property and interest from Russia, etc.), 15% on Russian dividends and do not pay Russian CFC tax.
- This definition let business people escape Russian CFC rules by spending less than half a year in Russia, even while deeply connected to Russia and doing business there. This situation has provoked dissatisfaction among regulators and led them to consider reducing the limit to 90 days in Russia and introducing the concept of centre of vital interest.



The Government's plan

- The MinFin proposes that those who spend 90 days in Russia are considered Russian tax residents and should pay personal income tax on their worldwide income, including CFC taxes. In addition, even if individuals do not spend 90 days in Russia, they will become Russian tax residents if they have a centre of vital interest in Russia.
- The Government's plan contains no further details on how "centre of vital interest" should be understood. Referring to the OECD model treaty, one might expect that a centre of vital interest will be where the individual has strongest personal, family and business links. It is not, therefore, surprising that many Russian businessmen feel that they may be considered Russian residents, considering their ties to Russia.

When this can become a law

- In theory, this can be done before November 31 this year, which would make the law effective from 2020. If so, many individuals would become Russian tax residents in 2020 and pay Russian income tax on their worldwide income and Russian tax on their CFC income earned in 2019. This would leave only two months to revise the CFC profits position for 2019, which may be hard to do.
- The Minister of Finance, however, has publicly stated (in a speech on 9 October) that the proposal will be discussed with the business community before it is submitted to the Duma. It is more likely, therefore, that the new rules will be introduced from 2021.



Impact on CFCs

- CFC taxation in Russia is based on a two-year cycle. If a CFC company earns profits during the first year and does not distribute them in full or in part as dividends, then the non-distributed profit will be subject to tax as CFC income in the hands of the individual when they file their tax return as a result of the next year.
- If the new definition of residency applies from 2021, only personal income earned in 2021 would be taxed under the new rules.
- However, CFC profits earned in 2020 (which were supposed to be distributed as dividends in 2021) would be taxed as well under the new rules.
- At present, it is not clear whether the Russian tax authorities might introduce any special interim tax rules to mitigate this negative effect.
- It is, therefore, necessary to take accounting and tax advice as to how the CFC will book the planned operations in 2020 so that you would not be subject to an unexpected tax in 2021, when you are considered tax resident in Russia and it is too late to change 2020 operations.
- Russian tax residents would also need to file information on the set up of trusts and similar structures (even if it was done prior to the change of tax residency to Russia), as well as evidence of ownership in foreign companies (if the share is more than 10%).



View of tax authorities

- The Federal Tax Service (FTS) for many years believed that the centre of vital interest concept should already apply to situations where there is a double tax treaty between Russia and another state to which an individual has connections. The FTS has issued numerous letters stating this position.
- This position was unfounded, however, as the so-called tiebreaker rules that refer to the centre of vital interest in double tax treaties come into play only if both countries believe that the individual is their tax resident based on their domestic law. Russian domestic law has always been 183 days a year, so there has been no grounds to involve double tax treaties.
- The MinFin, as the supervisory authority of the Federal Tax Services, has formally revoked the relevant FTS letters, stating that until the law changes, 183 days a year is the only criterion for Russian tax residency.

Potential solutions

1. The new rules will keep the tax rate (13%) at one of the lowest levels in the world. For some people, Russian tax residency will be a good solution. Before making any decisions, however, we recommend that you analyse the overall impact of the new tax status on your tax position, including the disclosure and taxation of your foreign companies.
2. Russia must obey the provisions of its double tax treaties. For example, if you are tax resident in the UK, both countries need to decide which has more grounds to tax you. The tiebreaker rules are focused on permanent home (typically available in both countries) as the primary rule, then on the centre of vital interest and then habitual abode (back-translated from Russian as where the individual permanently lives), followed by the passport and the agreement of the authorities of the two countries in complex cases. Reliance on habitual abode may be used to ensure that your habitual abode exists only in the UK, even though business trips to Russia are frequent and long. Every case is unique and all double tax treaties are worded a bit differently. To remain non-resident, a strong plan is needed.



Private Wealth Team



Ekaterina Lazorina

Partner, international tax

+7 (495) 967 63 65
ekaterina.lazorina@pwc.com



Mikhail Filinov

Partner, international tax

+7 (905) 543 07 13
mikhail.filinov@pwc.com



Anna Modyanova

Director, international tax

+7 (495) 967 11 89
anna.modyanova@pwc.com



Aleksandra Derevyanko

Manager, international tax

+7 (495) 967 23 61
aleksandra.derevyanko@pwc.com



Aleksandra Alekseeva

Manager, international tax

+7 (903) 208 60 54
aleksandra.alekseeva@pwc.com



Private Wealth Team



Karina Khudenko

Partner, individual taxation

+7 (495) 232 54 18
karina.khudenko@pwc.com



Evgeny Sivoushkov

Director, individual taxation

+ 7 (495) 967 62 86
evgeny.sivoushkov@pwc.com



Natalia Parkhamovich

Director, individual taxation

+7 (495) 223 51 16
natalia.parkhomovich@pwc.com



Gregory Kharitonov

Director, individual taxation

+ 7 (495) 223 51 07
gregory.kharitonov@pwc.com



Diana Kalyaeva

Director, private wealth clients

+ 7 (495) 967 60 26
diana.kalyaeva@pwc.com



© 2019 PwC. All rights reserved. Not for further distribution without the permission of PwC. "PwC" refers to the network of member firms of PricewaterhouseCoopers International Limited (PwCIL), or, as the context requires, individual member firms of the PwC network. Each member firm is a separate legal entity and does not act as agent of PwCIL or any other member firm. PwCIL does not provide any services to clients. PwCIL is not responsible or liable for the acts or omissions of any of its member firms nor can it control the exercise of their professional judgment or bind them in any way. No member firm is responsible or liable for the acts or omissions of any other member firm nor can it control the exercise of another member firm's professional judgment or bind another member firm or PwCIL in any way.