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# Russian Anti-Offshore Policy: Current Regulation and Perspectives

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***Abstract:*** The paper outlines the regulatory landscape of an anti-offshore policy in Russia. In the first part of this paper, the author gives an overview of effective regulations against offshore businesses that Russia has adopted in the past decade. The CFC rules were developed and subsequently passed because of Russia's participation in the BEPS project. They are of the highest importance for the implementation of the anti-offshore policy. Other measures include transfer-pricing rules, registers of beneficial owners, exchange of financial information and revision of double tax treaties with Cyprus, the Netherlands, Luxembourg and Switzerland. Sanctions imposed by the EU, the USA, the UK and their allies against Russia, Russian individuals and companies in 2022 and counter-measures against Western countries and their residents introduced by Russian authorities also stimulate deoffshorization of the Russian economy. They have limited the free movement of capital between offshore holding companies and their Russian subsidiaries and, consequently, have contributed to the isolation of the Russian economy from the rest of the world, including its offshore infrastructure. The second part of the paper deals with the proposals for the Russian anti-offshore policy. The author shares his ideas on how to make the policy for deoffshorization of the Russian economy more effective. A few of

these anti-offshore actions have already been implemented in draft laws and are currently being considered in the Russian Parliament. All of the measures that are being considered would result in unfavourable tax implications and possible damage to the reputations of those Russian individuals and organizations who still use offshore companies and trusts for the purposes of minimizing taxation and maintaining anonymity. The most important action proposed by the author for the implementation of the anti-offshore policy is the forced deoffshorization of strategic enterprises. Passing the relevant law would entail fundamental changes to the Russian business environment and result in the restoration of economic sovereignty over the Russian economy.

***Keywords:*** deoffshorization; offshore company; controlled foreign company; double tax treaty; redomiciliation; registers of beneficiaries

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## Contents

## I. Introduction

There is a common understanding that offshorization of economies is one of the biggest and most serious challenges for the international community. Thus, many countries suffer from a shortfall in taxes since their national taxpayers use offshore jurisdictions to avoid or minimize taxation. However, in recent decades the situation has changed due to the international implementation of the BEPS action plan. In Russia, offshorization of the national economy has undermined the sovereignty of the country and threatened national security because the Russian way of dealing with offshore companies is fundamentally different from its peers. Russian companies have set up holding and sub-holding companies in offshore jurisdictions in order to transfer monetary assets from Russia, as well as to protect themselves from hostile or forcible takeovers and fraudulent activity, whereas foreign companies usually set up their subsidiaries in offshore territories and use them primarily to minimize taxation.

The issues surrounding anti-offshore policy in Russia will be addressed in detail below. The author starts with an analysis of the current regulations in force regarding the use of offshore companies in Russia and the restrictions currently stipulated by Russian law, including counter-measures that have been introduced as a response to the Western sanctions. Following this, the paper reviews the prospective measures that should be taken for the further implementation of deoffshorization policy. In particular, the author considers the federal draft legislation regarding restriction of the capacity of offshore companies, public registers of beneficiaries of offshore companies and trusts, and the forced deoffshorization of strategic enterprises. Finally, the author explores the issues regarding different instruments that are used in foreign practice and could be introduced or further developed in Russia, such as dividend-stripping rules, exit tax, the taxation of the indirect sales of immovable properties and the redomiciliation of offshore companies.

## II. Current Anti-Offshore Measures

### II.1. Overview of Russian Anti-Offshore Policies

The offshorization of the Russian economy poses one of the biggest threats to the sovereignty and prosperity of the country. According to statistical data, over 80 % of transactions regarding assets located in Russia have been performed by purchases of shares in the offshore companies that hold the relevant assets (Kheyfets, 2008, p. 210). Consequently, from the perspective of Russian society, offshore jurisdictions play a negative rather than positive role, being "custom-made political jurisdictions — tax havens — that enable them to exercise decisive influence on the historical course of events" (Deneault, 2011, p. viii). Companies may use privileges provided by offshore laws, even if they do not have any substantial relation with the particular jurisdiction, when "the offshore 'laws' provide neither more nor less for the absence of laws" (Deneault, 2011, p. 216).

Proposals to adopt anti-offshore measures have been raised on both international and national levels. On the international level, these measures have been established in the BEPS action plan developed within the framework of the OECD and G20[1] in 2013 and finally approved in 2015.[2] It is necessary to note that the main responsibility for the offshorization of the world economy lies on developed countries, but not on the offshore jurisdictions themselves. As it was rightly pointed out, "the tax havens have traditionally been politically acceptable as long as they are rainy and cold places such as Denmark, Delaware, the Netherlands, Ireland and the United Kingdom. However, if you add a white sand beach and some palm trees it becomes a different story. The tax haven becomes an offensive villain, not only guilty for 'unfair tax competition' but of virtually every other thinkable evil, including terrorism, money laundering, and all poverty on the Earth. The fact that the lion's share of international money laundering takes place in London and New York, not in the Caymans or the British Virgin

[1] BEPS — Base Erosion and Profit Shifting.

[2] The BEPS Monitoring Group website. What is BEPS? Available at: https://www.bepsmonitoringgroup.org/what-is-beps [Accessed 15.06.2022].

Islands, is usually conveniently omitted in any debate on the subject" (Magnusson, 2014, p. 5).

Russian law does not prohibit businesses from registering offshore companies or buying or dealing with shares in them. However, certain legislative acts restrict activities in some areas. For example, the Tax Code in Article 284(3)(2) stipulates that dividend paid by companies registered in offshore jurisdictions to their Russian shareholders have to be subject to 13 % tax, whereas the dividends coming from other countries are not taxable in Russia. The list of offshore jurisdictions was approved by the Russian Ministry of Finance in 2007 and now includes 40 countries and territories.[3]

In Russia, the need to take anti-offshore action was first declared by President Putin in his Address to the Federal Assembly in both 2012 and 2013.[4] The next considerable step was the introduction of rules on controlled foreign companies (CFC) into the Russian Tax Code in 2014. There have been other steps to this effect that will be described in detail below. At this stage, it is necessary to define the term "anti-offshore policy." It should be noted that none of the Russian Federal Laws contains a definition of this notion. Nevertheless, the Letter from the Ministry of Finance No. 03-01-11/38162 dated 27 May 2019[5] states that anti-offshore policy (or "de-offshorization policy") includes the following instruments:

a) Taxation of income from CFCs,

b) Recognition of foreign companies as Russian tax residents being subject to certain conditions,

c) Implementation of the concept of beneficiary ownership into Russian practice,

d) Automatic exchange of financial information,

[3] Russian Ministry of Finance Order No. 108n dated 2 November 2007 "On the List of States and Territories which Provide Tax Benefits and/or which do not Provide Information while Conducting Financial Operations." Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

[4] Presidential Address to the Federal Assembly dated 12 December 2012; Presidential Address to the Federal Assembly dated 13 December 2013. Available at: http://www.consultant.ru/. (In Russ.). [Accessed 10.01.2021].

[5] Letter from the Ministry of Finance No. 03-01-11/38162 dated 27 May 2019. Available at: http://www.consultant.ru/. (In Russ.). [Accessed 25.12.2020].

e) Qualification of the Russky and Oktyabrsky islands as special administrative areas,

f) Capital amnesty.

Although the letter from the Ministry is not a legislative act, but rather their opinion, we will rely upon the definition of the anti-offshore policy given in this Letter because it seems logical and reasonable.

It should be noted that some of the aforementioned anti-offshore measures have already been implemented in Russia. Particularly, the Russian State:

A) Introduced CFC rules into the Russian Tax Code (Chapters 14.4.-1 and 20.2) that have been in force since the 1st of January 2015.

B) Signed the CbC MCAA[6] in January 2017[7] and introduced special rules into the Russian Tax Code (Chapters 14.4.-1 and 20.2) that regulate the collection and automatic international exchange of Country-by-Country Reports.

C) Ratified the MLI[8] in May 2019[9] that covers 71 double tax treaties (DTTs) between Russia and foreign countries.

D) Introduced and changed transfer pricing rules.

We will analyse the most important anti-offshore actions below, particularly the CFC rules, the revision of DTTs, TPRs, registers of beneficial owners, and the exchange of financial information. We will also review prospective measures, such as taxation of immovable property and the restriction of the capacity of offshore companies.

