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Putin's 'Deoffshorization' Brings Major Firms Back to Taxman

By The Moscow Times

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Heeding the demands of President Vladimir Putin, several major Russian companies said they would leave their offshore assets and move their business activities back to home soil.

Metal producers RusAl and Metalloinvest, telecoms giant MTS, electricity generator RusHydro and vehicle manufacturer Kamaz announced this week that they would either stop using their offshore entities or relocate to Russia altogether.

Faced with a need to shore up tax revenue as GDP growth stalls, Putin in his State of the Nation Address on Dec. 12. proposed three measures to tug major firms back into the taxman's orbit.

First, taxes will be levied on Russian-owned companies registered in offshore tax zones according to the Russian Tax Code. Second, companies registered abroad will be barred from receiving support or guarantees from the budget or such state banks as VEB. Third,

foreign firms will be forbidden from winning state contracts.

The speed of the reaction took the Finance Ministry by surprise, a ministry official told Vedomosti. Authorities were also not counting on companies to begin a wholesale relocation to Russia. The important thing, the official said, is that companies "calculate their taxation base correctly, which can be done in offshore locations and jurisdictions with low taxation."

But in the background of Putin's initiatives, the Finance Ministry has been making offshore zones less comfortable for their residents, tightening up the tax code to curb tax minimizing schemes on capital transferred to offshore zones via countries that have signed agreements to avoid double taxation.

From 2014, major companies will be liable to have their transfer prices investigated by the taxman. At the same time, firms registered abroad that do not disclose their beneficiary owners may be subjected to a 30-percent tax rate on unearned income, with the proviso that if the company chooses to reveal its owner, the money may be reimbursed.

Corporate taxpayers have responded to this by being more careful with their internal financial transactions, as well as restructuring their businesses, deputy head of the Federal Tax Service Alexei Overchuk said, adding that some industries known previously to lower their profits in Russia have been demonstrating higher profits lately.

The government's "deoffshorization" drive is key to balancing the state budget, said Jacob Nell, executive director of Morgan Stanley in Russia. Expenditure is growing, in part due to Putin's May decrees, issued soon after his re-election in 2012 and aimed and improving Russians' quality of life. At the same time lackluster economic growth is keeping budget revenue flat, and there is no surplus to absorb the difference, he said. In 2013, the country's oil revenue piggybanks were raided to plug the gap. Next year, the government hopes that deoffshorization, by boosting the tax base, will provide much-needed extra funds.

However, the process of reorganizing a complex company structure and changing jurisdictions back to Russia is likely to be both expensive and long-drawn-out, taking a minimum of a year, said PwC partner Natalya Kuznetsova. Once it has done so, the company's tax burden is likely to increase substantially, coming under Russia's 20 percent tax rate on profit, and its capitalization may fall.

Many overseas corporate operations are economically justified, said Mikhail Filinov, also a partner at PwC, while attempts to forcibly move them to the Russian jurisdiction, as well as attempts to fight them, are useless.

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