Korpus Prava

#3 / Autumn, 2015

Analytics

Tax & Law Journal for Top Executives

Tinker Tailor Soldier Spy or Identification of Beneficial Owners by Russian Courts

Co-publisher

Dear readers,

I am pleased to welcome you on the pages of our autumn issue of "Korpus Prava. Analytics". This issue is dedicated to the concept of an actual income recipient.

Our Senior Lawyer Alexey Oskin has prepared an article, where he covered the issues of the concept, beginning from its history and reviewed the real legal proceedings conducted in the Russian Federation. We recommend you to pay attention to this topic as it is actual and concerns all Russian companies involved in monetary transactions with foreign contractors, while enjoying the advantages of tax agreements.

Our specialists have examined the world problem of tax base erosion and profit shifting. In this issue, you will find materials on the action plan developed by OECD and the Group of Twenty (G20). The new, 4th EU Directive aimed at combating money laundering and terrorism financing has also been examined in the new issue.

We have considered Hong Kong as a favorable place to do business in Asia. You will see why it is more profitable to start your business in Hong Kong, but not in China, find out about the requirements to accounting and tax returns.

Sanctions and countersanctions have been a major topic for discussion among the politicians and housewives for two years. Korpus Prava specialists have analyzed the problems and perspectives of international isolation of the Russian economy. Of course, some issues still remain open and one can only guess...

Korpus Prava team seeks to include the most actual and interesting topics in the issue, we give constant consideration to various ideas of our subscribers and follow the trends in the professional environment. If you have any ideas or comments, please, feel free to contact us by any means convenient for you.

See you soon on the pages of "Korpus Prava. Analytics".

Artem Paleev
Managing Partner
Korpus Prava

Korpus Prava

LAW & TAX

LAW

Trade & Investments
Banking & Finance
M&A & Due Diligence
Corporate & Commercial
Competition & Antitrust
Intellectual Property
Litigation
Restructuring & Insolvency

TAX

International Tax Planning
VAT & Indirect Taxes
Transfer Pricing
Tax Audit & Advise
Tax Disputes
Financial Services & Funds
Corporate
Custom & Excise
International Trade

FIDUCIARY & TRUST

Incorporation & Administration
Hedge Funds Formation
Corporate Services
Trust & Asset Management
Offshore & EU

PRIVATE WEALTH

Individual Tax Planning
Wealth Management
Real Estate
Legal Protection
Investments
Accounts and Operations

Founder and Publisher

Korpus Prava
LAW & TAX

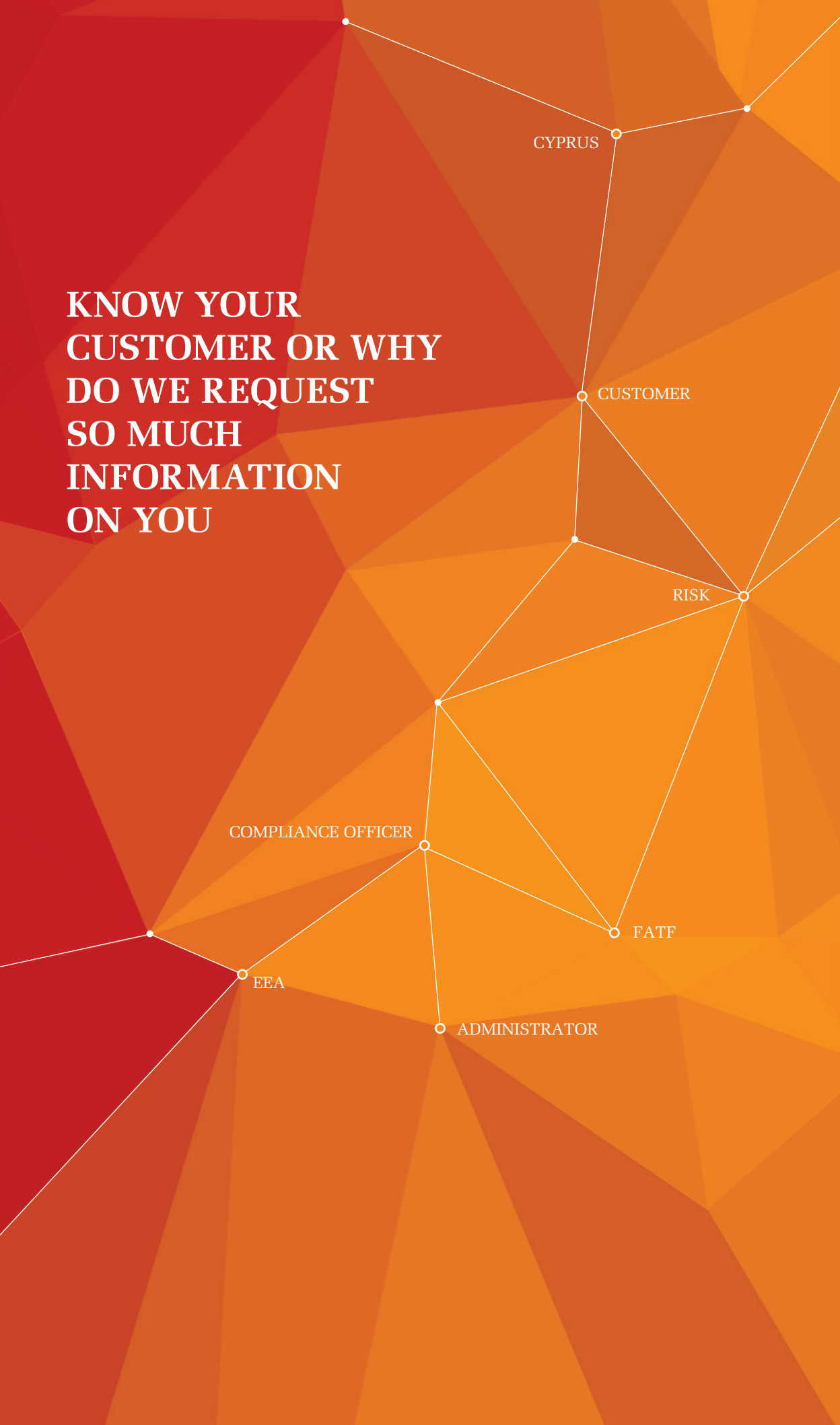
МГЮА

Phone: +7 495 644-31-23 (Russia)
Phone: +357 25-58-28-48 (Cyprus)
E-mail: kaperska@korpusprava.com

Editorial's address: 10 Bolshoy Nikolovorobinsky pereulok, Moscow, 109028, Russia

"Korpus Prava. Analytics" magazine 5 issues are published per year.
The circulation depends on subscription.

KNOW YOUR CUSTOMER OR WHY DO WE REQUEST SO MUCH INFORMATION ON YOU



Irina Otrokhova
Lawyer
Corporate Services
Korpus Prava (Cyprus)

Initially, the procedure named "Know your customer" (KYC) was used as a term within the scope of the bank and stock exchange regulation for financial institutions and bookmaker's offices and any other companies processing individuals' funds, which meant that they should identify and prove identity of a counterparty as well as identify a source and beneficiaries of funds in order to determine legitimacy of the monetary funds before carrying out a financial transaction. Such practice helps to prevent money laundering, terrorist financing and tax evasion.

In this article, we are going to consider the KYC procedure of the companies providing fiduciary services in Cyprus (Administrators). Korpus Prava Corporate Services Ltd. is one of such companies

The KYC procedure is provided for by the following Cyprus legislative acts:

- The Law Regulating Companies Providing Administrative Services and Related Matters of 2012 (L.196 (I)/2012) and the Amending Law 109(I)/2013 wef. 09/09/2013;
- The Prevention and Suppression of Money Laundering Activities Law (Law 188(I)/2007. This Law brings the Cyprus laws into line with the EU Third Directive;
- The Directive of the Cyprus Securities and Exchange Commission for the Prevention and Suppression of Money Laundering and Terrorist Financing (DI 144-2007-08 of 2012).

The latter places Administrators on the same footing as financial institutions, in particular, as regards requirements to the KYC procedure and accepting customers for servicing. Requirements to the financial institutions are provided for by the abovementioned regulations as well as EU Directives.

The KYC procedure is based on the risk estimations as well as basic identity information for customer identification. The companies aim to assess the risk of each individual customer's involvement in illegal activity.

The basic standard KYC aspects are as follows:

- Customer identification;
- Accepting customer for servicing;
- Transaction monitoring;
- Risk management.

Identification of the customer, both at company registration and at transfer of the customer's company for servicing, represents an important phase of the KYC procedure. When accepting the customer,

the Administrator shall request information and documents related to an individual customer himself/herself as well as to his/her future or existing business. After obtaining information and relevant documents the Compliance officer reviews the same, assess risks and makes decision on whether the customer is to be accepted or not. If a new customer does not provide the Administrator with all the required information, the latter shall be entitled to refuse servicing the customer. If the customer whose company is already being serviced fails to provide all the required documents or information regarding himself/herself personally or his/her company's activity, the Administrator shall cease business relations with such customer.

IF A NEW CUSTOMER DOES NOT PROVIDE THE ADMINISTRATOR WITH ALL THE REQUIRED INFORMATION, THE LATTER SHALL BE ENTITLED TO REFUSE SERVICING THE CUSTOMER

Client acceptance policy shall be developed by the Administrator incompliance with the laws and corporate policy. When accepting the customers, the Administrator categorizes risks and decides to which customers it may provide its services. The Cyprus Administrator shall not accept the customer for servicing in the following cases:

- If the client fails to provide documents and information required for identification of his/her personality, uses fictional names or is an anonymous customer;
- If the client is on the "Specially Designated Nationals List" of the US Office of Foreign Assets Control (OFAC SDN) and/or United Nations;
- The client fails to confirm the source of his/her income including that invested in the company and/or it is impossible to confirm legitimate nature of the client's income;
- The client was or is a suspect, defendant and/or convict in connection with the economic crimes, terrorist financing, fraud, money laundering;
- By the decision of the Administrator's Compliance officer.

When accepting the client the Compliance officer assesses the level of risk to which the client and his/her business are exposed. There are three basic risk levels: high, medium and low. The risks are also classified as: customer risks, company risks and geographic/exposition risks. A number of factors such as the customer's behavior, history and nature of conduct of business, customer's political activity shall be taken into account when determining the customer risks. When considering company risks such factors as the company structure, duration of its activity, its turnover and nature of its activity shall be reviewed. Such factors as jurisdiction of the customer's place of location and his/her company's registration shall be taken into account when considering geographic/exposition risks.

High Risk Customers

In the context of the customer risks the customer may be assigned a high level of risk in the following circumstances: Detection of behavioral risks:

- Customer is represented by third parties, was identified other than through a personal meeting;
- Customer fails to clearly define the purposes of registration (transfer) of the company, describe the expected transactions diagram;
- Customer fails to confirm his/her source of income;
- Company has a lot of related accounts;
- Customer is of ill repute, mass media contain negative information on the customer;
- A prior Suspicious Activity Report (SAR) or a Currency Transaction Report (CTR) related to the company.

Detection of business risks to which the following activities are related: activity connected with the production and trade of arms, precious metals, objects of art, antiques, luxury items, realtors' activity, non-regulated profit making organizations, non-regulated charitable foundations, currency exchange, companies providing financial intermediary services, online gambling (via the Internet), cash transactions. Detection of the customer's relation to any political activity as well as his/her connections with any politically exposed persons.

CLIENT ACCEPTANCE POLICY SHALL BE DEVELOPED BY THE ADMINISTRATOR INCOMPLIANCE WITH THE LAWS AND CORPORATE POLICY

In the context of the company risks the customer may be assigned a high level of risk in the following cases: Detection of structural risks: complicated company structure with no sufficient grounds therefore, presence of bearer shares, trust accounts, registration of the company in the offshore centers, company accounts opened in favor of 3 persons. Companies incorporated less than a year ago are classified among the companies with high risk exposure. The company's turnover related to one specific transaction exceeds the expected turnover by over 30%.

In the context of the geographic risks the customer may be assigned a high level of risk if the company is incorporated in the state which is specified on the following lists established by the Central Bank of Cyprus, Directive of the Cyprus Securities and Exchange Commission 2005/60/EU:

- States which are not members of the Financial Action Task Force (FATF) or other similar organizations such as MONEYVAL group of the Council of Europe;
- States listed on the sanctions lists of the abovementioned groups due to non-compliance with FATF requirements (http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions/);
- States under sanctions imposed by the European Union and UN Security Council, International Money Laundering Information Network (IMOLIN) and International Monetary Fund (IMF).

The customer shall be assigned a high level of risk if:

- His/her company owns immovable property and/or registered office situated within the states specified in the sanction lists;
- Majority of the beneficiaries or shareholders of his/her company live or reside in the states specified in the sanction lists;
- Any other customer's relation to the states specified in the sanction lists is detected.

Low Risk Customers

The customer shall be assigned a low level of risk in the following cases:

- The Company is a credit or financial institution specified in the EU Directive;
- The Company is a credit or financial institution registered in the state situated outside the European Economic Area (EEA);
- The Company which complies with the EU Directive requirements as confirmed by the decision of the Anti-Money Laundering and Terrorist Financing Advisory Committee;
- The Company which is supervised for the purpose of ensuring compliance with such requirements;
- The Company is public, its securities are quoted on the regulated market within the EEA states as well as in the other states, if such Company discloses data on its activity in accordance with the laws;

- The organization represents a national authority of the EEA states;
- The Company transfers pension contributions in accordance with the laws;
- The Company has no nominal structures (shareholders, directors), the Company's activity is clear and transparent, evokes no suspicions (confectionary production, supply of toys, medical equipment, etc.), the Company has a physical office, employees.