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[6] CbC MCAA — Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports. Available at: https://www.oecd.org/tax/automatic-exchange/about-automatic-exchange/cbc-mcaa.pdf. [Accessed 15.06.2022].

[7] The Russian Federal Tax Service signed the CbC MCAA in January 2017 in accordance with the Order of the Russian Government No. 2608-r dated 7 December 2016. (In Russ.).

[8] MLI — Multilateral *Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*. Available at: http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf [Accessed 15.06.2022].

[9] Federal Law on Ratification of the Multilateral *Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* No. 79-FZ dated 1 May 2019. (In Russ.). Available at: http://www.consultant.ru/ [Accessed 15.06.2022].

## II.2. CFC Rules

The BEPS project calls on relevant countries to strengthen and implement CFC rules (Action 3). As a response to this call, over 50 countries have already implemented CFC rules into their domestic legal systems.[10] Russian CFC rules were introduced into Russian Tax Code (Chapters 14.4.-1 and 20.2) in 2014 and they have been in force since the 1st of January, 2015. These rules are similar to those that have been adopted in foreign countries and contain certain provisions. Particularly, they:

a) establish that the tax benefits stipulated by DTTs can be granted to the actual beneficial owners of the income but not to transit or conduit companies;

b) oblige residents to notify the tax authorities about their CFCs;

c) oblige residents to declare the undistributed income from their CFCs and pay a profit tax from this income at the rate of 13 % if the resident is an individual, or 20 % if it is a legal entity;

d) ensure liability for the violation of CFC rules;

e) establish rules for the recognition of foreign companies as tax residents of the Russian Federation and being subject to certain conditions.

Russian residents should notify the tax authorities about their CFC's in cases their share in a company's charter capital is equal to or exceeds 10 %, or if a resident exercises actual control over a company in his interests or in the interests of his family. It is obvious that in the latter scenario it is the beneficiary of the offshore company who normally manages it by using nominee shareholders.

Russian judicial practice documents that the courts have refused to grant tax benefits to those foreign companies that were not the beneficial owners of the respective income. For example, in the Severstal JSC case[11] the company paid dividends to Cypriot companies that were in

[10] Action 3 Controlled Foreign Company. Available at: http://www.oecd.org/tax/beps/beps-actions/action3/. [Accessed 05.06.2022].

[11] Decision by the Arbitrazh Court of the City of Moscow, case No. A40-113217/16-107-982 dated 31 October 2016. Available at: http://www.consultant.ru/. (In Russ.). [Accessed 25.12.2021].

turn transmitted to BVI parent companies. Severstal JSC intended to use the 5 % tax rate on income under the Russia — Cyprus DTT of 1998. However, since the Cypriot companies were not beneficiaries of the income received, the court applied for the regular dividend tax rate of 15 % as stipulated by the Russian Tax Code instead of the 5 % rate under the 1998 DTT with Cyprus. The following factors were taken into consideration by the court:

A) The dividends received by the Cypriot companies were transmitted in their entirety to the BVI companies.

B) The charters of the Cypriot companies were identical and the companies were restricted in the disposition of the Severstal JSC shares.

C) Finally, the Cypriot companies did not do any business activities, except the payment of dividends and did not have any other assets except the Severstal shares.

In another case, Vladimirsky Energosbyt JSC,[12] the court established that in May 2011 the company purchased shares of the Russian company Energoservice from Cypriot company Mosslow Ltd. for 900 million RUB. Upon completion of this transaction, those funds were transmitted as dividends to Ronix Ltd., a BVI company that was a parent company of Mosslow Ltd. Vladimirsky Energosbyt JSC applied the rate of 5 % under the 1998 Cyprus-Russia DTT instead of the 20 % income tax rate stipulated by Russian Tax Code. The court concluded that Mosslow Ltd. was a technical company and did not have a right to the income from the sale of Energoservice shares since:

a) It did not have any assets or personnel.

b) It did not pay any taxes in Cyprus.

c) The only deal completed by this company over 4 years was the purchase of Energoservice shares.

d) All of its income was transferred to its BVI shareholder immediately after the sale and transfer of the dividends.

e) The company did not perform any other business activities after the completion of the transaction and was subsequently liquidated thereafter.

[12] Resolution by the Arbitrazh Court of Volgo-Vyatskiy Circuit No. F01-3058/2017, case No. A11-6602/2016 dated 7 August 2017. Available at: http://www.consultant.ru/. (In Russ.). [Accessed 25.12.2021].

Ronix Ltd. was determined to be the end receiver of the income, and therefore its beneficial owner. In this circumstance, Vladimirsky Energosbyt JSC should have withheld 20 % tax under the Russian Tax Code since there was no DTT between Russia and the BVI, and the 5 % tax rate under the 1998 Russia-Cyprus DTT should not have been applied since Mosslow Ltd. was a transit company being used to obtain tax benefits. As a result, Vladimirsky Energosbyt JSC was obliged to pay 180 million RUB in additional taxes.

These cases evidence the fact that the Russian tax authorities, while applying tax benefits, consider the following factors when determining the actual economic activities of a company:

a) the availability of its personnel,

b) employee obligations,

c) office availability,

d) expenditures related to its business activities,

e) commercial risks and cash flow.

Only companies that have an economic presence in the country of residence and wide discretionary authority over the disposition of a company's income may seek tax benefits under the applicable DTT (Arakelov, 2017, p. 55). In addition, under the Russian Tax Code a foreign company that is managed from the territory of the Russian Federation can be qualified as a Russian tax resident and consequently recognized as a Russian taxpayer.

It should be noted that recently, a number of offshore jurisdictions have adopted special laws on economic substance that oblige local companies to rent office space, hire personnel and pay salaries. Thus, under the BVI Economic Substance (Companies and Limited Partnerships) Act, that has been in force since the 1st of January, 2019, companies registered in the BVI should be undertaking business activities, as well as having enough staff and renting office space there.[13] All BVI companies need to pass this information to the BVI authorities and this data has to be integrated and shared with the

[13] Economic substance — BVI law in force. Available at: https://www.harneys.com/insights/economic-substance-bvi-law-in-force/ [Accessed 15.06.2022].

BOSS system.[14] Companies and individuals can be held liable for any violations of economic substance rules and can be delisted, fined, or in the case of individuals also imprisoned.[15] Similar laws on economic substance were adopted and entered into force in 2019 in Bermuda,[16] the Caymans,[17] Guernsey,[18] Jersey[19] and the Isle of Man.[20] Considering these foreign laws, as well as Russian law requirements, many owners created economic substance for their overseas offshore companies, including renting office space, having a qualified director and personnel with substantiated market salaries and drafting commercial and accounting documents.

### II.3. Revision of DTTs

In March 2020, the Russian President Vladimir Putin ordered the Russian Government to determine and revise the DTTs to which Russia was party. It was suggested that the tax rate on dividends and interests be 15 % in all of the DTTs and that this tax should be withheld by the Russian tax authorities upon the payment of dividends and interests

[14] BOSS — Beneficial Ownership Secure Search System was introduced in the BVI in June, 2017, by a special law that obliged local incorporating agents to upload data about the beneficiaries of BVI companies into the BOSS, to which the BVI authorities have access.

[15] Government of the Virgin Islands. Economic Substance Legislation. Available at: http://www.bvi.gov.vg/economic-substance-legislation [Accessed 05.06.2022].

[16] Bermuda Economic Substance Act 2018. Available at: http://www.bermudalaws.bm/laws/Consolidated%20Laws/Economic%20Substance%20Act%202018.pdf [Accessed 15.06.2022].

[17] Cayman Islands. International Tax Co-Operation (Economic Substance) (Amendment) Bill 2019. Available at: http://www.legislativeassembly.ky/portal/pls/portal/docs/1/12930557.PDF [Accessed 15.06.2022].

[18] Guernsey Statutory Instrument 2018 No. 90. The Income Tax (Substance Requirements) (Implementation) Regulations, 2018. Available at: https://www.gov.gg/CHttpHandler.ashx?id=116235&p=0 [Accessed 15.06.2022].

