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Foreign Holding Companies and Russian Beneficiaries: Current Regulation and Risks

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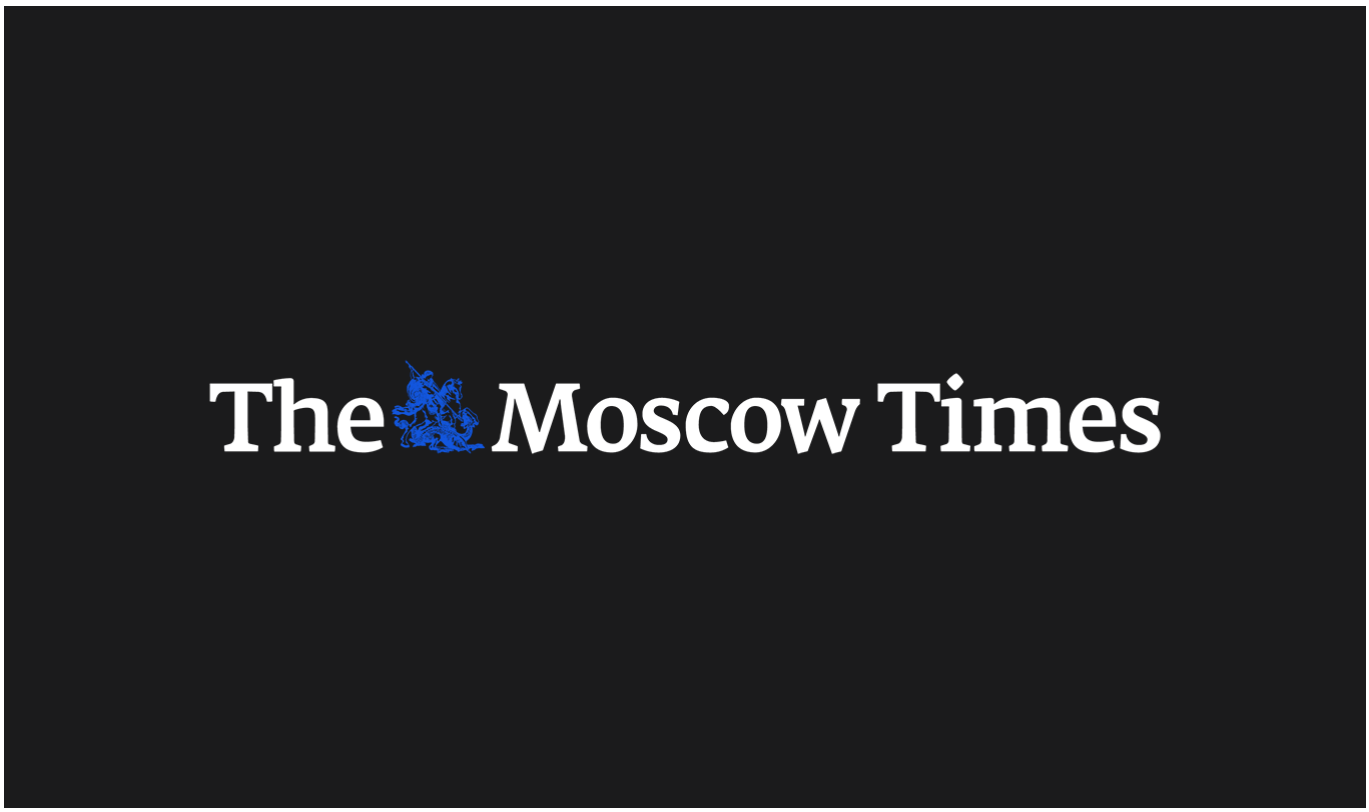

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A holding company can nowadays be established for a variety of reasons and purposes, the essential ones are the following: improvement of the safety and security of business assets; improvement of the corporate governance; consolidation of business assets; protection of shareholders' interests; reduction of overheads; monitoring of financial transactions; tax optimization; improvement of investment appeal; raising and maintenance of capital; creation or improvement of image. The best way to accomplish these purposes without sacrificing one for the benefit of another is to set up a holding company offshore (See European holding companies. E-Magazine, No. 2, 2011).

A process of setting up a foreign holding structure is divided into two key stages: first, the development of the structure of domestic companies, identification of responsibility centers, and corporate group harmonization; second, the setting-up of a holding company in a foreign jurisdiction based on the specifics of the Russian business model as a whole.

The main requirements for corporate structuring in Russia are the streamlining of business ties between the group members and third parties, and the development of effective corporate governance procedures. For a holding company, the most important thing is to choose the best jurisdiction for the incorporation of the group's parent company. For owners, the key factors in the choice of jurisdiction are normally high security for the owners' assets, regulatory environment of the holding company's business partners, as well as possible tax optimization.

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This being the case, the most appropriate jurisdictions for setting up holding entities are not tax havens, which used to be popular, but European jurisdictions, which offer many advantages for the above purposes. In view of the latest trends in offshore legislation and case law, the use of tax havens for offshore incorporation has become not only much less cost-effective but also unsafe. There are many cases in point in Russian and global litigation.

Today any company that wants to reach global markets and attract investors must ensure statutory and also adequate transparency of its business; the company must be structured to be clear for the investor in terms of both its organogram and financial model.

Structuring schemes that give a glimpse, behind the "cut-off" Cypriot, Swiss and Dutch payees, of Russian beneficiaries moving the money on to tax havens can no longer be used even to qualify for the tax rates provided for in Double Taxation Treaties (as reported by the Vedomosti daily, Dec. 2, 2009, No. 228, 2498.

In this context, practical measures taken by the tax authorities of Switzerland seem illustrative, where prior to authorizing reduced rates applicable under the Agreement between Switzerland and the EU (Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments) or Double Taxation Treaties, a full audit of the shareholding structure down to the ultimate beneficiary is conducted.

A reduced rate will not be applied if any company down the chain fails to meet the criterion of "actual presence," which means for the Swiss tax authorities a registered office (which involves not only a postal address but also real office space that is owned or rented), a local resident director, at least one employee (other than the company's director) and "adequate"

business transactions of the company, and for the holding entities being a shareholder in at least one company.

For the reasons mentioned above, the entity's use of the soi disant beneficial, or indirect, holding, with an offshore company appearing as the registered owner, is not worth the ream of paper used to produce the offshore company's corporate documents.

Recent legal precedents show the following trend: The courts deny taxpayers the tax relief available under international treaties if the hearing reveals that a) the offshore company is used solely for the purposes of qualifying for relief under the treaty and does not conduct business, and b) the income received by the company is passed on in full to a company incorporated in a tax haven.

Even where dividends or other disbursements go through the "corporate veil" of a European entity, this does not always guarantee that the payee will be free from problems if the ultimate payee is a beneficiary, again "hiding" in a tax haven.

The key criterion of transparency, soundness and respectability of a holding company is information on business's ultimate beneficiary, who is the main person of interest for public authorities as well as potential investors.

Indeed, with asset security and tax planning mechanisms improving, the term "beneficial owner" is not going to disappear from our legal vocabulary, but there are already ways to minimize the situation where technically the legal definitions of a holding company's owner and beneficiary in the overall structure of the corporate group are not perceived as synonyms.

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