Medium Risk Customers

In all other cases, the customer shall be assigned a medium level of risk.

When assessing risks and making decision on whether to accept the customer the Compliance officer shall make a comprehensive decision taking into account all the information and documentation provided by the customer which not always may be based exclusively on the formal definition of the level of risk. For instance, if the customer was not introduced in person but a shareholder of the serviced company is represented by a large public company data on which is open to public, the Compliance officer may accept the customer in accordance with the simplified procedure provided for such persons by the laws.

The Compliance officer monitors the company activity while it is being serviced by the Administrator, regularly monitors transactions on the company's bank accounts, verifies legitimacy of each and every transaction, conformance to the declared business profile of the company, is entitled to request additional documents and information on the counterparties. The Compliance officer manages risks through identifying the customer's personality, his and his company business activity. Such measures are aimed at prevention of involving the Administrator in any illegal activity.

It must be noted that tightening KYC procedure on Cyprus, which took place relatively recently is connected with tightening national laws under the influence of EU and USA. For example, provision of corporate and fiduciary services is a regulated type of activity on Cyprus since 2012 which performance requires a special license. Of course, such client acceptance procedure may confuse the businessmen who worked with this jurisdiction before and are not accustomed to such close attention. However, such measures promote upgrade of business environment, improve Cyprus reputation as a jurisdiction in the global business community, bring Cyprus to the European level making it a territory attractive in terms of investment.

LEGAL REFERENCE SYSTEM

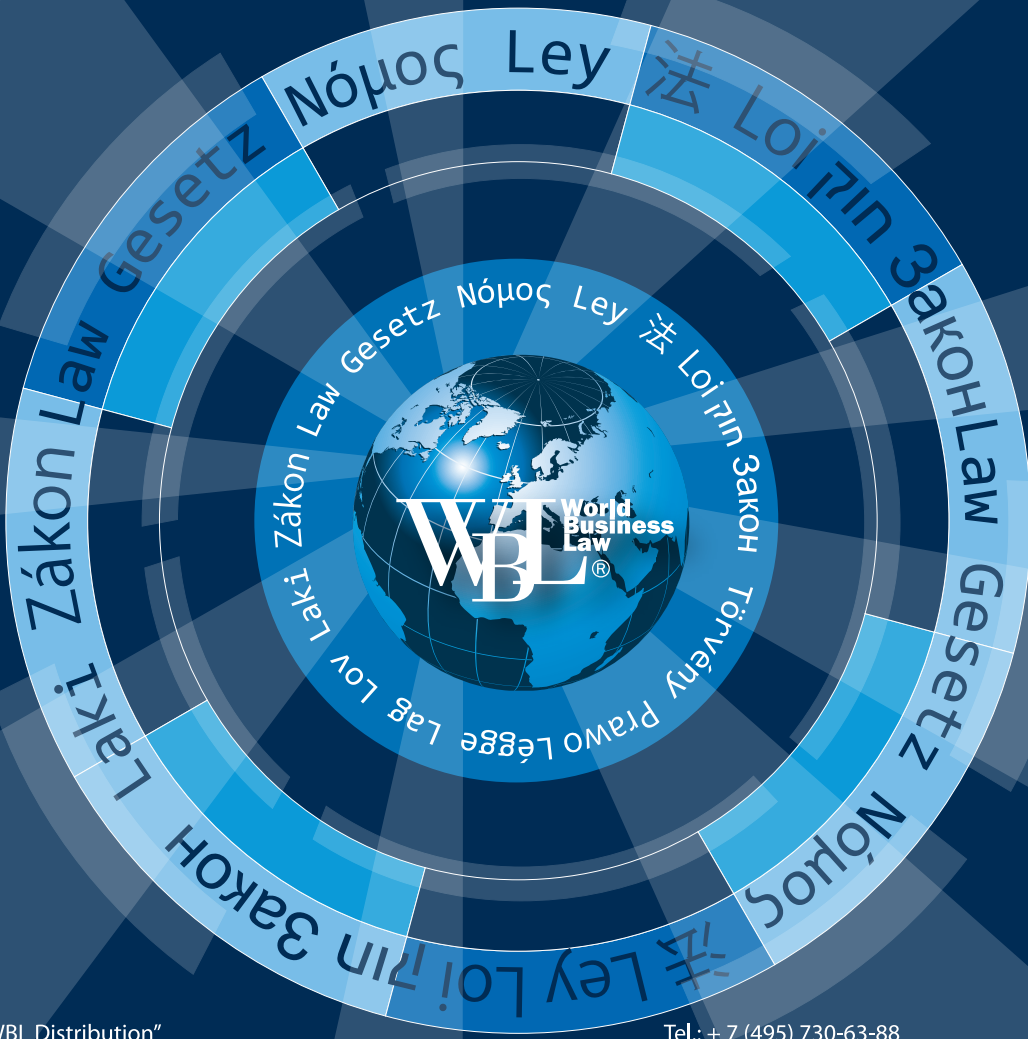
WORLD BUSINESS LAW

FOREIGN LEGISLATION IN RUSSIAN

Legal instruments of 35 foreign jurisdictions, regulating different aspects of business activity within their territories

Procedural law and judicial system,
Court practice

International acts

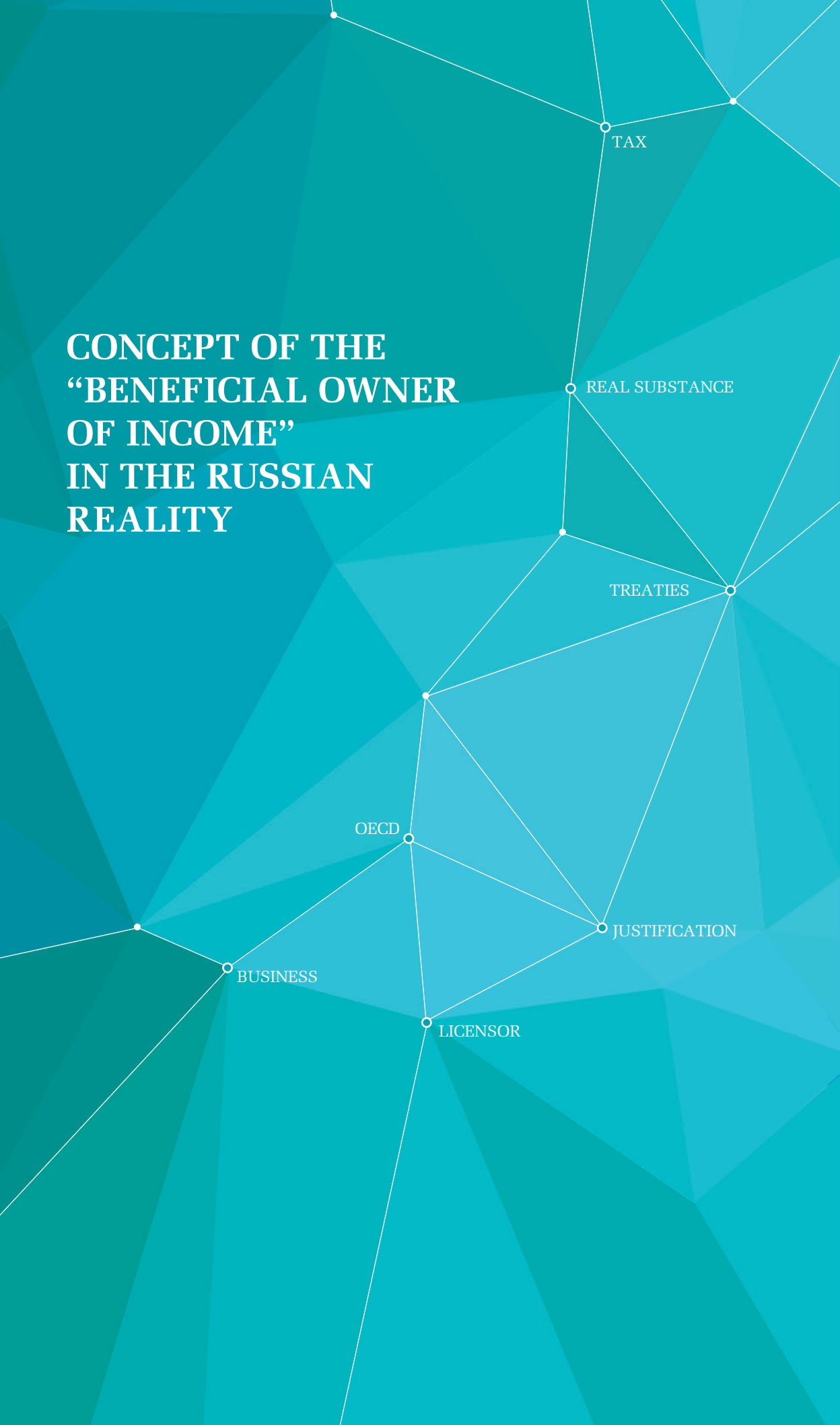


ZAO "WBL Distribution"
Russia, 129329, Moscow, Kolskaya st., 8

www.worldbiz.ru

Tel.: + 7 (495) 730-63-88
Fax: + 7 (495) 189-45-69

CONCEPT OF THE “BENEFICIAL OWNER OF INCOME” IN THE RUSSIAN REALITY



Aleksey Oskin
Senior Lawyer
Tax and Legal Practice
Korpus Prava (Russia)

In the context of the present-day reality, the regulatory agencies start paying closer attention to all the financial transaction and money payments performed by the residents of the Russian Federation in favor of the foreign counterparties. If earlier taxpayers could count on protection from our law enforcement agencies (represented by the judicial bodies), now they may no longer rely on judicial protection when such cases are considered.

The key aspect of consideration of such disputes is represented by the ability to apply provisions of the international tax treaty executed by the country of residence of the relevant income recipient, in other words — application of the concept of the "beneficial owner (actual recipient) of income".

Gist of Concept

The concept of the "beneficial owner (actual recipient) of income" is as follows. In accordance with the new tax legislation of the Russian Federation, in cases when an international treaty containing provisions on taxation and levies establishes rules and standards, which differ from those provided for by the Tax Code, the international treaty rules and standards shall be applied[1].

A FOREIGN PERSON SHALL NOT BE RECOGNIZED A BENEFICIARY OF SUCH INCOME

However if an international tax treaty of the Russian Federation provides for application of the reduced tax rates or tax exemption as regards income gained from the Russian Federation sources by the foreign persons being beneficiaries of such income, then for the purposes of applying such international treaty a foreign person shall not be recognized a beneficiary of such income, if it has limited authority to dispose of such income, exercises functions of intermediary with respect to such income for the benefit of other person without performing any other functions or assuming any risks, if it directly or indirectly distributes such income (in full or in part) to such other person that would not itself have the

1. Clause 1 Article 7 of the Russian Federation Tax Code.

right to apply the provisions of the international tax treaty of the Russian Federation if such income had been distributed directly to such person[2].

Therefore the company applying preferential fiscal terms provided for by the international treaty shall be ready to confirm and prove its status of "beneficial owner (actual recipient) of income":

- I.e. that it is a company with real substance, and
- Carries out real business activity (which means that its transactions have real economic / business goal).

The table below represents the detailed gist and content of these two aspects.

Legal Rationale. Background

International Treaties

The concept of the "beneficial owner (actual recipient) of income" is not a new concept in the international tax planning practice. It was initially reflected in the Model Tax Convention of the Organization for Economic Co-operation and Development (OECD). The Model Convention is used as a basis for the majority of the executed agreements including treaties executed by the Russian Federation with other countries, which provide that only the beneficiaries of such income

Real Substance	Real Business Activity
• Appointment of the qualified directors who are able to make decisions and understand the nature of business, have relevant expertise; • Hiring real employees (registration in the social security scheme, payroll calculation and distribution, payment of the (corporate) income tax); • Accounts generation and filing; • Rented office with a landline, fax, Internet connection, furniture, computer, multi function device (printer + scanner + fax + connected with a computer via USB/Ethernet), SIP phone, firewall, webcam; • Maintaining Internet link with a static IP address and local telephone connection (for fax) engaging a local provider; • Using standard hosting for mail and web-site (development and putting web-sites on the network and mail server development); • IP-telephony connection using a local telephone number; • Acquisition of a domain digital certificate for the purpose of ensuring encryption and authentication of resources; • Keeping original minutes of the meetings of the Board of Directors and general meetings, records, accounts at the place of the company's registration; • Execution of the agreements through the company without issuing Powers of Attorney granting authority to execute agreements and make decisions.	• Applying pro rata principle when assigning functions, distributing assets, risks, profit and losses of the company within the holding company; • Vesting the company with authorities to dispose of assets, make business decisions; • Justification of the economic expediency (real business goal) when making a deal.

2. Clause 3 Article 7 of the Russian Federation Tax Code.

as, for instance, interest, dividends, royalty may apply benefits of the double tax treaties (including reduced rates).

Moreover nearly all the double tax treaties contain provisions stipulating that the resident of the contracting state shall not be provided any benefits, concessions or exemption from taxes, if such resident's goal (or one of the main goals) (or a goal of a person related to such resident) was to obtain benefits and advantages of such treaty.