[19] Jersey Taxation (Companies — Economic Substance) (Jersey) Law 2019. Available at: https://www.jerseylaw.je/laws/revised/Pages/24.970.aspx [Accessed 05.06.2022].

[20] Income Tax (Substance Requirements) Order 2018 (Isle of Man). Available at: https://www.gov.im/media/1363889/approved-isle-of-man-legislation-income-tax-substance-requirements-order-2018.pdf [Accessed 05.06.2022].

to non-residents. In addition, it was stipulated that if there were any disputes, then the DTTs were to be dissolved.[21] Notices regarding the revision of DTTs have been sent to several countries, including Cyprus, Luxembourg, Malta, the Netherlands and Switzerland. Initially some of these countries provisionally agreed to introduce these amendments into the relevant treaties.

However, in December 2020, the Netherlands refused to amend their DTT with Russia, although the suggested amendments were identical to those that had already been agreed upon by Cyprus, Luxembourg and Malta. As the Russian Ministry of Finance noticed, the DTT in force allows the Netherlands to transfer profits to their territory at the extremely low rates of 2 % and 3 %, whereas the applicable Russian rates to dividends and interests are 15 % and 20 % respectively. The DTT between Russia and the Netherlands was used to transfer profits overseas for many years. For example, about 457 billion RUB were transferred to the Netherlands in 2017 through Dutch companies. In 2018 and 2019, the amounts transferred through Dutch entities were 412 billion and 339 billion RUB respectively. Since the Netherlands did not agree to raise the applicable tax rates to the level stipulated by Russian law, the Russian Government has decided to dissolve the DTT.[22]

Unlike the Netherlands, countries such as Cyprus, Malta and Luxembourg have agreed to amend the respective DTTs. In September 2020, Cyprus and Russia signed the Protocol[23] that raised the tax rates in the current DTT for the transfer of dividends and interests up to the level established by the Russian Tax Code. It should be noted

[21] Russian Presidential Order No. Pr-586 dated 28 March 2020. Available at: http://www.consultant.ru/. (In Russ.). [Accessed 25.12.2021].

[22] The Ministry of Finance of Russia starts denunciation of the Double Tax Treaty with the Netherlands. Available at: https://minfin.gov.ru/ru/press-center/?id_4=37312-minfin_Rossii_pristupaet_k_denonsatsii_soglasheniya_ob_izbezhanii_dvoinogo_nalogooblozheniya_s_niderlandami. (In Russ.). [Accessed 16.06.2022].

[23] Protocol amending the DTT between the Russian Government and Cypriot Government dated 8 September 2020. Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

that the respective DTT with Cyprus was used as a traditional route for transferring funds overseas for many years. For example, in 2019 about 1.9 trillion RUB were transferred through Cyprus.[24] According to the new Protocol, both dividends and interests payable to Cypriot shareholders and lenders should be taxable in Russia at a 15 % tax rate, whereas previously the applicable rates for dividends were between 5 % and 10 %, and 0 % for interests. Russia has also signed protocols amending the respective DTTs with Malta[25] and Luxembourg,[26] with provisions similar to those stipulated in the new Protocol with Cyprus.

### II.4. Transfer Pricing Rules and Controlled Transactions

As stipulated by the BEPS project (Action 8), countries are required to implement Transfer Pricing Rules (TPRs) which allow parties to apply market prices in transactions between interdependent companies (intragroup transactions) based on the arm's-length principle. These rules have been in force in Russia since the 1st of January, 2012, and they relate to intragroup transactions between domestic and offshore companies. The Tax Code specifies that transactions involving offshore companies be qualified as "controlled," and requires that they be reported to the tax authorities if they amount to 60 million RUB or more. The tax bodies may recognize the costs of goods or services included in these controlled transactions as non-market prices and calculate taxes based on the average market price.

It should be noted that Russia has followed international standards in development and implementation of TPRs, such as Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations of

[24] The Double Tax Treaties with Cyprus, Malta, Luxembourg and the Netherlands to be applied from 2021. Available at: https://www.audit-it.ru/articles/account/court/a56/1021507.html. (In Russ.). [Accessed 15.06.2022].

[25] Protocol amending the DTT between the Russian Government and Government of Malta dated 1 October 2020. Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

[26] Protocol amending the DTT between the Russian Federation and Luxembourg dated 6 November 2020. Available at: http://www.consultant.ru/. (In Russ.). [Accessed 05.06.2022].

2017, adopted by the OECD.[27] The recommendations contained in this document can be used both by OECD members and non-members since it is part of the BEPS action plan. Countries such as Russia, China and Brazil use the OECD Guidelines for improvement of their domestic legislation. For example, following the OECD Guidelines Russian law has established that the main principle of transfer pricing is the arm's length principle.[28] This principle has been applied by many countries from all over the world, such as Australia, China, Switzerland, the UK, Argentina, the USA, and others. According to this principle, transaction prices between interdependent entities should correspond to the average market prices between independent market players. In order to effectively implement TPRs, Russia acceded CbC MCAA in January 2017.

In addition, Russia has implemented rules about controlled transactions that should be reported to the Federal Tax Service. Transactions with offshore companies[29] are classified as controlled transactions provided that the income from them exceeds 60 million RUB per year for each company.[30] This mechanism of control over transaction prices between interdependent entities is aimed at preventing businesses from manipulating prices and stopping offshore capital flow.

## II.5. Registers of Beneficial Owners

[27] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017. Available at: https://read.oecd-ilibrary.org/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2017_tpg-2017-en#page1 [Accessed 15.06.2022].

[28] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017, p. 38. Available at: https://read.oecd-ilibrary.org/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2017_tpg-2017-en#page1 [Accessed 15.06.2022].

[29] The list of offshore jurisdictions, which includes 40 countries and territories, approved by the Ministry of Finance Order No. 108H dated 13 November 2007, as amended on 2 November 2017. Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

[30] Tax Code of the Russian Federation, Art. 105.14.

Russian anti-money laundering rules have established that legal entities should identify their beneficial owners, and document, update and store this information for a period of 5 years. In addition, they have to provide it to the authorised state authorities upon request.[31] The Russian Central Bank has outlined methods for the identification of beneficiaries.[32] However, unlike the legislation of some foreign countries, Russian law does not require the creation of public registers of such beneficiaries. Furthermore, all information about beneficial owners has to be collected and kept by the banks, rather than centralized.

In addition, Russian law obliges Russian legal entities to gather information solely about their beneficial owners, whereas offshore companies are not required to do so. Despite this, local court practice gives us an example of another approach. In a number of cases, it has been established that since information about the ownership of offshore companies was not publicly available, these entities had to bear the burden of proof on the circumstances that protected them in their business relationships with third parties. In particular, offshore companies have to disclose information about their ultimate beneficial owners.[33] If this information is not provided, the offshore company will experience legal complications.[34] For example, the courts will accept

[31] Art. 3, 6.1. and 7(1), Federal Law On Countering Money Laundering of Criminally obtained Incomes, and Financing of Terrorism No. 115-FZ dated 7 August 2001 (as amended on 20 July 2020). Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

[32] Bank of Russia's Informational Letter on Identification of Beneficial Owners by Organizations Operating with Money and other Properties No. 14-T dated 28 January 2014; Bank of Russia's Letter On Issues related to the Identification of Beneficial Owners No. 014-12-4/4780 dated 2 June 2015. Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

[33] Resolution of the Russian Supreme Arbitrazh Court No. 14828/12, case No. A40-82045/11-64-444. Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

[34] Resolution of the Arbitrazh Court of Volgo-Vyatskiy Circuit No. F01-1545/2018 dated 21 May 2018, case No. A43-30569/2015; Resolution of the Arbitrazh Court of Moscow Circuit No. F05-7221/2017, case No. A40-96862/2016 dated 29 March 2018; Resolution of the Arbitrazh Court of the Moscow Circuit No. F05-12062/2014 dated 20 January 2016, case No. A40-26432/12; Resolution of the 14th Arbitrazh Court of Appeal No. 14AP-2998/2018 dated 22 June 2018, case No. A13-10654/2016; Resolution of the 18th Arbitrazh Court of Appeal No. 18AP-4133/2017 dated 10 May

evidence submitted by offshore companies provided that the relevant information about the company's beneficiaries is disclosed.[35] Despite this, in some cases the courts have decided that due to the secretive nature of the beneficial ownership, it is difficult to provide information about a company's beneficial owners to the party to the proceedings. Therefore, the court's decision to dismiss the claim based upon the fact that the relevant evidence was not provided by the parties, would have been a breach of their right to a fair trial.[36] It should be noted that this approach means that Russian courts have implemented the Institute of Disclosure order from English law, which allows a claimant to get access to the necessary evidence. In cases where the party is not willing to provide the relevant information about the beneficiaries of an offshore company or trust, their refusal to do so could have adverse effects on the party itself, and on the offshore company.

