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Possible Eurobond Tax Alarms Businesses

By The Moscow Times

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The Finance Ministry will prepare legislation this year allowing it to collect taxes on interest paid out on international bonds.

The plan, which has been criticized by lenders including VTB Group and Barclays, won't apply to bondholders from countries that have a prior agreement with Russia and won't be levied on eurobonds issued before Jan. 1, 2012, according to a statement on the ministry's website.

Ministry officials held talks on the proposed levy Thursday, Deputy Finance Minister Sergei Shatalov said.

While payments to foreign debt holders through offshore units known as special purpose vehicles, or SPVs, are taxable under existing laws, the rules haven't often been enforced, Shatalov said Thursday.

Shatalov estimated the volume of outstanding corporate eurobonds at $116 billion, with $73 billion issued by companies and $43 billion by banks.

"Previously, the tax authorities didn't pay much attention to this, and now they have started checking and found that there is a problem," Shatalov said.

The tax could cost issuers of eurobonds an estimated $1.5 billion a year on the total $100 billion of outstanding international debt in Russia, according to a research note e-mailed Friday from Alfa Bank.

About half of the cost of the eurobond tax would fall on Gazprom, VTB Group and Russian Agricultural Bank, Alfa Bank analysts Natalia Orlova and Dmitry Dolgin wrote in the note.

"The initiative reflects a renewed attempt to curb the use of offshore structures by Russian corporates," Vladimir Pantyushin, a Moscow-based economist at Barclays, wrote in an e-mailed note Friday. "We believe the tax is an awkward way to achieve this, lacking support even within the Finance Ministry and having potentially significant negative implications, and therefore expect this proposal to be scrapped."

State oil pipeline monopoly Transneft said Thursday that it might redeem more than $4 billion in eurobonds at face value as a result of the ruling, potentially imposing losses on investors as the bonds trade above par.

Transneft has four dollar-denominated eurobonds outstanding with a combined nominal value of $3.45 billion and one euro-denominated issue worth 700 million euros ($925 million).

Eurobonds are typically structured as so-called loan participation notes, or LPNs, issued by SPVs in low-tax jurisdictions such as Ireland or Luxembourg, with the proceeds deposited on account at Russian banks.

Typical clauses in loan documentation allow for bonds to be called at par by the issuer if there is a material tax change — something one London debt capital markets banker said would be highly unlikely.

"Given that 99 percent of all Russian ... international bonds are in LPN format, it's outlandish to suggest that it would generally result in an additional 20 percent tax payment," the banker said.

Issuers would face "serious losses" from the tax, Vladimir Dmitriyev, chairman of state development bank Vneshekonombank, said in an interview in Davos, Switzerland, on Friday.

"Banks will take a consolidated stand on that proposal," he said. "It's important to understand what is behind it, who will compensate them for the 20 percent loss."

Changes to budget legislation will be prepared in time to allow an interest-free installment plan for related tax liabilities, Interfax cited the Finance Ministry as saying on Sunday.

Earlier the Finance Ministry sent a letter to the Federal Tax Service explaining regulations for taxation of interest payments made through SPVs registered outside Russia.

When paying a yield on eurobonds, double taxation avoidance agreements signed between Russia and foreign countries should be applied depending on the tax residence of the specific eurobond holder receiving coupon payments, and not the SPV through which the coupons are being paid to end investors, the letter said.

The letter reflects the current laws regarding the taxation of the actual income beneficiary, and the ministry has repeatedly made its position known to the market participants, the Finance Ministry said, according to Interfax.

⊠(MT, Bloomberg, Reuters)

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