Explanation of the Regulatory Agencies

The regulatory agencies formed a stand on such issue before the modifications to the Russian Federation Tax Code were adopted and initially the Ministry of Finance expressed its opinion in the Letter of the Russian Ministry of Finance of April 09, 2014 No. 03-00-P3/16236, executed by the Deputy Minister. In the Letter dd April 09, 2014 the Ministry of Finance, acting as an agency competent in the sphere of applying existing tax treaties in connection with the tax concession application, informed that when applying principles of the international tax treaties as regards application of concessions (exemption) in the process of imposing taxes on specific types of income gained from the sources situated in the Russian Federation, it is necessary to determine whether a person applying for concessions (reduces rates and exemptions) provided for by the treaty is an actual recipient (beneficial owner) of the relevant income.

It should be noted that the Ministry of Finance turned to this issue earlier but not on the official level. After this Letter was published the new definitions and requirements emerged in the sphere of the tax legislative practice. In particular there arose a necessity to assess the status of a foreign recipient of income. And the relevant duty is vested with a tax agent — a source of the Russian Federation income which is now obliged to accurately determine whether a foreign recipient is an actual recipient (beneficial owner) of the relevant income.

The specified position was further on consolidated in the following letters[3].

Russian Federation Tax Code

As regards consolidation of theses of the concept of the "beneficial owner (actual recipient) of income" in the national laws of the Russian Federation, it should be noted that until recently the Tax Code did not contain any relevant provisions. Article 7 of the Russian Federation Tax Code was relevantly amended by the Federal Law No. 376-FZ dd November 24, 2014; amendments became effective on January 01, 2015.

In accordance with the tax legislation developments now a Russian entity paying income to a foreign (non-resident) company shall each time determine whether its foreign counterparty is a beneficial owner (actual recipient) of income. By virtue of direct reference of the Russian Federation Tax Code the following persons may act as beneficial owners of income:

- A person which is entitled to use and/or dispose of the income due to its direct and/or indirect participation in the entity or control over the entity or otherwise, or
- A person in which interests some other person is empowered to dispose of such income.

When identifying the beneficial owner of income the functions performed by the persons specified in this Clause as well as risks assumed by them shall be taken into account.

If the recipient of the income is represented by a foreign person, the taxes shall be assessed in compliance with the rules of the international treaty of the state of residence of such person[4]. For this purpose, as well as before, there should be submitted a duly executed

3. Letters of the Ministry of Finance of Russia No. 03-08-05/64201 dd December 12, 2014; No. 03-08-05/32054 dd July 02, 2014; No. 03-08-13/23614 dd May 19, 2014.
4. Sub-clause 2, Clause 4, Article 7 of the Russian Federation Tax Code.

confirmation of the fact that the above-mentioned recipient domiciles abroad (a Certificate of Residence).

If the recipient of the income is a resident of the Russian Federation, then the taxes shall be imposed in accordance with the requirements of the Russian Federation Tax Code. And in such case no withholding shall be performed if the Russian taxpayer notifies the tax authority at the place of its tax registration thereof[5]. The specified procedure of notification has not yet been approved. In order to eliminate such gap the Federal Tax Service of Russia issued a Letter No. GD-4-3/6713@ dd April 20, 2015 binding for the territorial tax inspectorates. The Letter contained recommendation to use a temporary template of notice of taxation of income paid to a foreign person who does not hold beneficial right of ownership to such income. The government official emphasized that the template represented a recommended form, i.e. its use is not obligatory and the entities may use their own forms of such notice.

The Way It Used to Be

Before now, neither the Ministry of Finance nor regulatory agencies imposed such requirements as regards assessment in the process of distributing payments in favor of foreign persons. In the past, such assessment duty was vested with a tax authority of the state of residence of the person applying for tax relief.

As a result of such assessment a taxpayer was provided a special document confirming its tax residency (a Certificate of Residence). Provision of a relevant Certificate to a tax agent before income payment was considered to be sufficient grounds for applying preferences of the tax treaty.

Earlier in its explanations[6] the Ministry of Finance specified that if a foreign person complies with the following two exhaustive terms than it may considered a "beneficial owner (actual recipient) of income":

- Existence of legal grounds for receiving income, in particular — existence of civil law contract;
- A person shall not only have a right to receive income but shall be an immediate beneficiary (a person which determines the subsequent economic fate of the received income).

As regards previous precedents: before now due to the lack of the principled ground of tax officials in relation to this issue the problem of determining a beneficial owner (actual recipient) of income was not regarded by the courts as a cornerstone. When considering a tax related dispute connected with the situation when a Russian company (Licensor) pays royalty to a Cyprus Company (Sub-Licensor), neither the court not the tax authority faced a problem of determining an owner of intangible asset and whether a Sublicensor may be considered a beneficial owner (actual recipient) of the paid royalty (i.e. a beneficiary)[7].

In another similar case,[8] the claims of the tax authority were focused on the fact of failure to withhold tax when paying income while the tax agent did not at the relevant moment have a confirmation of the income recipient's tax residency status. In such case the court stood in defense of the taxpayer as at the moment of the field audit the company had the relevant evidences (which mean confirmation of the tax residency status) at its disposal, and was not obliged to submit any other explanations and documents.

New Approaches of the Courts to Considering the Issue

A new milestone in the history of development of the concept of the "beneficial owner (actual recipient) of income" in Russia is connected not only with the change in the approach of the Ministry of Finance to applying such concept and amendments to the Russian Federation Tax Code. It is also related to the new

5. Sub-clause 1, Clause 4, Article 7 of the Russian Federation Tax Code.
6. See f. ex. Letter No. 03-08-02 dd April 21, 2006.
7. Award of the Federal Arbitration Court of the North-Western District in a case No. A21-6798/2007 dd November 14, 2008.
8. Award of the Supreme Arbitration Court of the Russian Federation No. 1646/07 dd May 29, 2007.

arbitration practice, which now gives priority to determination of the beneficial owner (actual recipient) of income when considering tax disputes.

Case of Severny Kuzbass

The decision of the Presidium of the Supreme Arbitration Court of the Russian Federation in the so-called case of Severny Kuzbass was the first shot in the sequence of judicial acts supporting the taxmen when considering disputes regarding possibility of applying international treaties principles, which to some extent predetermined further course of judicial practice development[9].

This case concerned possibility of applying preferences of tax treaties, which allow the Russian subsidiary to recognize the interest on loan in the loss bypassing the requirements of Clause 2, Article 269 of the Russian Federation Tax Code (rule of thin capitalization). In this case, the court made an unambiguous decision that if the cases are connected with the thin capitalization avoidance of application of Clause 2, Article 269 of the Russian Federation Tax Code using the benefits of the tax treaties is impossible.

The award in this case was followed by a sequence of arbitration court awards, which strengthened the consistent approach of the courts of all levels to considering such cases (see f. ex. cases of Dalelsprom (No. A73-7402/2010), Terminal Sibir (No. A45-3310/2011), SRV-Papula (No. A56-23858/2011).

As one can see, the subject of the abovementioned cases was not represented purely by the application of concept of the "beneficial owner (actual recipient) of income". The specified cases were connected with the question whether the taxpayers had lawful grounds for recognizing the accrued interests in the loss bypassing the rules of Clause 2, Article 269 of the Tax Code of the Russian Federation. They did not consider requirements of the tax authorities to classify the accrued interest as dividends because no actual repayment of the accrued interest took place. However, the principle, which served as a basis for the court decision (absence of any possibility to apply benefits of the tax treaties bypassing the provisions of the Russian Federation Tax Code) shares origins with the considered concept.

Case of Naryanmarneftegaz

For the first time the tax authorities' reclassification of the paid debenture interest into dividends was recognized legitimate within the scope of the case of Naryanmarneftedaz, LLC[10]. In spite of the taxpayer's arguments that there were no signs of controlled debt (a foreign lender was not a member of the Russian company and did not hold any shares in its charter capital (neither directly nor indirectly) the courts recognized that in fact the foreign parent company used its foreign subsidiary in order to provide a loan to its Russian subsidiary. Therefore the court recognized the lender (fellow subsidiary (sister company)) to be a conduit company used for the purpose of income transformation and obtaining advantages established by the international treaties.

Case of Oriflame Cosmetics

If the previous cases were indirectly related to the issue in question, this case perfectly reflects the Russian courts' perception of the concept of the "beneficial owner (actual recipient) of income".

The company being a Russian entity with 100% foreign participation executed a number of contracts for assignment of exclusive rights with its parent company, which, in its turn, executed a similar agreement with its parent company.

When paying a license fee (royalty) to the foreign company the Russian company:

- Deducted VAT from the relevant amounts acting as a tax agent and later on claimed the paid VAT amounts to recovery;
- Included the royalty amounts in the expenditure when forming an income tax base.

9. Decision of the Presidium of the Supreme Arbitration Court of the Russian Federation No. 8654/11 dd November 15, 2011.
10. Award of the Federal Arbitration Court of the Moscow District in the case No. A40-1164/11-99-7 dd February 27, 2012.

The relevant scheme looked as follows:

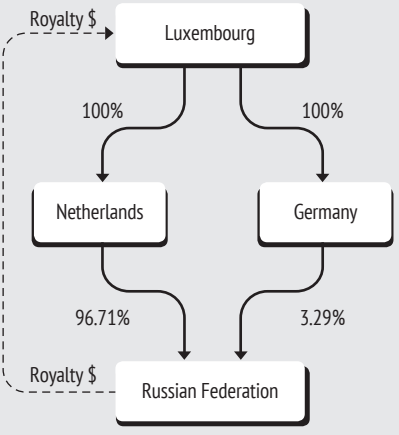


Fig. 1.

When making decision to dismiss the claims of the Company[11] the court was governed by the following logic (the court's findings are represented in the sequence, which was applied by the court):

1. The Company (Russian Federation) is a dependent entity (96.71%) of a foreign company (Luxembourg).
2. The Company is technically registered as a Russian legal entity but in fact it carries out activity for and on behalf of a foreign company.
3. The Company is a dependent agent of a foreign company (Luxembourg).
4. The Company acts as a Permanent Establishment of a foreign company (Luxembourg) within the Russian Federation.
5. The Company pays royalty to the parent company (Netherlands) with a single goal of transferring royalty to a parent company registered at Luxembourg, i.e. the use of an intermediate link represented by the Dutch company is a technical operation/scheme which allows the Company to pay royalty with a minimum tax burden.
6. The Company's payment of royalty to the recipient — parent company (Luxembourg) — was in fact payment transferred by the Company to itself.
7. In view of the foregoing, the Company is not entitled to claim to recovery the VAT amounts deducted by it when acting as a tax agent paying royalty and to reduce the income tax base by the amounts of the license fees.

As we see the legitimacy of the position of the Inspectorate as regards this case supported by the statements of motivation was justified using three concepts:

- Unjustified tax benefit;
- Actual recipient of income;
- "Piercing corporate veil".

In view of the foregoing, and on the basis of analysis of this case it seems that the specified legal proceedings represented a test case evidencing the ambience and position of the state (including legislature, law enforcement officials and regulatory agencies) in relation to the tax optimization schemes aimed at using legal business structures for applying concessions and preferences of an international tax planning and withdrawal of capital abroad. Taking into account the present-day political and economic environment such position of the state is more likely to be regarded as logical than unexpected.

The subsequent awards in the similar cases evidence the intention of the courts to follow the chosen path[12].

Conclusions

Notwithstanding the fact that concept of the "beneficial owner (actual recipient) of income" was introduced into the Tax Code of the Russian Federation only in 2015 the double tax treaties did provide for the ability to apply benefits of the double tax treaties (including reduces rates) before only in relation to the entities:

11. Award of the Federal Arbitration Court of the Moscow District in the case No. A40-138879/14 dd June 11, 2015.
12. See Award of the Moscow City Arbitration Court in the case No. A40-12815/15 dd May 08, 2015.

- Which hold beneficial right to own such income (interest, dividends, royalty);
- Which main object(s) of incorporation or existence did not include obtaining concessions under a treaty.

The concept of the "beneficial owner (actual recipient) of income" has quite a long history and is successfully applied within the territories of the other countries (including Switzerland, Austria, Germany, Netherlands, etc.).

Therefore, we cannot blame the regulating agencies, courts and our legislature that that "created" something new trying to complicate the taxpayers' life, refusing in some cases to apply concessions and preferences with the only aim of replenishing budget with new taxes. They failed to take note of the method of applying tax treaty preferences in time having allowed their foreign colleagues to tread this thorny path.

In view of the foregoing, all the Russian companies carrying out monetary transactions with the foreign counterparties shall be ready to close attention and inspection of the inspection authorities when making use of the benefits of the tax treaties. The key aspects to which the inspection authorities pay attention in such cases and the grounds on which they base their arguments were reflected in the considered cases (Oriflame case reflects them in the most detailed manner). That is why in order to minimize the studied risks we advise you to review them and avoid making the same mistakes.

Moreover, in order to minimize the reviewed risks it seems advisable to adhere to the characteristics required to qualify as a beneficial owner of income of a foreign company acting as a counterparty of the Russian organization. Certainly the specified recommendations may not be considered exhaustive and eliminating the risk in its entirety. Now it is impossible to accurately predict the development of the judicial practice as regards application of the new principles of the tax legislation. However, compliance with such recommendations is an essential minimum and failure to comply shall definitely expose the specified transactions to a risk. A

IS HONG KONG A GOOD PLACE FOR YOU TO SET UP YOUR BUSINESS IN ASIA?