### II.6. Exchange of Financial Information

In order to effectively apply the CFC rules and implement other anti-offshore measures, Russia may use the international mechanisms on exchange of financial information stipulated by some DTTs, as well as the Convention on Mutual Administrative Assistance in Tax Matters No. 127 of 1988, as amended by the 2010 Protocol,[37] to which Russia has been party since 2015. However, this information exchange process is time-consuming and requires the completion of several formalities. Convention No. 127 stipulates three methods for the exchange of information — upon request, spontaneous exchange

2017, case No. A07-17994/2015. Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

[35] Resolution of the 17th Arbitrazh Court of Appeal dated 19 September 2017 No. 17AP-1083/2017-GK, case No. A60-27089/2016. Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

[36] Ruling of the Supreme Court of the RF No. 5-KG15-34 dated 7 July 2015. Available at: http://www.consultant.ru/. (In Russ.). [Accessed 25.11.2021].

[37] The Multilateral Convention on Mutual Administrative Assistance in Tax Matters. Available at: http://www.oecd.org/tax/the-multilateral-convention-on-mutual-administrative-assistance-in-tax-matters-9789264115606-en.htm [Accessed 15.06.2022].

and automatic exchange. It is noteworthy that BRICs countries had exchanged financial information for a long time before 2015, when Russia acceded to Convention No. 127. For example, in the period 2009–2011 Russia received approximately 8,000 spontaneous requests, whereas China and India received less than 1,000 requests. Despite this, in relation to the automatic exchange of information both China and India made more than 10,000 exchanges annually between 2009 and 2012, whereas Russia has only tested the automatic exchange of information with OECD countries since 2013 (Wilson, 2018).

Russia is the Party to the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (CRS MCAA) of 2014[38] that provides an effective mechanism for the automatic exchange of information about non-residents' bank accounts. Nearly 100 countries carried out automatic exchanges of information in 2019, enabling their tax authorities to obtain data on 84 million financial accounts held offshore by their residents, covering total assets of EUR 10 trillion.[39] In September 2018, the Russian tax authorities received information about Russian residents' accounts in foreign banks from 58 countries,[40] including the BVI, the Caymans and other offshore jurisdictions. The mechanism provided by the CRS MCAA allows the Russian tax authorities to effectively implement CFC rules. Foreign banks collect information about Russian residents who have personal accounts or control company accounts in local banks, and transfer this information to their internal state authorities that, in turn, forward it to the Russian tax authorities. Therefore, Russian residents who have received income in their foreign bank accounts from offshore companies

[38] Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information. Available at: http://www.oecd.org/ctp/exchange-of-tax-information/multilateral-competent-authority-agreement.pdf [Accessed 15.11.2022].

[39] International community continues making progress against offshore tax evasion. Available at: https://www.oecd.org/tax/transparency/documents/international-community-continues-making-progress-against-offshore-tax-evasion.htm [Accessed 15.06.2022].

[40] Federal Tax Service of Russia website. Mikhail Mishustin summarizes the results of tax authorities work in 2018. Available at: https://www.nalog.gov.ru/rn77/news/activities_fts/8434593/. (In Russ.). [Accessed 15.11.2022].

to which residents are beneficiaries, have to be prepared to justify the sources of these funds.

In order to effectively implement CFC rules globally, it is recommended to create an international instrument, in the form of a convention, treaty or protocol for the introduction of public registers of the beneficiaries of offshore companies and trusts. This instrument could be effectively drafted into the OECD, FATF or G20 and offshore jurisdictions would be forced to implement its standards. However, so far, there have been no uniform rules adopted on an international level and most jurisdictions are not committed to creating public registers of beneficiaries. Some countries have created internal registers of beneficiaries, whereas others have established that these registers have to be formed by the companies themselves or by their incorporating agents. Finally, not all jurisdictions are prepared to make registers publicly available.[41]

### II.7. Anti-Russian Sanctions of 2022 and the Russian Response to Them

So far, the EU, the UK, the USA and their allies have introduced 10,563 "sanctions" and 6,140 of which were imposed prior to 22 February 2022[42] when the Donetsk and Lugansk regions were officially recognized as independent countries by the Russian State. As it happens, most of these Western sanctions will help with the de-offshorization of the Russian economy. We will consider some of these below.

First, the EU authorities in Council Decision (CFSP) 2022/335 dated 28 February 2022[43] and Council Regulation (EU) 2022/334 dated

[41] U4 Anti-corruption Resource Center. Beneficial ownership registers: Progress to date. Available at: https://knowledgehub.transparency.org/assets/uploads/helpdesk/Beneficial-ownership-registers_2020_PR.pdf [Accessed 15.06.2022].

[42] Live monitoring of all sanctions against Russia. Available at: https://correctiv.org/en/latest-stories/2022/03/01/sanctions-tracker-live-monitoring-of-all-sanctions-against-russia [Accessed 13.11.2022].

[43] Council Decision (CFSP) 2022/335 dated 28 February 2022 amending Decision 2014/512/CFSP concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32022D0335 [Accessed 13.06.2022].

28 February 2022[44] prohibited any aircraft operated by Russian air carriers to land in, take off from, or overfly the territory of the EU. Russian airlines operate with 1,367 aircrafts in total. It has been revealed that 739 of all aircraft used by Russian airlines are registered in the Bermuda register[45] and 37 in Ireland (Levinskiy, 2022). Most of these aircraft are Boeings and Airbuses. In March 2022, the Bermuda Civil Aviation Authority (BCAA) *"provisionally suspended all Certificates of Airworthiness*" of aircraft operating under the "*agreement between Bermuda and the Russian Federation."* Russian airlines had registered their aircraft in the Bermuda Registry (VP-B** and VQ-B**) in order to have them accepted at airport worldwide. The certificates were suspended due to safety reasons, because "*BCAA is unable to confidently approve these aircraft as being airworthy."*[46]

As a result, on 14 March 2022, the Russian President signed Federal Law No. 56-FZ that allows aircraft from Bermuda and Irish registers to be re-registered on a Russian register along with the issuance of Russian *certificates of airworthiness,* provided that the aircraft meets Russian technical requirements.[47] Consequently, the EU sanctions have stimulated the de-offshorization of the Russian aircraft industry, since aircraft were forced to be re-registered on the Russian aircraft register. The aircraft are still able to conduct their operations, but only within Russian territory because their Russian certificates of airworthiness would not be recognized worldwide. In addition, even if they were able to fly abroad, the aircraft would certainly be seized by foreign authorities

[44] Council Regulation (EU) No. 2022/334 dated 28 February 2022 amending Council Regulation (EU) No. 833/2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32022R0334 [Accessed 15.11.2022].

[45] Ministry of Transport of the RF disclosed the number of aircraft registered abroad. Available at: https://www.rbc.ru/business/11/03/2022/622b1c6f9a7947d280f3d1b9. (In Russ.). [Accessed 13.06.2022].

[46] Bermuda CAA suspends certificates of Russian aircraft. Available at: https://www.aviation24.be/miscellaneous/russo-ukrainian-war/bermuda-caa-suspends-certificates-of-russian-aircraft/ [Accessed 13.06.2022].

[47] Federal Law No. 56-FZ dated 14 March 2022 "On the Introduction of Amendments to the Air Code and Other Legislative Acts of the Russian Federation." Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

at the request of foreign leasing companies, because most of the aircraft were leased by Russian airlines, the lease agreements were terminated and the leasing companies demanded the return of the aircraft.

