

Russia Readies for Showdown Over Taxing Offshore Companies

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November 18, 2014



Russian nationals and companies will have to pay taxes on the retained earnings of any organizations in which they are a "controlling entity."

Russia's lower house of parliament on Tuesday took aim at the offshore holdings that have become ubiquitous in Russian business, passing in its final reading a bill that will make Russian taxpayers declare and pay taxes on their assets abroad.

But once signed into law, this product of President Vladimir Putin's drive to repatriate domestic capital and boost tax revenues is expected to face a long, hard fight with individuals and companies reluctant to bring their assets — and dirty laundry — into the limelight.

The law's impact on the modern Russian business world will be huge. Essentially all large Russian companies and many high net worth individuals have offshore and other non-Russian business structures of some kind, along with most mid-sized businesses and many small ones, said Artem Toropov, a senior associate in international tax law at Goltsblat BLP.

These arrangements allow Russian companies and the country's wealthiest to evade taxes and avoid regulatory scrutiny at home.

By April 1 next year, all of these companies and individuals will be required to inform the tax authorities of any stakes in foreign companies higher than 10 percent. If they own 50 percent or more of a structure, it will have to pay tax on retained earnings to the Russian taxman. This threshold will fall to 25 percent by 2017.

Previously, only dividends transferred from offshore companies to Russia were taxed, which left businessmen with a range of legal means for getting their money out of Russia tax-free.

Safer to Hide

While some will take the plunge, tax experts expect many individuals and companies will choose to defy the law, banking on their ability to keep undeclared assets out of sight.

Avoiding taxes is one common motive among companies with related entities overseas, but there are others who specifically do not want the Russian authorities to have access to certain information.

For these companies, "it will be very difficult to disclose information and to deal with the potential tax audits and questions from the tax authorities," said Anna Lessova, head of the Russia tax practice at international law firm Morgan Lewis.

Businesses are afraid that ignoring the law may be safer than risking investigations into past offenses. As a result, many will wait and see how the first to come forward are treated before deciding on their own strategy, Toropov said.

Further heightening concerns, the State Duma's budget committee last week declined to include business-friendly amendments to the law that the government had developed in cooperation with the business community.

Deputy Finance Minister Sergei Shatalov has said that the amendments may be introduced in the spring with retroactive effect, Toropov said, but the outcome remains to be seen.

Government Reach

As business struggles to adapt to the new reality, the Russian government is facing its own challenge: enforcement.

Offshore structures are highly complex and often extend across multiple jurisdictions, meaning that the government will have to develop deep and reliable exchanges of information with countries around in the globe in order to investigate them effectively.

Some big strides have already been made in this direction — for instance, Russia earlier this month ratified an OECD convention on the exchange of tax information — but it will take several years to get these mechanisms up and running.

All told, the law is full of trouble for the government, which may see a sharp increase in disputes between tax authorities and taxpayers in addition to the cost of investigating

companies' holdings abroad.

And while there is clearly a lot of Russian capital stored offshore, no one actually knows how much the budget stands to gain from the law. The Finance Ministry on Tuesday told The Moscow Times that no such estimate has been made.

“I think that we do not see the figure because even they do not know how many companies, how many structures, they will be able to catch,” Lessova said.

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Original url:

<https://www.themoscowtimes.com/2014/11/18/russia-readies-for-showdown-over-taxing-offshore-companies-a41473>