Sunny Adeel
Corporate Administrator
Corporate Services
Korpus Prava (Hong Kong)

In present day, Hong Kong has managed to achieve outstanding milestones economically and socially through its highly competitive labor force, geographical location and more importantly its free economy.

Hong Kong has grown from a fishing village with an unpopulated territory in the early nineteenth century to become one of the most important financial centers of the world with a population of seven million. Before achieving the status Hong Kong has today, it has gone through various transitions.

History of Hong Kong — 1842 to 1949

A portion of Hong Kong, named Hong Kong Island, was ceded to the British under the Nanking Treaty in 1842, with a population of only 8000 inhabitants across the whole city at the time. By the end of the century in 1898, the whole of Hong Kong was ceded to the British for 99 years.

Hong Kong was consequently affected by the disastrous events in China during the war periods. The overthrow of the dynastic system in 1911 in China, the Great Depression and fluctuations in the price of silver disrupted China's relations with the outside world as well as its stability. From 1937 onwards, China engaged in the Sino-Japanese war and a civil war which further pushed China's economy into a downward spiral.

WEALTHY ENTREPRENEURS AND BUSINESSES WERE DIVERTED TOWARDS HONG KONG FROM CHINA DUE TO UNCERTAINTY OF CHINA'S FUTURE WHICH CAUSED A RAPID INCREASE IN BUSINESSES AND CAPITAL INVESTED IN HONG KONG

During this period, wealthy entrepreneurs and businesses were diverted towards Hong Kong from China due to uncertainty of China's future which caused a rapid increase in businesses and capital invested in Hong Kong. Since Hong Kong was a British colony at that time, it was a relatively safer and stable choice for the new arrivals.

Industrialization of Hong Kong — 1949 to 1978

After the establishment of the People's Republic of China (PRC) in 1949, it began a process of isolation from the global economy due to ideological reasons introduced by the then leader Chairman Mao Zedong and also because of the embargoes imposed by the United Nations in 1951. During this period, Hong Kong was rapidly transforming into an industrialized economy with the help of lucrative businessmen, labors and capital from up north. Hong Kong's main industry during the 1950s was production of textiles which then gradually diversified into different industries in the 1960s to production of electronics, clothing, plastics and other labor-intensive products for exports.

HONG KONG'S MAIN INDUSTRY DURING THE 1950S WAS PRODUCTION OF TEXTILES WHICH THEN GRADUALLY DIVERSIFIED INTO DIFFERENT INDUSTRIES IN THE 1960S

The government did not intervene much in the market and maintained the industrialization process as a free market since it was more focused on housing projects and building infrastructure to cope with the rapidly increasing population. Hong Kong has its own unique Asian economic development success when compared to other developed Asian countries such as Japan, Taiwan, South Korea or Singapore. Low taxes, lax employment laws, absence of government debt, and free trade have all been pillars of the Hong Kong experience with economic development.

Although Hong Kong faced minor shocks during its time such as the global oil crisis and the Cultural Revolution in China during the late 1960s and 1970s, it managed to maintain a positive growth rate for its GDP averaging at 6.5% per year.

China's Open-Door Policy in 1978: The World's Factory

The Open-Door Policy was announced by China's then leader Deng Xiaoping in 1978. The main objective of such a policy was for China to attract foreign investment. China then set-up Special Economic Zones around the Pearl River Delta for foreign enterprises to set up their factories. This move was highly favored by entrepreneurs around the world since China was able to provide a low-priced labor force as well as other costs at a minimum price.

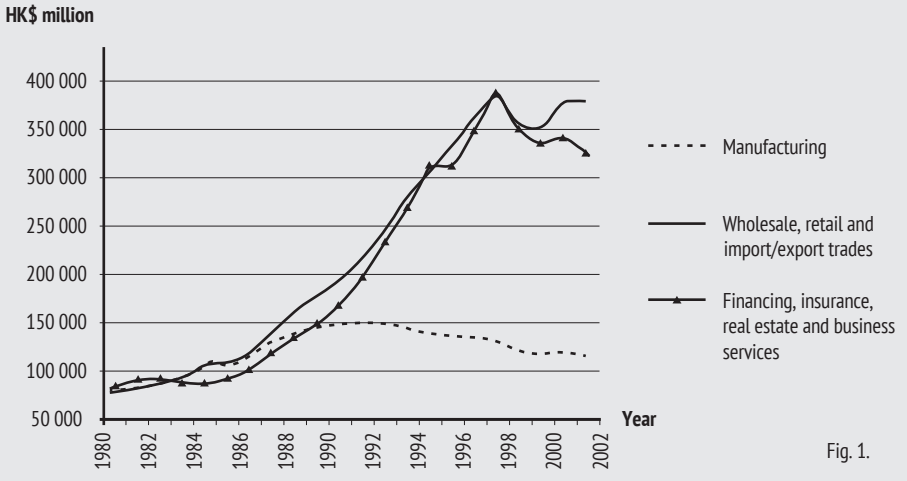


Fig. 1.

As a result of this policy, factories in Hong Kong started to relocate back to China in order to save costs. This was a turning point in the economy status of Hong Kong, it had to shift from an industrial-based economy to another one in order to survive. Hong Kong saw a surge in commercial and financial based services demand after the announcement of China's Open-Door Policy (Fig. 1).

As seen from Figure 2, the manufacturing industry was at a steady decline while the financing and services-related sector was booming. Hong Kong had transformed into a serviced-based economy.

According to a survey done by the Hong Kong Census and Statistics Department, the services sector accounted more than 90% of the contribution to Hong Kong's GDP.

Hong Kong after the handover — 1997 till now

The handover of Hong Kong was made on the 1st of July 1997 from the British to the Chinese. Hong Kong was given the right to practice its own laws and policies while being under surveillance by China. The 'One Country, Two Systems' policy has been adopted ever since. The advantage of such a policy is that Hong Kong has been able to maintain its British colonial times' lax employment laws, low taxes and free trade while also serving as a stepping-stone for China.

Due to Hong Kong's rising importance as a serviced-based economy providing professional services, many foreign companies decided to set up their offices in Hong Kong rather than China due to risk concerns, expertise of the labor force and Hong Kong's simple taxation system. In addition, Hong Kong is a free port that only taxes tobacco, hydrocarbon oil, spirits and methyl alcohol. Other than that, everything that comes in and goes out of the city is tax free. Earned profit in Hong Kong is taxed at 16.5%. However, if you have a Hong Kong registered company that only earns offshore profits, the tax rate is 0%.

Why Hong Kong and not China for setting up your business?

You might wonder why not directly set up a business in China instead of setting up somewhere next to it.

According to the World Investment Report released in 2009 by the United Nations Conference on Trade and Development, Hong Kong is one of the largest destinations for Foreign Direct Investments (FDI). Hong Kong attracted US $68 billion of inward investment during 2008 and has continued to be the second largest Asian and the world's seventh largest FDI recipient.

For over a decade, Hong Kong has been ranked the "World's Freest Economy" by the Heritage Foundation, Wall

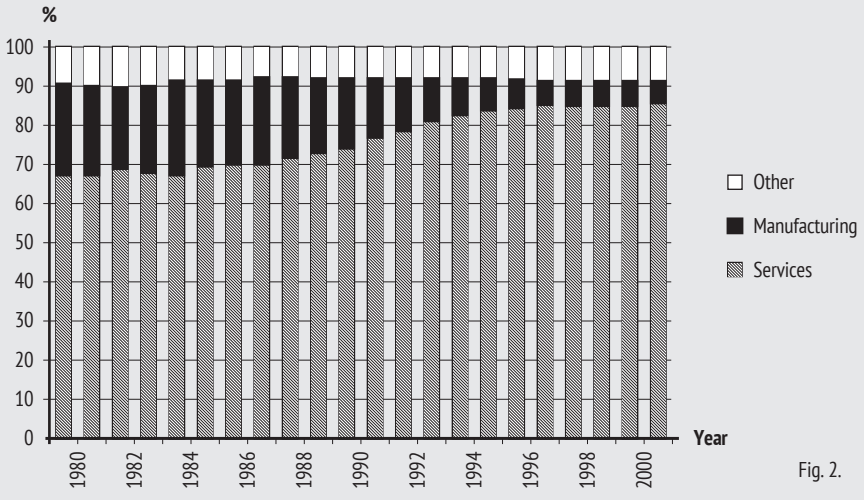


Fig. 2.

Street Journal and the Fraser Institute. It comes to no surprise that many multinational companies choose Hong Kong for their regional headquarter in Asia. With no trade barriers, low level of government intervention and in addition, an expansion and encouragement in its service sector, Hong Kong's position is strengthened even further.

The structure of taxation in Hong Kong is relatively simple; Hong Kong imposes income tax on a territorial basis. This means that generally income is only taxed in Hong Kong if it arises in or derives from Hong Kong. There are three main direct taxes, profits tax, salaries tax and property tax. Any income that is not within any of these categories is not subject to tax. Hong Kong does not impose payroll, turnover, sales, value-added, dividends, withholding and capital gains taxes.

Hong Kong's enduring appeal is built on political stability, pro-business governance, rule of law and an independent legal system from China, free flow of information with English and Chinese being the two main languages of business.

Hong Kong is a natural gateway to China due to its geographic location and its beneficial business, finance and legal systems. It is therefore no surprise that a Hong Kong Company is the most common entity incorporated as a holding company for businesses entering the China market.

Trading with a Hong Kong Company

With a Hong Kong company, it is possible to sell directly from Hong Kong to worldwide clients without involving the headquarters, and without goods burdening the warehouse. As a result, lower Freight on Board (FOB) prices Asia prices are offered. In addition, a bank credit is not required since clients could open a transferable Letter of Credit. This frees up capital and improves the cash flow. Most importantly, the business can also be operated with minimal cost.

Accounting and Tax Filing Requirements

A Hong Kong company is required to file an audit and a tax return each year so regular bookkeeping according to Hong Kong standards is advisable. The standard profit tax rate is 16.5%. However, if the company has only conducted offshore business and is able to prove this to the Inland Revenue Department (IRD) in Hong Kong, it can apply for 0% tax rate. In order to justify an "offshore business" status, the company should:

- Have no employees in Hong Kong;
- Not issue or receive any invoices from other Hong Kong companies;
- Shipments should not go through Hong Kong.

The duration until the tax exemption is approved differs on the profit the company made in the specific tax year and very often a long negotiation process is involved.

In order to minimize the financial and administrative expenses, service providers such as KorpusPrava have developed cost-effective outsourcing solutions for companies. You do not need to rent an office in Hong Kong or hire staff. A simple incorporation of a limited liability company in Hong Kong along with an opening of a bank account can get your business running. With a well-developed economy, a competitive labor force that speaks both Chinese and English and minimal government interference, Hong Kong is without a doubt a much preferred destination for setting up a business.

COMPASS OFFICES

PROUDLY SUPPORTING
[YOUR BUSINESS]

WE PROVIDE PREMIUM BUSINESS SOLUTIONS AND WORLD CLASS CUSTOMER SERVICE.

- Customisable office spaces
- Virtual offices
- Meeting rooms
- Video conferencing

+852 3796 7188

www.compassoffices.com

AUSTRALIA • CHINA • HONG KONG • JAPAN • KAZAKHSTAN • MALAYSIA • PHILIPPINES • POLAND • SINGAPORE • SOUTH KOREA • THAILAND • VIETNAM

SHIPPING IN CYPRUS

Antonis Karitzis
Advocate — Legal Consultant
Managing Director
A. Karitzis & Associates L. L. C.

Cyprus has one of the largest registered merchant fleets of the World. This achievement has been accomplished due to the many advantages of the flag. Some of them are the following:

1. Is a member of the European Union since 2004.
2. Is a democratic country with a free market economy, in a strategic location at the crossroads of three continents.
3. Provides modern and efficient legal, accounting and banking services based on English practices, and a liberal Foreign Direct Investment regime allowing up to 100% foreign participation in most sectors of the economy.
4. Has double tax treaties with more than 50 countries.
5. Imposes no tax on profits from the operation or management of Cypriot registered vessels or on dividends received from a ship-owning company (applies to tonnage tax qualified vessels).
6. Imposes no capital gains tax on the sale or transfer of a Cypriot registered vessel or the shares of a ship-owning company (applies to tonnage tax qualified vessels).
7. Has a favourable tax regime for ship management.
8. Has low set up and operating costs for companies, excellent telecommunications and easy access by air and sea, and many others.

Eligibility of Ownership

According to article 5 of the Merchant Shipping (Registration of Ships, Sales and Mortgages) Law of 1965 (Law 45/1963) (hereinafter mentioned as "the Law"):

"A ship may not be registered in the Register unless:

1. More than fifty percent of her shares are owned
   a) By Cypriot citizens; or,
   b) By Citizens of any other European Union Member State or any other contracting party to the European Economic Area Agreement who in the instance of not being permanent residents of the Republic of Cyprus, will have appointed and maintain, during the whole period of the registration of the ship in the Register of Cyprus Ships, an authorised representative in the Republic in accordance with the relevant provisions of the Law.