The EU has introduced another measure that helps the de-offshorization policy in Russia. Council Regulation (EU) 2022/576 dated 8 April 2022[48] stated that "It shall be prohibited to register, provide a registered office, business or administrative address as well as management services to, a trust or any similar legal arrangement having as a trustor or a beneficiary: (a) Russian nationals or natural persons residing in Russia; (b) legal persons, entities or bodies established in Russia." It shall be prohibited as of 10th of May 2022 to act as, or arrange for another person to act as, a trustee, nominee shareholder, director, secretary or a similar position, for a trust or similar legal arrangement (Art. 5m). It is suggested that this Regulation (EU) 2022/576 covers not only trusts, but also similar legal instruments such as Treuhand in Germany. However, it is obvious that the primary target of this Resolution is trusts created in Cyprus. For a long time, the creation of Cypriot trusts has been a widespread practice among wealthy Russian individuals and businesses.

The Regulation (EU) 2022/576 also states that it shall be prohibited:

(i) to accept any deposits from Russian nationals or residents, or Russian legal entities, if the total value of deposits exceeds EUR 100,000;

(ii) to provide above mentioned persons with crypto-asset wallet, account or custody services, if the total value of crypto-assets exceeds EUR 10,000;

(iii) to sell, supply, transfer or export to the persons as above the banknotes denominated in any official currency of an EU Member State (Art. 5b and 5i).

[48] Council Regulation (EU) No. 2022/576 dated 8 April 2022 amending Regulation (EU) No. 833/2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine. Available at: https://eur-lex.europa.eu/eli/reg/2022/576/oj [Accessed 13.06.2022]; *See* also: Council Decision (CFSP) 2022/884 dated 3 June 2022 amending Decision 2014/512/CFSP concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32022D0884&from=EN [Accessed 15.11.2022].

These initiatives also stimulate Russian businesses and individuals to move away from using any overseas offshore and quasi-offshore services.

In addition to the aforementioned sanctions, Russian companies were also de-listed from foreign security exchange markets. Their shares and other securities can no longer be traded. As a result, these companies have, until now, lost interest in their offshore structures.

The sanctions adopted by Western powers encouraged the Russian authorities to take counter-measures to preserve the stability of the Russian economy. Overall, life has proved that these counter-measures have been effective, timely and reasonable.

The Russian legislator introduced a concept of "unfriendly nations," and this list was approved by Russian Government Decree No. 430-r dated 5 March 2022.[49] It includes 48 countries and territories, including all EU countries, the USA, the UK, Australia, Canada and Japan. It should be noted that corporate management by Russian companies was usually conducted through such jurisdictions as the BVI, Jersey, Cyprus, Liechtenstein, the Netherlands and Switzerland, and all of these countries are included in the list. As will be shown below, the Russian laws contain certain restrictions for unfriendly nations, and therefore these restrictions concern offshore business as well.

As a response to de-listing the securities of Russian companies abroad, Federal Law No. 114-FZ dated 16 April 2022[50] prohibited Russian companies from listing their depositary receipts on foreign exchanges (Art. 6). Those receipts that had been listed prior to the date of the Federal Law, had to be de-listed by Russian companies from foreign exchanges and converted into local Russian securities in order to reduce foreign control over these companies. "Depositary receipts are certificates issued by a bank representing shares in a foreign company

[49] Government Decree No. 430-r dated 5 March 2022 "On the List of Countries and Territories which Introduced Unfriendly Actions against the Russian Federation, Russian Legal Entities and Individuals." Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

[50] Federal Law dated 16 April 2022 No. 114-FZ "On the Introduction of Amendments to the Federal Law on Joint-Stock Companies and Other Legislative Acts of the Russian Federation." Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

traded on a local stock exchange. They allow investors to dabble in overseas stocks in their own geography and time zone." There were more than "30 depositary receipts on Russian companies including Gazprom, Rosneft, Lukoil and Norilsk Nickel issued by BNY Mellon, Deutsche Bank, Citigroup, JPMorgan, among others, trading on U.S. and European markets" (Cruise and Mandl, 2022).

Specific counter-measures against residents from "unfriendly countries" were introduced by a number of decrees of the Russian President, in particular No. 79, 81, 95 and 126 adopted in February and March 2022 and further amended.[51]

Firstly, payments of dividends in excess of RUB 10 million per month to shareholders and bondholders who are non-residents from unfriendly countries can only be made in Russian roubles. These payments can only be made in special accounts opened in Russian banks in the name of these foreign shareholders or bondholders (Decree No. 95).

Secondly, if the amount of payment exceeds to non-residents who are from unfriendly nations under a credit or loan agreement exceeds RUB 10 million per month, it can be made only in Russian RUB. These payments can only be made in special accounts opened in Russian banks in the name of these foreign creditors or lenders (Decree No. 95).

In addition, non-residents from unfriendly states can buy or sell securities issued by Russian issuers if they have obtained permission to do so from the special governmental foreign investments commission (Decree No. 81). Thus, if a foreign resident wishes to buy or sell the shares of a Russian joint-stock holding company, this transaction requires permission from the aforementioned governmental commission, since

[51] *See* Decree of the Russian President No. 79 dated 28 February 2022 "On Application of Special Economic Measures in connection with the Unfriendly Actions on the Part of the United States and Foreign Countries and International Organizations which Supported them"; Decree of the Russian President No. 81 dated 1 March 2022 "On Additional Temporary Economic Measures to Ensure the Financial Stability of the Russian Federation"; Decree of the Russian President No. 95 dated 5 March 2022 "On the Temporary Procedure for the Fulfilment of Obligations to Certain Foreign Creditors"; Decree of the Russian President No. 126 dated 18 March 2022 "On Additional Temporary Economic Measures to Ensure the Financial Stability of the Russian Federation in the Field of Currency Regulation." Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

the shares are securities. However, a transaction regarding shares in a limited liability company (LLC) does not require the approval of the governmental commission and can be done freely, because a share in an LLC is not a security.

Furthermore, Russian residents may provide non-residents from unfriendly nations with loans in Russian rubles or foreign currencies provided that they have obtained permission from a special governmental commission on foreign investments (Decree No. 81).

Finally, until 31 December 2022 the following operations can be performed only by Russian residents provided that they obtain permission from the Russian Central Bank:

a) payment into the charter capital of a company or fund which was incorporated in the unfriendly state, and

b) contribution to non-residents from an unfriendly state in the course of the performance of obligations under non-contractual joint venture agreements (Decree No. 126).

Consequently, these measures introduced by the Russian authorities *de-facto* contribute to anti-offshore policy in Russia. Specifically, they restrict transfer dividends, interest and loan amounts from Russian subsidiaries to their offshore holding companies. In addition, the prohibition of Russian companies from listing their depositary receipts on foreign exchanges and the mandatory conversion of these receipts into company shares in Russia is also a serious measure against the offshore nature of the Russian economy. As can be seen from public sources, before the crisis started, legal entities who were non-residents owned approximately of 44 % of Sberbank JSC shares,[52] and up to 24 % of Gazprom JSC shares[53] in 2021. This created serious concern regarding the security of the national economy. Now, the situation has changed. The non-residents' share in Gazprom is only 16 %. Information about current Sberbank shares is not available, but there can be no doubt that non-resident shares in this bank have been also decreased significantly.

[52] Sberbank website. Structure of Shareholding Capital of Sberbank JSC. Available at: https://www.sberbank.com/common/img/uploaded/pdf/shareholder_structure_ru_2021.pdf. (In Russ.). [Accessed 13.06.2022].

[53] Gazprom. Shares. Available at: https://www.gazprom.ru/investors/stock/. (In Russ.). [Accessed 13.06.2022].

## III. Perspectives regarding Anti-Offshore Regulation in Russia

For the effective implementation of anti-offshore measures, it would be advisable to take legislative action, such as:

a) restricting the capacity of offshore companies,

b) liberalization of the rules on the migration of offshore companies to Russia,

c) raising taxes on dividends for non-residents and for those individuals who have recently changed tax residence,

d) introducing the concept of centre of vital interests and exit tax,

e) improving the rules on indirect sales of immovable property.

It would also be necessary to adopt rules for the creation of public registers of beneficiaries of offshore companies and rules regarding the forced deoffshorization of strategic enterprises. We will analyse these legislative initiatives below.