2. The total percentage (100%) of her shares are owned by one or more corporations, which have been established and operate:
   a) In accordance with the laws of the Republic and have their registered office in the Republic; or
   b) In accordance with the laws of any Member State and have their registered office, central administration or principal place of business within the European Economic Area and which will, during the whole period of the registration of the ship in the Register, have either:
      - Appointed and maintain an authorised representative in the Republic, in accordance with the relevant provisions of the Law; or
      - Ensured that the management of the ship in respect of her safety is entrusted in full, to a Cypriot shipmanagement company or a Community shipmanagement company, having its place of business in the Republic; or
   c) Outside the territory of the Republic and outside the territory of any other Member State, but are controlled by Cypriot citizens or natural persons who are citizens of any other Member State and who will, during the whole period of the registration of the ship in the Register, have either:
      - Appointed and maintain an authorised representative in the Republic, in accordance with the relevant provisions of the Law; or
      - Ensured that the management of the ship in respect of her safety is entrusted in full, to a Cypriot shipmanagement company or a Community shipmanagement company, having its place of business in the Republic."

Types of Registration

According to Article 23 of the Law, a ship can be registered to the Cyprus Registry "provisionally" first, provided that at the time of her registration she is out of the territorial waters of the Republic. Otherwise, when the ship is in the territorial waters of the Republic, there is no option other than to "permanently" register the ship directly.

The benefits of the "provisional" registration of the ship compared to the direct "permanent" registration relate to the documentation that needs to be submitted, and therefore the actions needed to be taken, in the course of each type of registration.

Provisional Registration

The provisional registration allows the owners of the subject ship to settle any administrative formalities with the vessel's previous flag, to collect and submit all the relevant and applicable documentation to the Registrar and complete all the necessary surveys of the ship.

The duration of the provisional registration lasts for six months from the date of the issuance of the Provisional Certificate of Registry with the option, on the Registrar's discretion, to be extended for three months and for an additional three month period if dictated by special circumstances.

It goes without saying that the provisional registration is as valid as the permanent registration and therefore the vessel enjoys immediately all the benefits the Cyprus flag has to offer.

Permanent Registration

In cases where the Vessel is initially registered provisionally, her Permanent Registration has to be completed before the expiration of the provisional registration, i.e. within 6 months from the date of her registration.

The physical presence of the ship in Cyprus is not obligatory. All the necessary inspections can take place at any port around the globe. However, all the related documentation has to be submitted either directly to the Department of

Merchant Shipping or to any consulate of the Republic abroad.

It has to be noted that the term "permanent" has its literal meaning. In other words, the registration of a Cyprus ship can only be ceased if the vessel is deleted after the submission of the relevant application from her owners or in cases where the competent Authority decides her deletion in accordance with the provisions of the relevant Law.

Parallel Registration

Part VA of the Law allows the parallel registration of vessels in the Registry of Cyprus Ships. By parallel registration, a foreign vessel can be registered, for a certain period of time, under the Cyprus flag while at the same time she will continue to be registered, in parallel, in the foreign registry and vice versa.

Parallel-in Registration

Parallel-in registration is used for cases of bareboat chartering where a bareboat charterer of a foreign ship wishes to register the ship in parallel under the Cyprus flag.

The relevant application has to be made by a person (legal or physical) who is eligible, under the Law, to own a Cypriot ship. Moreover, the laws and regulations of the country of the foreign registry must allow the parallel registration of ships registered in its registry and maintain its consent for all the period of the parallel registration.

The application will be examined once all the required documents are submitted, and if it is approved, the parallel-in registration will be effected. Immediately after, the subject ship will be registered in the Special Book of Parallel Registration, kept by the Registrar of Cyprus Ships, and the special Certificate of Cyprus Registry will be issued.

During the whole period of her parallel registration, the Vessel has to fly the Cyprus flag only and she will be subject to Cyprus Laws and Regulations. Additionally, she must be marked with her name and the Cyprus port of registry.

Parallel-out Registration

In contrast, Parallel-out registration is used when a bareboat charterer wishes to register in parallel a vessel, which is already registered permanently under the Cyprus flag, to a foreign Registry. Exceptionally, the Minister may approve the parallel-out registration of a vessel which is provisionally registered under the Cyprus flag at the time of filling the application. This form of registration allows the financing of a ship and her mortgaging under the Cyprus Laws and later her parallel registration in a foreign registry.

Moreover, the subject foreign registry must allow the parallel-in registration from a foreign registry and the vessel has to be chartered to a foreign person (physical or legal).

The relevant application has to be made by the owner of the Vessel who must submit all documents required to support the application.

According to the Law, the parallel-out registration stays in force as long as the subject bareboat charter party is valid and neither the Cypriot authorities nor the authorities of the foreign flag withdraw their corresponding consents. In any case, the parallel-out registration must be for a period no more than three years.

Finally, the subject vessel has to fly the flag of the foreign registry and the name of the foreign port of registry has to be marked on her stern. However, any matters relating to the ownership of the vessel or to any mortgages created against her are exclusively governed by the Cypriot legislation and handled by the Registrar of Cyprus Ships.

Conditions for Registration

Cypriot nationality is automatically acquired if a ship is successfully registered in the Cyprus Register.

Subject to the Minister's statutory powers to revoke the Cypriot nationality from a registered vessel at any time after her registration, a ship is not eligible to be registered in the Cyprus Register if she:

- Has an overall length less than thirteen meters and is employed solely in navigation on the coast of the Republic or of the Sovereign Case Areas. In that case, the subject vessel may be registered in the Small Ship Registry;
- Does not have a whole or fixed deck and is employed solely in fishing, lightering or trading coastwise on the shore of the Republic or of the Sovereign Base Areas or within such a radius therefrom as may be prescribed;
- Does not comply with the Government Policy which has been issued in accordance with sections 14A and 14B of the Law, as amended from time to time.

Government Policy on the Registration of Ships under the Cyprus flag

The Government Policy for the registration of ships, which has been issued by virtue of Articles 14A and 14B of the Law, adds some additional requirements or conditions which are deemed necessary for the achievement of a safe, secure and efficient shipping on clean waters and for safeguarding the interests of the Cyprus ships and of their owners, bareboat charters, managers and operators.

The Registrar of Cyprus Ships does not consider applications for registering ships either in the Register of Cyprus Ships or in the Special Book of Parallel Registration which:

1. At the time of the application for their registration, are banned on port State control grounds by a State member of any one of the Memoranda of Understanding on port State control, from entering the ports of the States party to that memorandum or which have been banned by a State from entering its ports.
2. Have been detained on port State control grounds on three or more occasions during the two years period prior to the date of application for registration by States of the Paris or the Tokyo or the Mediterranean Memoranda of Understanding on port State control or by the United States Coast Guard.
3. Have been constructed for exclusive use on inland navigation or to be used exclusively on inland navigation (e.g. in internal waters, rivers, inland waterways, canals, natural or artificial lakes, water reservoirs or dams).
4. At the time of filing the application for their registration, satisfy the conditions related to their age.

Age Related Conditions

It should be noted that "Age" means the age of the ship which is calculated by deducting the year within which the keel of the ship was laid from the year in which the application for its registration was filed with the Registrar of Cyprus Ships.

In case a ship has undergone major conversion or reconstruction, the year in which the major conversion or reconstruction begun may be taken into account (in lieu of the year in which its keel was laid) for the calculation of the age of the ship, provided the ship, at the end of the major conversion or reconstruction, complied with all the requirements of the applicable international treaties to which Cyprus is a State Party, as if it was a new ship whose keel was laid in the year in which the major conversion or reconstruction begun. In such a case the application for the registration of the ship should be accompanied by documentation from the recognized organization which is surveying and certifying the ship on behalf of its flag State or from its flag State attesting so.

Annual Tonnage Tax

In 2010 Cyprus introduced by virtue of the Merchant Shipping (Fees and Taxing Provisions) Law of 2010 (Law 44(I)/2010), a new Tonnage Tax System (hereinafter mentioned as "the TTS"), by which every qualifying owner of a Cyprus or foreign ship, charterer and/or ship manager may be subject to an annual tax referred to as tonnage tax and calculated based on the net tonnage of the qualifying ship that he

Age Related Conditions

Type of Ship	Related Conditions		
	Maximum age limit	Entry Inspection required	Additional Inspection required
Cargo ships and Cargo High Speed Craft	Yes ⩽ 25 years	Yes, if ⩾ 15 years	No
Passenger ships and Passenger High Speed Craft engaged on international or short international voyages	No	Yes, if ⩾ 30 years	Yes, if 2 years ⩽ Age ⩽ 10 years Biennial if Age > 10 years Annual
Passenger ships and Passenger High Speed Craft engaged on domestic voyages within the territory of a State, other than Cyprus	No	Yes, if ⩾ 25 years	Yes, if 2 years ⩽ Age ⩽ 10 years Biennial if Age> 10 years Annual
Passenger ships and Passenger High Speed Craft engaged on domestic voyages within the territory of Cyprus	No	Yes, if ⩾ 20 years	No In order to operate they are required to be inspected and certified annually
Fishing vessel	Yes ⩽ 25 years	Yes, if ⩾ 20 years	No
Floating Production Storage Offloading; Floating Storage Offloading Vessels and Mobile Offshore Drilling Units	Yes ⩽ 25 years	Yes, if ⩾ 15 years	No
Ships of types other than those listed above	Yes ⩽ 35 years	Yes, if ⩾ 20 years	Yes, if the ship is carrying industrial or special purpose personnel and 2 years ⩽ Age ⩽ 10 years Biennial Age > 10 years Annual

owns, charters or manages. Ship managers, however, are required to pay only the 25% of the amount applicable to shipowners or charters who own or charter a qualified ship with the same net tonnage.

Beneficiaries

Owners of Cyprus Ships

Any owner of a Cyprus Ship falls automatically within the scope of the TTS if:

- Owns a "Qualifying Ship" (defined further below); which is
- Engaged in a "Qualifying Shipping Activity" (also defined further below).

Owners of Foreign Ships

Eligible for the TTS is an owner of a foreign ship, who:

- Is a tax resident of the Republic of Cyprus;
- Has opted to be taxed under the TTS;
- Owns a "Qualifying Ship"; and
- The ship is engaged in a "Qualifying Activity".

Moreover, the owner of foreign ships must also comply with the following:

1. Satisfy the "Community — Flagged Share" Requirement, which means that the ship-owner has to have a share of his fleet, registered under one or more EU flag(s). This share has to remain invariant for a period of three years following the exercise of the option to be taxed under the TTS.
2. In case the Community ships are less than sixty per cent of the fleet in terms of tonnage, the commercial and strategic management of the fleet must be carried out from the territory of the European Union/EEA.

Charterers

A Charterer is eligible for the TTS if he charters ship(s) under bareboat, demise, time or voyage charter and:

- Is a tax resident of the Republic of Cyprus;
- Has opted to be taxed under the TTS;
- The chartered ship is a qualifying ship; and
- The ship is engaged in a qualifying shipping activity.

Moreover, the Charterer must comply with the following requirements:

1. Minimal Share of the Fleet in Ownership 75% of chartered-in ships or 90% if the sips chartered are EU/EEA ships or their crew and technical management are carried out from the EU/EEA.
2. "Community — Flagged Share" Requirement, (as above).

Ship Managers

A Ship Manager is eligible for the TTS if he:

- Is a tax resident of the Republic of Cyprus;
- Has opted to be taxed under the TTS;
- Provides ship management services (crew and/or technical) to qualifying ships and meets at any time the following requirements:
  a) Maintain a fully fledged office in Cyprus;
  b) Employ a sufficient in number and qualified personnel;
  c) At least 51% of the total number of that personnel must be EU/EEA citizens;
  d) "Community — Flagged Share" Requirement, (as above);
  e) Economic link of managed ships with the Community — "The 2/3 Rule" which provides that at least 2/3 of the management activities are entirely carried out from the territory of the EU/EEA;
  f) Provision of crew management services in accordance with the MLC 2006 requirements for crew managers (Notification P. I. 511/2010)
  g) Certified under the ISM Code (DOC) by the competent author-

ity of the flag States of the Ships under its technical management.

Calculating the Tonnage Tax

The owner of a ship which cannot be considered as a qualifying ship and/or does not carry a qualifying shipping activity, is excluded from the provisions of Tonnage Tax System and is required to pay income tax under the provisions of the Income Tax Laws.

Contrary, the owner of a qualifying ship engaged in a qualifying shipping activity is obliged to pay an annual tax calculated in the ship's net tonnage as follows:

0–1 000	1 001–10 000	10 001–25 000	25 001–40 000	> 40 000
€35,50 per 100NT	€31,03 per 100NT	€20,08 per 100NT	€12,78 per 100NT	€7,30 per 100NT

Definitions

Qualifying ship

Any seagoing vessel certified under applicable international or national rules and registered in the ship register of any member of the International Labour Organisation, which is recognised by Cyprus.

The TTS excludes certain types of vessels, such as:

- Fishing Vessel;
- Ships used primarily for sports or recreation;
- River vessels;
- Non-self-propelled floating cranes;
- Non-ocean going tug boats;
- Floating Hotels, Restaurants, Casinos and others.

Qualifying activity

A qualifying activity is considered as any commercial maritime activity, including transport, crew management and/or technical management.

By "maritime transport" is meant, the traditional carriage of goods and passengers, as well as ancillary services such as hotel, catering, entertainment and retailing activities on board a qualifying vessel, the loading and unloading of cargo, the operation of ticketing facilities and passenger terminals. Towage, dredging and cable lying are also eligible for tonnage tax.

In conclusion, Cyprus offers a very attractive package of economic advantages and a wide range of professional services and therefore is classified among the best shipping countries in the world.

NEW REALITY: PLAN TO COMBAT BASE EROSION AND PROFIT SHIFTING

Anna Senchenko
Lawyer
Tax and Legal Practice
Korpus Prava (Russia)

For years the Organisation for Economic Co-operation and Development (OECD) has advocated a policy of improved international tax co-operation between governments, including better information exchange and transparency to counter international tax avoidance and evasion. The OECD's work in this area focuses on helping governments to respond more quickly to tax risks, to identify trends and patterns already identified and experienced by some tax administrations, and to share experiences in dealing with them.

Base erosion and profit shifting (BEPS) is a global problem which requires global solutions. BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid. BEPS is of major significance for developing countries due to their heavy reliance on corporate income tax, particularly from multinational enterprises.

In an increasingly interconnected world, national tax laws have not always kept pace with global corporations, fluid movement of capital, and the rise of the digital economy, leaving gaps that can be exploited to generate double non-taxation. This undermines the fairness and integrity of tax systems. Fifteen specific actions (Fig. 1.) are being developed in the context of the OECD/G20 BEPS Project to equip governments with the domestic and international instruments needed to address this challenge. The first set of measures and reports were released in September 2014. Combined with the work to be completed in 2015, they will give countries the tools they need to ensure that profits are taxed where economic activities generating the profits are performed and where value is created, while at the same time give business greater certainty by reducing disputes over the application of international tax rules, and standardising requirements. For the first time ever in tax matters, non-OECD/G20 countries are involved on an equal footing (see table on next page).

There are number of key areas of work on which the OECD Committee on Fiscal Affairs, through its subsidiary bodies, is currently focusing on. These include:

- Aggressive Tax Planning;
- Transfer Pricing;
- Tax Treaties;
- Tax Policy and Statistics;

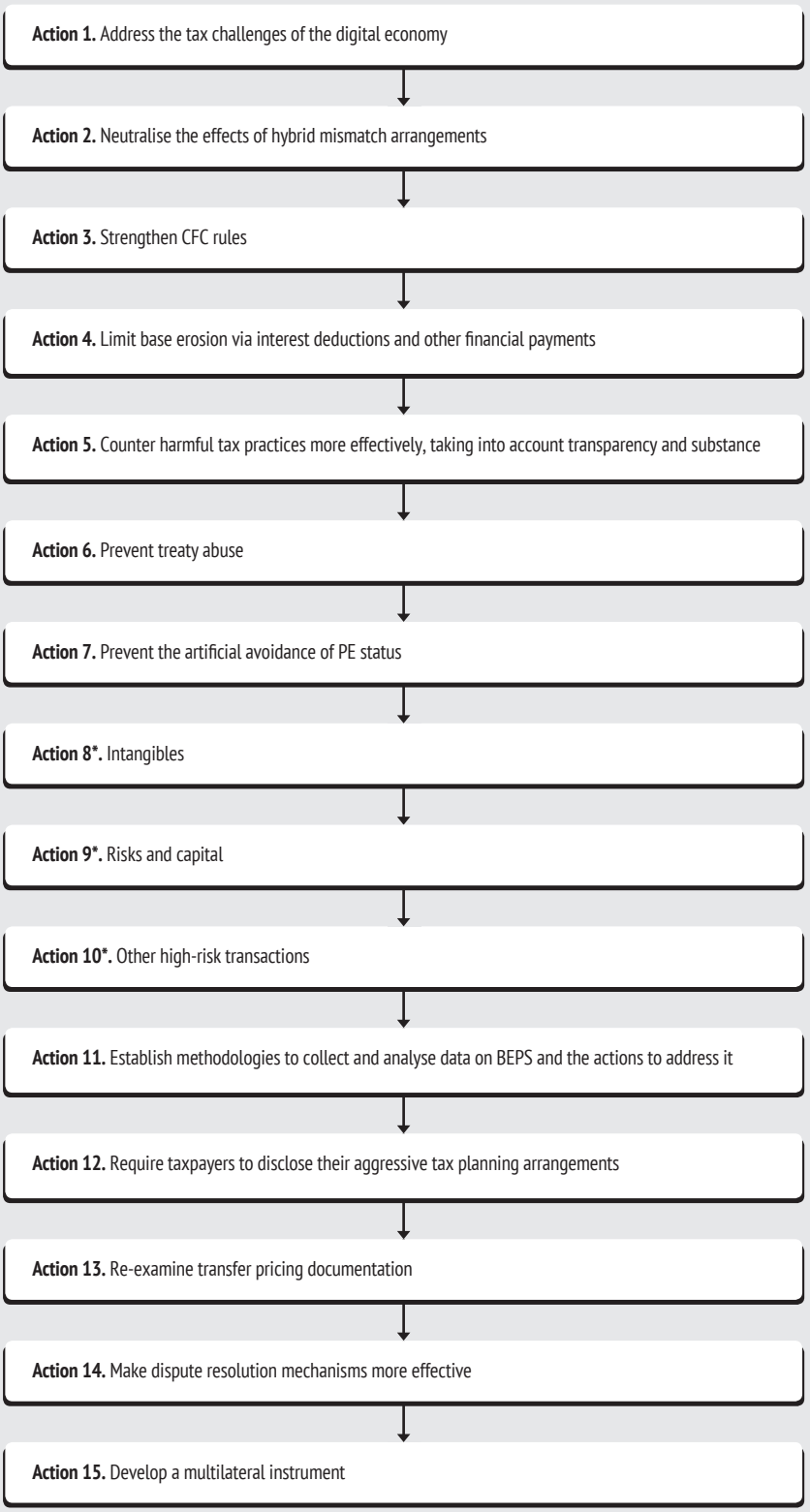


Fig. 1. * Action 8, 9, 10: Assure that transfer pricing outcomes are in line with value creation.

- OECD's Programme on Tax and Development;
- Tax Compliance.

OECD and G20 countries have agreed three key elements that will enable implementation of the BEPS Project:

- A mandate to launch negotiations on a multilateral instrument to streamline implementation of tax treaty-related BEPS measures;
- An implementation package for country-by-country reporting (CbC) in 2016 and a related government-to-government exchange mechanism to start in 2017;
- Criteria to assess whether preferential treatment regimes for intellectual property (patent boxes or IP boxes) are harmful or not.

August,7 2015 the OECD released three new reports to help jurisdictions and financial institutions implement the global Standard for automatic exchange of financial account information. The Standard calls on jurisdictions to obtain information from their financial institutions and automatically exchange that information with other jurisdictions on an annual basis. Over 90 jurisdictions have committed to implement the Standard, with the first exchanges starting in 2017/2018, subject to the completion of necessary legislative procedures.

The Global Forum is the continuation of a forum which was created in the early 2000s in the context of the OECD's work to address the risks to tax compliance posed by tax havens. The original members of the Global Forum consisted of OECD countries and jurisdictions that had agreed to implement transparency and exchange of information for tax purposes.

The Global Forum has been the multilateral framework within which work in the area transparency and exchange of information has been carried out by both OECD and non-OECD economies since 2000. The Global Forum's main achievements have been the development of the standards of transparency and exchange of information through the publication of the Model Agreement on Exchange of Information on Tax Purposes in 2002 and the issuance of a paper setting out the standards for the maintenance of accounting records Enabling Effective Exchange of Information: Availability Standard and Reliability Standard developed by the Joint Ad Hoc Group on Accounts in 2005.

The Global Forum meeting in Mexico on 1 and 2 September 2009 was a turning point in the global progress to improve transparency and exchange of information for tax purposes. In response to the G20 Leaders' call for jurisdictions to adopt high standards of transparency and information exchange in tax matters, the Global Forum was restructured as a consensus based organisation where all members are on an equal footing. All OECD countries, G20 economies and jurisdictions participating in the existing Global Forum were invited to become members.

With an ambitious agenda to improve transparency and exchange of information for tax purposes, the Global Forum agreed on a three-year mandate to promote the rapid implementation of the Standards through the peer review of all its members and other jurisdictions relevant to its work. The Global Forum is chaired by Mr Kosie Louw, from South Africa.

The Standards require:

- Existence of mechanisms for exchange of information upon request;
- Availability of reliable information (in particular bank, ownership, identity and accounting information) and powers to obtain and provide such information in response to a specific request in a timely manner;
- Respect for safeguards and limitations and strict confidentiality rules for information exchanged.

The Global Forum now includes 126 member jurisdictions and the European Union, together with 15 observers, making it the largest tax group in the world. Membership of the Global Forum is open to all jurisdictions willing to:

1. Commit to implement the international standard on transparency and exchange of information on request.

2. Participate and contribute to the peer review process.
3. Contribute to the budget.

Its current membership includes all G20 countries, OECD member countries, off-shore financial centres and many developing countries, all of whom have committed to adhere to the international standard. The procedure for becoming a member of the Global Forum is simple. A request letter of membership (English template) signed by an authorised person in the government should be sent to the Global Forum Secretariat.

There are multiple benefits in joining the Global Forum.

1. It ensures participation in a unique forum where all financial centres are present, which considerably enhances developing countries' ability to negotiate information exchange agreements.
2. The Global Forum is a unique source of expertise on transparency for tax purposes. All Global Forum members have found that the peer review process provides an opportunity to reflect on how their legal frameworks can be improved.
3. To help in improving their legal framework for transparency and exchange of information members may benefit from assistance which the Global Forum may provide directly or in partnership with other providers.
4. By monitoring and reviewing the implementation of the new global standard on AEOI, the Global Forum help its members to recover tax revenue lost to non-compliant taxpayers, and further strengthen international efforts to increase transparency, cooperation, and accountability among financial institutions and tax administrations. Additionally, AEOI will generate secondary benefits by increasing voluntary disclosures of concealed assets and by encouraging taxpayers to report all relevant information.
5. Being a member of the Global Forum provides your jurisdiction with international visibility and heightens their profile as a reliable locations in which to do business. It should also assist in the fight against corruption and money laundering.
6. All members have an equal voice in the decision making process of the Global Forum as all decisions are taken by consensus.

Korpus Prava

LAW & TAX

in Cyprus

- International tax planning
- Legal consulting
- Tax consultancy
- Formation and support of hedge funds
- Registration and administration of companies
- Opening of bank accounts

Korpus Prava (Cyprus)
Griva Digeni 84, office 102
3101 Limassol, Cyprus
Tel.: +357 (25) 58-28-48
E-mail: cyprus@korpusprava.com
www.cy.korpusprava.com

TAX AMNESTY — IS IT WORTH COMING OUT OF SHADOW?

Leonid Kunin
Senior Lawyer
Tax and Legal Practice
Korpus Prava (Russia)

People and mass media named this law "tax amnesty" long before it was executed and even before the bill was introduced to the State Duma. This law was anticipated, logical and, what's more important, it was mentioned by the President in his Address to the Federal Assembly. In fact, it would be more correct to use another common name — "capital amnesty", first of all due to the fact that amnesty 2015 releases not only from the tax liability but also from the criminal and administrative responsibility.

For the man in the street any amnesty implies "remission of sins" and relief from punishment. The legal meaning of the amnesty lies in the fact that the law cancels prosecution for certain types of law violation and releases those already enduring the punishment from further execution of sentence.

There were a great number of amnesties both in our country's history and in the history of humanity, they differed in scope and form but had one common feature — although any amnesty betters the lot of the pardoned it was never a real goal of the amnesty. Release of those granted amnesty from the liability/responsibility is just a side effect and in case of a voluntary amnesty, it is also a bait.

For example, the best known amnesty of "the cold summer of 1953" did not pursue the aim of easing the prisoners' lot but was intended for compensation of loss of the labor pool caused by the war losses as well elimination of demographic imbalance and even "dynastic amnesty" effects, and "dynastic amnesty" has been widely known since feudal times when the sovereign who took the throne released from punishment all the people sentenced by the previous ruler.

Capital Amnesty of 2015 is, probably, a rare exception and it is aimed at releasing those people who apply for the amnesty from the responsibility and legalizing their capitals. Perhaps it is due to the fact that interests of the legislature and interests of those granted amnesty coincide.

Amnesty was introduced by the Federal Law No. 140-FZ "On Voluntary Declaration of Property and Bank Accounts (Deposits) by Individuals and on Amendments to a Number of Legislative Acts of the Russian Federation" dd June 08, 2015; it became effective on July 01, 2015.

Who it is designed for and who will benefit from the amnesty? Answers to these questions become clear once we clearly realize consequences of participation in the amnesty. We will tell you the truth!

The Way It Works

Amnesty is a voluntary procedure: a person who seeks release from responsibility/liability shall submit to a tax authority a special declaration. It shall be filed before December 31, 2015. This term is preclusive which means that if you failed to comply with it you won't get release! The declaration shall be filled in by the declarant himself/herself in accordance with the form established by the Supplement to the Federal Law No.140-FZ (hereinafter — Amnesty Law).