### III.1. Restriction of the Capacity of Offshore Companies

From the point of view of Russian law, an offshore company is a foreign company the legal status of which is determined by the law of the country of registration (Art. 1202 of the Russian Civil Code). However, Russian law restricts the capacity of offshore companies in certain areas. For example, offshore companies may not participate in public procurement tenders,[54] receive state loans, budget investments or state or municipal guarantees,[55] and acquire control over companies that play a strategic role in ensuring Russia's defence and state security without special permission from the state authorities.[56]

[54] Federal Law No. 44-FZ dated 5 April 2013 (as amended on 16 April 2022) "On Contractual System in the Sphere of the Procurement of Goods, Works and Services for State and Municipal Needs," Art. 31(1). Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

[55] Federal Law No. 23-FZ dated 15 February 2016 "On Amendments into the Russian Budget Code." Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

[56] Federal Law No. 57-FZ dated 29 April 2008 (as amended on 15 April 2022) "On Procedures for Foreign Investments in Business Entities of Strategic Importance

There are legislative initiatives to restrict the capacity of offshore companies in Russia. Below, we are considering three draft laws related to this issue.

Draft Federal Law No. 858074-7[57] proposes that an offshore company taking part in proceedings as a plaintiff or defendant, should disclose the identity(s) of their beneficial owner(s) and controlling person(s). In case the plaintiff refuses to disclose this information or provide the respective documents, such as trust deeds or contracts for the provision of nominee services, its claim will not be acted upon and consequently it will be denied judicial protection. Similarly, the defendant will experience legal complications in case it refuses to disclose the identity(s) of an offshore company's beneficiaries or controlling persons.

Another draft Federal Law No. 915223-7[58] proposes that offshore companies have to disclose the identity(s) of their beneficial owners and controlling persons. Without the disclosure of this information and its placement into the Unified Register of Legal Entities, an offshore company may not be a shareholder in any Russian legal entity. Furthermore, it will not be allowed to do business in the Russian Federation, including the signing of contracts with Russian organizations and individuals, acquisition of properties or participation in other commercial relations.

As Explanatory Notes to both drafts explain, in the past the disclosure of this information was problematic because the laws of offshore jurisdictions prohibited or restricted parties from doing so. It was further complicated because there were no international agreements on the exchange of information between Russia and the offshore jurisdictions. However, many of them have now acceded to Convention EST No. 127, to which Russia has been party since the 1st of July 2015.

to Russian National Defense and State Security," Art. 2. Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

[57] Draft Federal Law No. 858074-7 "On Amendments into the Russian Civil and Arbitrazh Procedure Codes" (version submitted to the Russian State Duma as of 10 December 2019). Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

[58] Draft Federal Law No. 915223-7 "On Amendments into the Russian Civil Code (version submitted to the Russian State Duma, as of 5 March 2020). Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

Therefore, Russian tax authorities now have the instruments to get access to information about the beneficiaries of companies registered in offshore jurisdictions. In addition, Russia and many offshore countries are parties to the CRC MSAA of 2014, which provides for the automatic exchange of financial information. Moreover, by using this mechanism, Russia can receive information from more than 90 countries about the accounts of offshore companies that are controlled by Russian beneficiaries.

### III.2. Dividend-Stripping Rules, Centre of Vital Interests and Exit Tax

The effect of CFC rules is being undermined because many wealthy Russian people have left the country and have changed their tax residencies. According to a research done in 2017, 40 % of the wealthy Russian people who participated in the survey declared that they had decided to renounce Russian tax residency (Khachaturov, 2017); at the time of writing this paper three years later, this number has even increased.

In accordance with the law, individuals who live outside of the Russian Federation for more than 183 days a year are considered non-residents and the CFC rules do not apply to them. This means that these people do not have to report about their CFCs to Russian tax authorities or pay taxes from their income to the Russian State. Furthermore, these people can create economic substance for their overseas companies and continue to apply the reduced tax rates stipulated by the respective DTT with Russia. According to statistics, the implementation of CFC rules created additional treasury revenue amounting to 3 billion RUB in 2016, 6 billion in 2017 and 4.4 billion in 2019.[59] The number of notifications about CFCs for the period of 2015–2019 was 25,913. However, these figures would be many times greater if Russian residents followed the law in a strict way.

[59] Federal Tax Service's Response No. ED-17-13/265 dated 25 October 2019. Available at: http://www.consultant.ru/. (In Russ.). [Accessed 25.11.2020].

In order to raise the effectiveness of the CFC rules, legislators could rely on international experience and make the following amendments to Russian law:

a) The introduction of "dividend-stripping rules" which do not allow the application of reduced dividend tax rates under the applicable DTT in cases where a shareholder has just changed their tax residency to a foreign country.

b) The introduction of the concept of "centre of vital interests," which assumes that if the income source is located in Russia, the respective individual should still be regarded as a Russian tax resident, notwithstanding the fact that he or she is domiciled in another country.

c) The introduction of an exit tax for those individuals who have just changed, or intend to change their Russian residencies. These individuals have "continued deemed residence" and they will have to pay an exit tax based on the value of their business.

The aforementioned concepts of dividend-stripping rules, centres of vital interests, exit taxes and continued deemed residences can be found in US law (Gidirim, 2016, pp. 84–88), which could be used by Russian legislators as the international standard to follow.

### III.3. Taxation of the Indirect Sale of Immovable Properties

The indirect sale of immovable property located in Russia is quite widespread. In order to avoid the payment of income tax, parties usually create an offshore company (a target company) that, in turn, holds shares of the Russian entity to which a real estate object belongs. Following this, parties conclude the sale and purchase agreement for the shares of the target company. Upon completing this deal, the purchaser gets control over the immovable property and the seller receives the purchase price abroad. As a result, the seller does not pay income tax under Russian law as it is common for the parties to complete the transaction in an offshore jurisdiction where transactions with companies' shares are not taxable. In addition to these tax benefits, the parties are released from registration formalities regarding the passing of property rights to a purchaser, since the subject matter of the sale is the shares of an offshore company, and not the real estate object itself. Furthermore, parties

may subject these transactions to a foreign law and the jurisdiction of foreign courts, which is an additional advantage for them. Finally, the beneficiaries of the transaction, i.e., the new owner(s) and seller of the immovable property are hidden from public view by their offshore companies.

The issues surrounding the taxation of indirect sales of immovable properties by way of offshore companies have been addressed on both the international and national levels. The current Russian tax rules on the indirect sale of immovable property[60] are similar to those stipulated by Article 13(4) of the OECD Model Convention with Respect to Taxes on Income and on Capital.[61] According to the Model Convention, gains derived by a resident of a Contracting State from the alienation of shares, may be taxed in the 2nd Contracting State if these shares derive more than 50 % of their value from immovable property situated there. These OECD Model Convention rules on the indirect sale of immovable assets have been replicated in one third of DTTs. In other words, currently most DTTs do not regulate the indirect sale of immovable property (Krasnobaeva and Blagova, 2017). The MLI also established that gains derived from the alienation of shares may be taxed in the jurisdiction where the immovable property is situated, provided that its value represents over a certain percentage of the value of the entity which owns it (Art. 9). However, the MLI does not stipulate a working mechanism for the taxation of gains in situations where both the seller(s) and buyer(s) of a target company are individuals or entities registered in non-contracting states to the MLI.

As it was noted in research prepared by the IMF, OECD, the UN and WBG which was released in 2017, the tax treatment of "offshore indirect transfers" (OITs), which refer to the sale of an entity which owns an immovable asset by the resident of a foreign country has emerged as a significant issue in many developing countries. It remains the case, however, that the relevant model Article 13(4) is found only in around 35 % of all DTTs and is less likely to be found when one party is a low-

[60] The Tax Code of the Russian Federation, Art. 309(1)(5).

[61] Model Tax Convention on Income and on Capital (Full Version). Available at: https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_g2g972ee-en#page1 [Accessed 08.01.2021].

income resource rich country. The MLI has increased the number of tax treaties that include Article 13(4) of the OECD Model Convention.[62]

The BRICs countries, such as India and China, have enacted legislation to allow the taxation of indirect share transfers made by non-residents. These countries are now seeking to enforce their tax laws and collect this tax (Cope and Jain, 2015). For example, according to the Indian Income Tax Act, all income arising directly or indirectly from any business activity, property or source of income connected with India, is subject to income tax. This issue was considered in the famous case *Vodafone Int'l Holdings B.V. vs Union of India*.[63] In 1992, Hong Kong company Hutchison Group ("Hutch"), formed a joint venture with an Indian multinational to operate a telecommunications business in India. Hutch owned approximately two-thirds of the joint venture directly and indirectly through a chain of holding companies. In 2006, Hutch entered into an agreement with Vodafone to sell its interest in the joint venture. This was accomplished by the sale of a single share of a Cayman Islands holding company to Vodafone. In 2007, the Indian tax authority issued a notice to Vodafone to explain why it did not withhold tax on payments made to Hutch when it purchased the single holding company share. The Supreme Court of India ruled in favour of Vodafone. Thus, in order to make such transactions taxable in the future, the Indian legislators then amended the tax rules and clarified the following. In the event there is a transfer of a share or interest in a company or entity registered or incorporated outside the country, and the value of the share or interest is derived substantially from assets located there, the transfer is taxable in India (Cope and Jain, 2015).

Russia has also tried to resolve the issue of the indirect sale of immovable assets. Thus, draft Federal Law No. 985268-7[64] suggests

[62] OECD website. The Taxation of Offshore Indirect Transfers — A Toolkit. Available at: https://www.oecd.org/ctp/PCT-offshore-indirect-transfers-draft-toolkit-version-2.pdf, 8 [Accessed 15.06.2022].

[63] Vodafone International Holdings, B.V. v. UOI (2012) 341 ITR 1/204 Taxman 408/247 CTR 1/66 DTR 265/6 SCC 613/Vol. 42.

[64] Draft Federal Law No. 985268-7 "On Amendments into Part Two of the Russian Tax Code Regarding the Taxation of the Indirect Sale of Immovable Property Through Offshore Companies" (version submitted to the Russian State Duma on 8 July 2020). Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

supplementing the Tax Code with a rule stipulating that income from the indirect sale of immovable property located in Russia should be regarded as income derived from Russian sources, which should be taxable at the standard income tax rate of 20 %. Therefore, if a foreign company receives income from the sale of shares in another foreign holding or sub-holding company, which in turn directly or indirectly owns immovable property located in Russia, then this foreign company has to pay income tax of 20 % of the value of the immovable asset. In case the foreign company does not have tax representation in the Russian Federation, the respective income tax should be withheld from the selling price of the immovable asset.

### III.4. Redomiciliation of Offshore Companies into Russia

The Russian beneficiaries of offshore companies may redomicile these assets into special administrative areas in Russky and Oktyabrsky islands, in accordance with the Federal Law on International Companies and International Funds of 2018.[65] Redomiciled entities may continue their work in Russia as international companies, in the form of limited liability or joint stock companies. Furthermore, they may use the tax benefits stipulated by Russian law and apply a foreign law to their internal corporate relations, subject to certain conditions. However, the number of companies that have been redomiciled during the period of four years since the law came into force is relatively low — 85 companies in Octyabrsky Island[66] and 7 in Russky Island (with the potential migration of 15 other companies) (Kudrin, 2022).

There are various explanations for the ineffectiveness of this law. First, the jurisdiction from which a foreign company could redomicile to these Russian islands had to be a member of the FATF[67]

[65] Federal Law No. 290-FZ dated 3 August 2018 (as amended 26 March 2022) "On International Companies and International Funds." Available at: http://www.consultant.ru/. (In Russ.). [Accessed 15.06.2022].

[66] *See* Special Administrative Region on the Territory of the Oktyabsky Island (Kaliningrad Region). Available at: https://www.russiasar.com/tpost/5gkbnroz81-v-sar-na-ostrove-oktyabrskii-zaregistrir. (In Russ.). [Accessed 15.06.2022].

[67] FATF — Foreign Action Task Force (on Money Laundering).

or MONEYVAL.[68] As offshore jurisdictions such as the BVI, the Caymans, Bermuda and others, are not members of the aforementioned organizations, companies registered in these jurisdictions could not migrate to Russia. Subsequently, this provision was substantially amended in February 2021 when a number of other regional organizations were added. Second, the infrastructure in the Russky and Oktyabrsky islands is inappropriate for doing business and as such, the redomiciliation of companies to other places, which are closer to main centres of business, should be allowed. Finally, the requirement for a foreign company to invest not less than RUB 50 million in the Russian economy inhibits the migration of most small and medium-sized companies. As a result, once the law is changed the popularity of redomiciliation will grow substantially.

It is worth noting that the idea of redomiciliation of offshore companies into Russia, rather than the adoption of suppressive measures was an attempt to find a positive solution of the problem. It is not a secret that many Russian businesspersons use offshore companies and non-corporate structures purely for asset protection purposes, such as to prevent hostile or forcible takeovers. However, as one of the authors pointed out, "asset protection planning has been used as a cover for offshore tax evasion so often that many prosecutors automatically associate the two" (Adkisson and Riser, 2004, p. 17). Therefore, even those individuals and companies whose initial and primary goal was asset protection, eventually start to use offshore companies for other purposes, such as tax evasion. That is why in order to be successful, redomiciliation policy should go alongside the development of a business-friendly environment.

### III.5. Public Registers of Beneficiaries of Offshore Companies and Trusts

In 2015, in order to support the international exchange of financial information and the transparency of the tax administration, the European Union adopted Directive No. 2015/249 on the prevention of

[68] MONEYVAL — Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism.

the use of the financial system for the purposes of money laundering or terrorist financing. It was amended by Directive No. 2018/843[69] in 2018. Both Directives contain rules on the mandatory disclosure of information about beneficiaries. According to Directive No. 2018/843, EU members should ensure that corporate and other legal entities incorporated within their territory are required to obtain and hold adequate, accurate and current information on their beneficial ownership, including the details of any beneficial interests held. The EU members had to set up beneficial ownership registers for corporate and other legal entities by the 10th of January 2020, and for trusts and similar legal arrangements by the 10th of March of the same year. Central registers should be interconnected via the European Central Platform by the 10th of March 2021. Member States also had to set up centralised, automated mechanisms allowing the identification of the holders of bank and payment accounts and safe-deposit boxes by the 10th of September 2020.

In order to implement directives, some EU countries such as Austria, the Czech Republic, Germany, Ireland, Luxembourg and the UK have created registers of the beneficiaries of legal entities. Similar registers have been created in some non-EU countries, including Singapore, Switzerland, and the UAE. Some of these registers are publicly available, whereas others are not. However according to Directive No. 2018/843, the EU Member States shall ensure that any information on the beneficial ownership is accessible to the relevant authorities, obliged entities such as financial institutions, and the general public in most cases. However, there are some exceptions to this, for example, if the beneficial owner is exposed to disproportionate risk, risk of fraud, kidnapping, blackmail, extortion, harassment, violence or intimidation, or where the beneficial owner is a minor or otherwise legally incapable.

[69] Directive (EU) 2018/843 of the European Parliament and of the Council dated 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2018.156.01.0043.01.ENG [Accessed 25.11.2020].

As it has already been noted, Russian law currently does not contain rules about central registers of the beneficiaries of companies created in Russia. Considering the experience of foreign countries, it would be highly recommended to introduce these rules. Furthermore, these central registers should also contain information about Russian beneficiaries of offshore companies and trusts. This initiative would be more progressive than the EU rules in force, which only require the public disclosure of information about the beneficiaries of domestic companies and trusts. The main features of this prospective Russian law should be as follows:

a) Individuals — Russian residents who are the beneficiaries of offshore companies and trusts would have to submit information about themselves and their offshore assets to the public register, which would be created and managed by the Russian tax authorities.

b) The information contained in the public register should be accessible to any interested parties. However, access to the information could be restricted in cases where the beneficiary is a minor or disabled person. Access should also be limited in cases where the beneficiary provides evidence that he or she is under threat of identity fraud or other criminal activity.

c) Failure to provide the relevant information would entail administrative fines for the respective beneficiaries of not less than RUB 1 million.[70]

### III.6. Forced Deoffshorization of Strategic Enterprises

The majority of large and medium-sized Russian companies, including key players in industries such as oil & gas, steel, telecoms and retail, have their holding companies registered abroad in offshore and quasi-offshore jurisdictions, i.e., Cyprus or the Netherlands. As it was correctly noted, "Today it is obvious to all that the Russian ministries

[70] This draft law, prepared within the framework of the Research Project "Deoffshorization as a Factor for the Development of National Economy: World Experience, Legal and Economic Aspects" performed in 2019 under the contract No. 01731000096190000910001, was submitted by the author and his co-authors to the relevant Committee of the Russian State Duma.

and state bodies do not manage the economy of the country but rather portray that they do. One of the reasons for this failure is the offshore character of the Russian economy. Today, the external management of the Russian economy exerts more influence than the internal administration. This external management is exercised by foreign states such as the US, as well as transnational companies and banks which manage do so in the interests of transnational moneylenders" (Katasonov, 2016, p. 173).