AMNESTY IS A VOLUNTARY PROCEDURE: A PERSON WHO SEEKS RELEASE FROM RESPONSIBILITY/LIABILITY SHALL SUBMIT TO A TAX AUTHORITY A SPECIAL DECLARATION. IT SHALL BE FILED BEFORE DECEMBER 31, 2015

What may be specified in the declaration? The declaration may contain data on the following:

1. Property (land lots, other immovable property, means of transport, securities including shares as well as participatory interest and equity units in the charter (contributed) capitals of the Russian and/or foreign companies) owned or beneficially held by the declarant at the date of filing the declaration.
2. Controlled foreign companies (CFC) controlled by the declarant at the date of filing the declaration.
3. Accounts (deposits) with the banks outside the Russian Federation opened by an individual at the date of filing the declaration if an individual has to inform a tax authority at the place of his/her registration on opening and changing details of such accounts (deposits) in accordance with the Federal Law No. 173-FZ dd "On Currency Regulation and Currency Control" December 10, 2003.
4. Accounts (deposits) with the banks if at the date of filing the declaration the relevant individual is recognized a beneficial owner in relation to the holder of such accounts (deposits) as well as description of the grounds for recognizing such individual a beneficiary owner.

The second condition of granting release from the responsibility/liability: connection between the violation of law and:

- Acquisition, use or disposal of the declared property;
- And/or CFC data on which is disclosed in the declaration;
- And/or opening and/or crediting funds to the accounts (deposits) information on which is disclosed in the declaration.

The third condition: the violation of law should take place before January 01, 2015, and no criminal, administrative or tax proceedings shall be commenced against the declarant in relation to the relevant law violation at the date of filing the declaration.

Amnesty covers only individuals, and in case if the declaration contains data on a legal entity's participation in acquisition (generating sources for acquisition), use or disposal of property and/or CFC, the amnesty shall also cover the management and other officials who performed organizational/management or business and administrative functions in accordance with the regulations of the specified entity.

Give me freedom!

Release From Criminal prosecution

As against confession, amnesty does not "forgive" all the sins — it only covers particular ones. Let's see from what liability does amnesty release from. First of all, it is criminal liability.

The amnesty is very specific in such case: the release from criminal liability

shall be granted only in relation to the criminal acts described in Article 193, Parts 1 and 2 of Article 194, Articles 198, 199, 199.1, 199.2 of the Criminal Code of the Russian Federation.

These are so-called "currency", "customs" and "tax" articles of the RF Criminal Code.

Article 193 of the RF Criminal Code provides for the liability for failure to carry our repatriation of currency in the Russian Federation. In accordance with Article 19 of the Currency Regulation Law the residents shall ensure that the foreign currency or Russian Federation currency payable for goods (works, services) transferred to the non-residents is credited to their bank accounts with the authorized banks within the term provided for by the foreign trade contracts (agreements) as well as ensure that the funds paid to the non-residents for the goods (works, services) not imported to the Russian Federation (not received in the territory of the Russian Federation) shall be returned to the Russian Federation. This is called repatriation of currency.

If the specified monetary funds were not received/returned to the accounts opened within the Russian Federation within the specified term and the amount of the non-received funds exceeds RUB 6 mln., then a person shall be criminally liable in accordance with Article 193 of the RF Criminal Code.

There is no clear understanding of what exactly should a person declare to be released from the liability described in this Article. The Amnesty Law does not provide for declaring monetary funds unless they are represented by the deposits of the beneficiary owner. There is an idea that a person should declare an account to which the payments shall be transferred under an international contract. But Article 19 of the Currency Regulation Law states that the resident must ensure that the currency is credited not to any account but to the account opened with an authorized bank. And the Amnesty Law provides for declaring the accounts opened with the banks outside the Russian Federation, i.e. excludes accounts with the authorized banks.

Article 194 of the RF Criminal Code describes the liability for failure to pay customs charges. There is nothing to declare in this case. In case a person declares the property, which was imported to/exported from the customs territory of the Russian Federation in violation of the requirements to pay customs charges (customs duties, levies, VAT), the relevant person who failed to pay the customs duties due before January 01, 2015 shall be released from the criminal liability for such failure.

Articles 198–199, 199.1, 199.2 cover all the variety of crimes related to tax default. In fact, this is the main bonus of the amnesty. In accordance with the specified Articles, evasion of taxes and levies by an individual, entity or tax agent as well as concealment of large amounts of funds from collection of taxes and levies shall be subject to punishment under criminal law. In case if tax default is related to acquisition, use or disposal of the property and/or CFC information on which is disclosed in the declaration, then one can avoid being held criminally liable by declaring the property and CFC provided that the obligation to pay taxes fell due before January 01, 2015.

Administrative Responsibility

The release from the administrative responsibility may be granted under the same terms: administrative infraction shall take place before January 01, 2015 and no administrative proceedings shall be commenced before the same date. The Law offers those willing to get release from the responsibility for the following administrative infractions:

1. Carrying out business activities without state registration as a legal entity or without relevant license (permit) (Article 14.1 of the Code of Administrative Offences of the Russian Federation).
2. Violation of the procedure for dealing with cash and carrying out cash transactions as well as violation of the requirements to use special bank accounts (Article 15.1 of the Code of

Administrative Offences of the Russian Federation).

3. Violation of the term established for filing an application for registration with a tax authority (Article 15.3 of the Code of Administrative Offences of the Russian Federation).
4. Violation of the term established for submitting information about opening and closing an account with a bank or other credit organization (Article 15.4 of the Code of Administrative Offences of the Russian Federation).
5. Violation of the term established for filing a tax return (Article 15.5 of the Code of Administrative Offences of the Russian Federation).
6. Failure (refusal) to submit data required for carrying out tax control (Article 15.6 of the Code of Administrative Offences of the Russian Federation).
7. Gross violation of rules for maintaining accounting records and filing accounts (Article 15.11 of the Code of Administrative Offences of the Russian Federation).
8. Violation of the currency legislation of the Russian Federation and acts of the currency regulating agencies (Article 15.25 of the Code of Administrative Offences of the Russian Federation).

The list of the Articles covered by the amnesty is quite logical, it would be strange to release from the criminal liability for committed crime while not releasing from the responsibility for an offence, which may not be classified as a crime.

Don't pay taxes — and don't worry!

And, finally, amnesty related to tax offence. The Law does not specify under which articles of the Tax Code of the Russian Federation the taxpayer shall be released from liability — it is stated that a taxpayer may be released from liability for any tax offences provided that such offences are connected with acquisition (generation of sources for acquisition), use or disposal of the property and/or CFC information on which is contained in the declaration and/or opening of accounts and/or crediting funds to the accounts (deposits) data on which is represented in the said declaration.

> CONDITIONS ARE MANDATORY — TAX OFFENCE SHALL TAKE PLACE BEFORE JANUARY 01, 2015 AND NO PROCEEDINGS RELATED TO IT SHALL BE COMMENCED AT THE DATE OF FILING THE DECLARATION

And of course conditions which are mandatory in any case — tax offence shall take place before January 01, 2015 and no proceedings related to it shall be commenced at the date of filing the declaration, in particular, no field tax audit (audit of completeness of calculation and payments of taxes in connection with the transactions between the related parties).

Non-repatriation

The legislature decided to increase attractiveness of the tax amnesty by the fact that it not only releases from the liability, but also cancels obligation to return the declared property to the Russian Federation except when at the date of filing the declaration the relevant movable property is situated:

- Within the state (territory) included in the list issued by the Financial Action Task Force on Money Laundering (FATF);
- Within the state (territory) which does not exchange information with the Russian Federation for the tax purposes.

Moreover, the amendments to Article 45 of the Russian Federation Tax Code introduced by the Law are

also a pleasant bonus. Clause 2.1 of Article 45 of the Russian Federation Tax Code formalizes non-collectability of the uncollected taxes if a taxpayer was released from the tax liability for such non-payment due to filing the relevant declaration.

What are the Real Bonuses of Amnesty?

The main bonus of the amnesty for those who will decide to apply for it will be their release from the criminal liability and opportunity not to pay taxes. But let's see in such cases such bonus may really be applied.

Let's consider taxes. We will consider opportunity to get release both from the tax and criminal liability as they are immediately interconnected and the lack of the first type of liability cancels the second.

MAIN BONUS OF THE AMNESTY FOR THOSE WHO WILL DECIDE TO APPLY FOR IT WILL BE THEIR RELEASE FROM THE CRIMINAL LIABILITY AND OPPORTUNITY NOT TO PAY TAXES

The basic tax in which individuals are interested is a personal income tax (PIT) (for legal entities — corporate income tax). Let's assume that in 2013 some individual gained profit from sale of a land lot, the assessed tax amounted to two million roubles, i.e. it may be classified as a large amount of money. The individual failed to pay tax when it fell due, i.e. before April 30, 2014.

It seems that the situation satisfies all the conditions of the amnesty:

- The offence was committed before January 01, 2015;
- No criminal proceedings were commenced;
- The offence is connected with disposal of immovable property;
- And the person has only one thing to do — file a declaration.

But this individual is not entitled to do that because the land lot was sold long time ago and it is registered in the Unified State Register of Real Estate Rights and Related Transactions in the name of another person, and in accordance with the Amnesty Law the declarant is entitled to specify in the declaration only that property which is owned by him/her.

Then may the buyer of the land lot be released from the liability for failure to pay PIT? Even if the buyer has some uncollected PIT, it is very unlikely that the amnesty may help to write it off because connection between an offence and the declared data is a mandatory condition of granting release from the responsibility. But acquisition of the land lot is not considered an income for the purposes of PIT that's why the buyer won't get anything either.

What are other property related taxes? Tax on land or property tax.

Yes, it is possible to get release from liability in connection with these taxes. But, for instance, the 2015 rates of the individual property tax were so minimal that any criminal liability issues connected with failure to pay such tax were very rare.

The same logic shall apply to the movable property or securities.

There is no chance to escape liability for failure to pay taxes imposed on income gained from the sale of any property because at the date of filing the declaration the declarant shall not be the owner of such property.

But it is possible to escape liability for failure to pay PIT related, for instance, to the income gained from leasing out such lot and any other way of gaining income from such property. The main condition is that such way of gaining income shall not imply disposal (sale) of the property itself.

The second moment for which no one would like to be held liable is failure to pay customs charges. However one shall take into account two aspects: a person shall be held criminally liable for failure to pay customs charges only if the relevant debt represents a large amount

of money. Evasion of customs charges payment is recognized to be committed on a large scale if the aggregate amount of the unpaid customs charges exceeds one million roubles.

If the amount is less than one million roubles, then such offence is not recognized to be a crime and such non-payment entails only administrative responsibility which may arise, for example, for non-declaration or inaccurate declaration of goods (Article 16.2 of the Code of Administrative Offences of the Russian Federation) or for failure to comply with the due dates of the customs charges (Article 16.22 of the Code of Administrative Offences of the Russian Federation). The amnesty does not grant release from the responsibility for administrative infractions in the sphere of customs.

Moreover, there is no provision that states that in addition to getting release from the responsibility a person is entitled not to pay the customs charges as in the case with the tax in arrears.

That's why as regards customs charges a person may only be released from the criminal prosecution but he/she will have to pay the relevant customs and, probably, administrative charges.

The criminal liability for non-repatriation has two ambiguities. First of all, it's not clear what is to be declared. The object of offence is represented by the monetary funds. The Amnesty Law does not provide for opportunity to declare any funds except for the deposits on the accounts of the beneficiary owners. It is useless to declare the account with a foreign bank as the Law provides for the liability for failure to credit the funds only to the accounts opened with the authorized bank. Do we have to declare the property, which was sold under an international contract and is related to the non-repatriated funds? The answer is not clear.

As in case with the customs charges we see that such situation implies only release from the liability, but the funds will have to be repatriated, otherwise starting from January 01, 2015 there will arise a liability for non-repatriation not covered by the amnesty.

Release from the liability related to opening and/or credit of the monetary funds to the accounts (deposits) information on which was disclosed in the declaration is the apparent advantage of the amnesty.

Recently the currency legislation tightened the rules of settlement using the accounts opened outside the Russian Federation, and the statutory regulation of such process remained extremely incomprehensible and inconsistent which caused a lot of violation in the sphere, most of which were unintentional. That's why the opportunity to be released from the liability for such offences seems very attractive.

THE RELEASE FROM LIABILITY OF THE PERSONS WILLING TO DECLARE FOREIGN COMPANIES IN RELATION TO WHICH THEY ACT AS A CONTROLLING PERSON SEEMS TO BE THE MAIN IDEA OF THE LAW

The release from liability of the persons willing to declare foreign companies in relation to which they act as a controlling person seems to be the main idea of the Law. Indeed the fact that the controlling persons were afraid that all the taxes and tax arrears for the periods preceding the disclosure would be collected served as a material hindrance for efficient operation of the CFC legislation provisions.

As regards release from the liability of the persons willing to declare foreign companies in relation to which they act as controlling persons, we believe that there is no liability from which the controlling person could be released.

However, the provisions of the Russian Federation Tax Code on controlling companies are applied by the taxpayers

recognized as the controlling persons of the CFC in relation to the foreign companies' income fixed starting from the periods, which commence in 2015.

Therefore, no liability for failure to pay taxes due to the existence of a controlled company could arise before January 01, 2015. The only exception is represented by the income gained from participation in a foreign company, such as dividends and interest. The obligation to impose PIT on such income existed before 2015, therefore there is an opportunity to be released from the liability for failure to pay such PIT.