In order to change this situation, in 2018 the State Duma considered Draft Federal Law No. 554243-7 "On Organizations and their Subsidiaries considered as Strategic to the Russian Economy."[71] The Draft Law proposed the following criteria for companies that could be qualified as strategic enterprises:

a) Income for the previous year should not be less than RUB 10 billion (not less than 4 billion for agriculture),

b) Taxes paid for the last three years should not be less than RUB 5 billion (not less than 2 billion for agriculture),

c) The number of personnel should not be less than 4,000 people (not less than 1,500 for agriculture).

It was proposed that the strategic enterprises and their subsidiaries should be located in the jurisdiction of the Russian Federation. As stated in the Explanatory Note, the purpose of Draft Federal Law No. 554243-7 is to relocate strategic enterprises and their subsidiaries into the Russian jurisdiction.[72] These organizations generate more than 70 % of gross domestic product (the GDP) and employ more than 20 % of the people employed in the Russian economy and therefore, the location of these enterprises and their subsidiaries in foreign jurisdictions undermines the national security of the country.

Draft Federal Law No. 554243-7 received negative feedback and was rejected by the State Duma. According to the conclusion of the

[71] Version submitted to the Russian State Duma as of the 26th of September 2018. Available at: https://sozd.duma.gov.ru/bill/554243-7. (In Russ.). [Accessed 25.12.2020].

[72] Explanatory Note to Draft Federal Law No. 554243-7 "On Organizations and their Subsidiaries considered as Strategic to the Russian Economy." Available at: https://sozd.duma.gov.ru/bill/554243-7. (In Russ.). [Accessed 25.12.2020].

Committee on Natural Resources No. 138[73] dated 23 January 2019 there were a number of reasons for this rejection, in particular:

a) The criteria for the qualification of a company as a "strategic enterprise" has not been substantiated.

b) The concept of "being in the jurisdiction of the Russian Federation" is unclear and undefined.

c) The legal consequences for the recognition of an entity as a "strategic enterprise" have not been defined.

d) The procedure for the transfer of strategic enterprises into the jurisdiction of the Russian Federation has not been defined.

e) The legal consequences in case of a company's refusal to relocate into the jurisdiction of the Russian Federation have not been defined.

f) Several strategic enterprises that had been registered abroad and specifically created for overseas activities, e.g., foreign subsidiaries of Russian banks, would have been required to relocate into the jurisdiction of the Russian Federation without any clear reason.

Therefore, according to the Committee's opinion, this proposal for the relocation of strategic enterprises into the jurisdiction of the Russian Federation would have triggered substantial risks for the Russian economy. In particular, they felt that it would have had a negative effect on the obligations undertaken by these companies under international contracts that could have undermined their competitive advantage in the international market.

From the author's perspective Draft Federal Law No. 554243-7 should be approved. However, certain amendments would have to be made.

Firstly, it should be clearly stated that holding companies of strategic enterprises must not be located abroad and if they are, then they should be redomiciled into the jurisdiction of the Russian Federation within 6 months, in accordance with the Federal Law on International Companies and International Funds.

[73] Conclusion of the Committee on the Natural Resources, Property and Land regarding Draft Federal Law No. 554243-7 "On Organizations and their Subsidiaries considered as Strategic to the Russian Economy." Available at: https://sozd.duma.gov.ru/bill/554243-7. (In Russ.). [Accessed 25.12.2020].

Secondly, in case the respective foreign law under which the holding company of a strategic enterprise is registered does not allow redomiciliation, the strategic enterprise should take the necessary measures for the liquidation of the holding company within one year. If the holding company has not been liquidated voluntarily in the specified period, the strategic enterprise should take measures to acquire its shares from the holding company. If this is not completed, the Russian tax authorities should introduce amendments into the Unified State Register of Legal Entities, which certify that the shares of the limited liability strategic company have been transferred from the holding company to the strategic enterprise. Regarding the shares of a strategic enterprise in the form of a joint stock company, the relevant records should be entered into a register of shareholders that would be maintained by a share registrar or depositor.

Thirdly, the shares obtained by the strategic enterprise should be distributed between the rest of the Russian shareholders according to Russian law. In case there are no other Russian shareholders, the shares should be allocated to the Russian state.

Finally, all disputes and disagreements connected with the transfer of shares of strategic enterprises should be resolved exclusively by the Russian courts in accordance with Russian law.[74]

### III.7. Influence of Post-Covid-2019 Theories on the Developments of Offshore Businesses

The impact of Covid-19 on all aspects of modern life has been enormous. Among other factors, Covid-19 has stimulated emerging theories regarding the future of economic development, such as Dr. Klaus Schwab's concept of The Great Reset (Schwab and Malleret, 2020) and

[74] All aforementioned provisions have been implemented into the Draft Federal Law "On Holding Companies of Strategic (Systematically Important) Organizations" that was submitted by the author and his co-authors to the relevant Committee of the Russian State Duma within the framework of the Research Project "Deoffshorization as a Factor for the Development of National Economy: World Experience, Legal and Economic Aspects" performed in 2019 under the contract No. 0173100009619000091000 1. *See* Analytic Notes. The State Duma's Publication, (2020). Moscow. Pp. 168–170. (In Russ.).

Lady de Rothschild's theory of Inclusive Capitalism.[75] As Dr. Klaus Schwab noted, "Whether espoused openly or not, nobody would now deny that companies' fundamental purpose can no longer simply be the unbridle pursuit of financial profit; it is now incumbent upon them to serve all their stakeholders, not only those who hold shares" (Schwab and Malleret, 2020). The recent trends in the development of the "Stakeholder Capitalism" (Klaus Schwab) or the "Inclusive Capitalism" (Ledy Rotchild) have lead us to the conclusion that offshore companies and trust arrangements can no longer be utilised for the enrichment of their beneficiaries only, but also for the development of society and national economies. For example, offshore companies can still be used, as they are convenient instruments for making investments in foreign economies or as flexible tools of corporate governance. Furthermore, as the traditional capitalistic economy shifts from the economics of shareholders to the economics of stakeholders, certain characteristics of offshore companies such as confidentiality or nominee service have lost their value. Today, as Klaus Schwab says, issues of worker safety, pay and benefits become more central and the agenda of stakeholder capitalism will gain in relevance and strength (Schwab and Malleret, 2020). Therefore, offshore businesses should either be rebuilt to satisfy the needs of the modern society, or become irrelevant.

## IV. Conclusion

The participant countries introduced and started to implement the BEPS action plan due to the negative effect of offshore businesses on their economies. Russia has already implemented most of the measures stipulated by the BEPS action plan. For example, it has introduced CFC rules, transfer pricing rules, revised its double tax treaties and actively participated in the exchange of financial information with foreign countries. However, the implementation of anti-offshore policy in Russia would require the introduction of new rules and the further development of existing regulations and ratification of draft laws. In this

[75] Embankment Project for Inclusive Capitalism. Available at: https://www.epic-value.com/ [Accessed 02.01.2020].

regard, Russia could rely on the experience of foreign countries such as the US, which already have the relevant tax rules in place. Apart from the introduction of tax rules and rules regarding public registers of the beneficiaries of offshore companies and trusts, it would be advisable to use administrative measures, such as those provided by the draft law on the forced deoffshorization of strategic enterprises. The positive effect of these measures would be felt if both international and national efforts were made simultaneously and the countries' actions were coordinated.

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