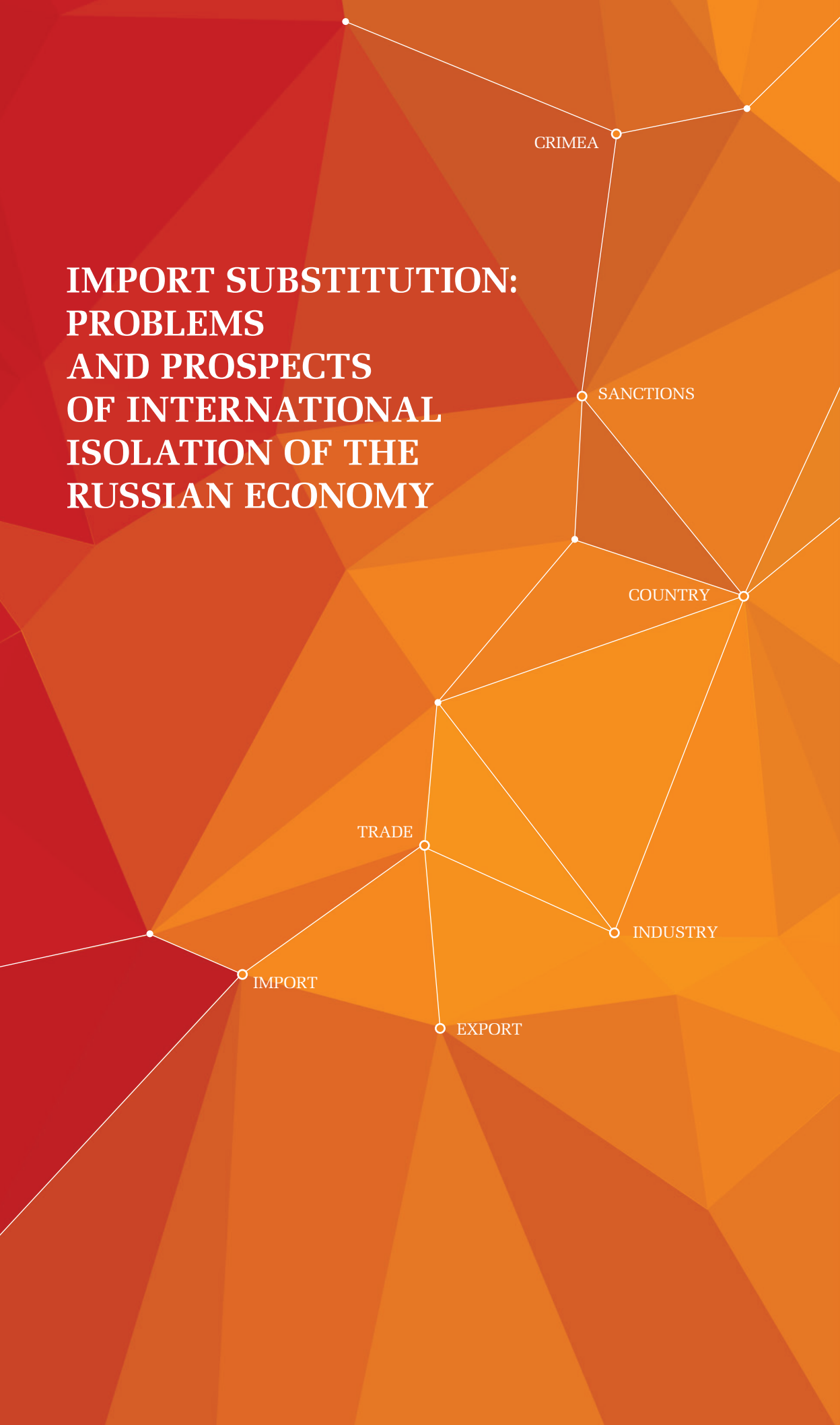
The issue of specifying data on the account (deposit) in relation to which the declarant acts as a beneficial owner in the special declaration is even more fascinating. Clause 2.3 of Article 15.27 of the Code of Administrative Offences of the Russian Federation represents a single provision providing for the liability for failure to disclose information on a beneficiary owner. However, the Amnesty Law does not include this Article in the list of Articles of Code of Administrative Offences of the Russian Federation in relation to which a person may be granted release from the administrative responsibility.

Therefore, in fact, specification of an account (deposit) in relation to which the declarant acts as a beneficiary owner makes sense only for the purpose of obtaining release from liability for failure to submit information concerning opening of the relevant account to a tax authority as well as violation of currency legislation committed using such account. However, at present day the Russian legislation contains no provisions, which would impose relevant responsibility on a beneficiary owner.

Summarizing it should be noted that the whole procedure and content of the amnesty of capital give a thought that the main goal of this project is to collect as much information on the property, securities, accounts and foreign companies as possible.

Of course some of the opportunities provided by the amnesty of capital may be used by the declarant for his/her own benefit. But if we take a closer look we shall see that to a considerable degree it looks like an attempt to receive information from the declarant on a voluntary basis, in most cases in exchange for release from the liability which was never or which may not be imposed on the declarant. A

IMPORT SUBSTITUTION: PROBLEMS AND PROSPECTS OF INTERNATIONAL ISOLATION OF THE RUSSIAN ECONOMY



Olga Kuramshina
Leading Lawyer
Tax and Legal Practice
Korpus Prava (Russia)

Notorious events in the Crimea and in the southeast of Ukraine have caused major changes in European and American economic policy concerning the Russian business and, subsequently and promptly, reciprocal measures on the part of the Russian administration. Development of sanction and countersanction movement has been the main topic for discussion among politicians and housewives over 2014-2015. As for the real business, over the last two years it has been learning to exist and operate by trial and error in the circumstances concerned.

Sanctions against certain persons and organizations such as major Russian banks and state companies are just a tip of the iceberg. Private companies, producing and supplying military, dual-purpose products and other goods, which have been included into sanction lists of importing countries for some reason, have also faced difficulties.

There are cases when organizations, which activities are in no way related to producing military and technical products face prohibitive measures from foreign states. Thus, the reality is that western companies demand representation and warranties from their Russian partners that the latter do not sell or purchase goods, works and services in the Republic of Crimea. Some contractors refuse to sell certain goods to Russian buyers by freely interpreting international legal norms and internal legal acts of their countries. There are also situations when the representatives of foreign companies completely refrain from any contacts with their Russian partners.

In response to western sanctions and acting in accordance with the relevant Decree of the President[1], the Government has imposed a ban on the import of certain types of agricultural products, raw materials and food whose countries of origin are the states supporting sanction policy towards Russia (see table below).

Despite the questionable legal status of both prohibitive measures of western countries (for instance, it is technically impossible to restrict the trade with the Republic of Crimea only by not restricting the trade with the Russian Federation[2]) and the Russian countersanctions,

1. Decree of the President of the Russian Federation No. 560 dated 06.08.2014 On Applying Certain Special Economic Measures to Ensure the Safety of the Russian Federation.
2. Article 8 of Constitution of the Russian Federation guarantees the integrity of economic space, a free flow of goods, services and financial resources. Considering the fact that the same Constitution incorporates the Republic of Crimea into the Russian Federation, no such restrictions will be effective for the Russian company.

Comparison table of sanctions and countersanctions:

Country	Sanctions against Russia	Rear sanctions Russia (food)
EU countries	+	+
USA	+	+
Australia	+	+
Canada	+	+
Norway	+	+
Ukraine	+	+
Albania	+	+
Montenegro	+	+
Iceland	+	+
Liechtenstein	+	+
Georgia	+	-
Moldova	+	-
New Zealand	+	-
Switzerland	+	-
Japan	+	-

restoration of status quo should not be expected anytime soon. Apparently, we will have to adjust to a new reality, which may last for several years.

Import substitution is probably a term, which can be very often heard in connection with any mentioning of sanctions and countersanctions. However, the import substitution issue has been on the agenda of the Russian legislators and law enforcers for a long time. It became a subject of active discussion in the beginning of the 2010s but it has significantly developed only by now.

Imposing western sanctions may be considered the beginning of the new phase of interest towards the import substitution. Then the Russian rule-making has gone "from decree law to legislative regulation" and "from prompt political response to economic efficiency". In this regard, two directions of legal regulation of import substitution have been singled out:

- First, imposing prohibitions and restrictions on the import of certain goods into Russia;
- Second, state campaign to support domestic producers.

Imposing Prohibitions and Restrictions

As mentioned earlier, the first step was the Decree of the President of the Russian Federation On Applying Certain Special Economic Measures to Ensure the Safety of the Russian Federation. This document declares prohibitions and restrictions to foreign economic operations providing the import of certain types of agricultural products, raw materials and food, which country of origin is a state decided to impose economic sanctions towards the Russian legal entities and (or) natural persons or which acceded to this decision, into the Russian Federation[3].

Pursuant to the Decree, the Government has approved the list of products prohibited for import into Russia[4]. It was initially assumed that the Resolution would be effective for one year but the analysts' forecasts came true, it is currently assumed that it will be effective at least until August 05, 2016. In the course of extension of the Resolution, the list of goods prohibited for import has not changed.

3. Article 1 of the Decree of the President of the Russian Federation No. 560 dated 06.08.2014 On Applying Certain Special Economic Measures to Ensure the Safety of the Russian Federation.
4. Resolution of the Government of the Russian Federation No. 778 dated 07.08.2014 On Measures for Implementation of the Decree of the President of the Russian Federation No. 560 dated August 06, 2014 On Applying Certain Special Economic Measures to Ensure the Safety of the Russian Federation.

By the middle of 2015, it became clear that the countersanctions would be extended for another year. At the same time, the Government has decided to tighten control over the implementation of imposed prohibitions and restrictions. The right to confiscate and to make a decision on destruction of "sanction" products has been granted to the following government authorities: the Federal Customs Service, the Federal Service for Supervision of Consumer Rights Protection and Human Welfare and the Federal Service for Veterinary and Phytosanitary Surveillance[5].

In this regard, the powers of customs authorities are still controversial. It is known that since the accession of Russia to the Customs Union the very notion of the border of the Russian Federation for customs purposes has lost its meaning. During the export or import of goods only the fact of transfer (or prohibition of transfer) of goods across the customs border of the Customs Union may have a legal effect. Any prohibitions or restrictions to the transfer of goods across the customs border of the Union may be formally introduced only by the decision of the Customs Union Commission and shall apply to its entire territory but not to the territories of certain states. That notwithstanding, the authorities of the Federal Customs Service detain and destroy the goods imported in violation of the established prohibitions to the best of their abilities (and within the scope of their powers).

As for other bodies authorized by the Government, their activities are related to goods already released for free circulation in Russia. In other words, even the goods legally transferred across the customs border of the Customs Union may be confiscated and destroyed by one of the following authorities: the Federal Service for Supervision of Consumer Rights Protection and Human Welfare and the Federal Service for Veterinary and Phytosanitary Surveillance, if they detect the availability of "sanction" goods in public circulation in Russia.

The Government has stipulated the following terms of destruction of goods:

- The detected "sanction" goods must be destroyed immediately (after preparing the act of detection thereof);
- Decision on confiscation and destruction must be made by authorized officials, which detected not so much "sanction goods" as the "fact of effecting foreign economic operations stipulating the import of goods prohibited for import into the Russian Federation" (in other words, if the goods are available in stock and (or) in public circulation in Russia but the fact of the import thereof is not established (for instance, the forwarding documents and invoices specify that the country of origin is Russia) there are no grounds for confiscation and destruction thereof[6]).

As we can see, the prohibitions and restrictions to import and sales of "sanction" goods in Russia are of rather political and legal nature. Unfortunately, it is possible to speak of appealing the decisions on confiscation and destruction of such goods only in a part of appealing the labeling of certain commodity items as "sanction".

Supporting Domestic Producers as a New Goal of Legislators

During the first year of the "Ukrainian crisis", the Russian legislators did not pay any significant attention to the import substitution, having concentrated mainly on assertion of sovereignty of the Russian Federation. The first legal act concerning the import substitution was adopted in the very end of 2014, it was the Federal

5. Resolution of the Government of the Russian Federation No. 774 dated 31.07.2015 On Approval of the Rules for Destruction of Agricultural Products, Raw Materials and Food Included into the List of Agricultural Products, Raw Materials and Food Whose Countries of Origin Are the United States of America, the European Union Countries, Canada, Australia and the Kingdom of Norway and Which Are Prohibited for Import into the Russian Federation up to August 05, 2016 (and Including).
6. Paragraph 2 of the Rules for Destruction of Agricultural Products, Raw Materials and Food Included into the List of Agricultural Products, Raw Materials and Food Whose Countries of Origin Are the United States of America, the European Union Countries, Canada, Australia and the Kingdom of Norway (and Including) and Which Are Prohibited for Import into the Russian Federation up to August 05, 2016 approved by the Resolution of the Government of the Russian Federation No. 774 dated 31.07.2015.

Law On Industrial Policy, which proclaimed the transition from raw materials export economy to innovation-driven economy, ensuring the defense capability and security of the state, and employment of population as the main objectives of industrial policy[7].

Probably the most important innovation of the law in question is the legislative setting of priority of the Russian goods over foreign goods during public purchases[8]. It should be noted that the purchase of the Russian goods for state and municipal needs has become not a right but an obligation of state and municipal customers. This requirement shall also apply to purchase of goods by legal entities with state participation[9]. Other than that, despite an outright declarative nature of this law, it has become an important stage of lawmaking by having become a springboard for introducing amendments into the other, sectorial and special, legal acts.

Currently the state support (by which we also mean the support on behalf of major government-sponsored enterprises) is also given to the following industries:

- Aviation industry — the Ministry of Industry and Trade has developed the time-schedule of localization of production of such elements as fuselage glazing, AC/DC generation systems, auxiliary power units, flight deck lighting, flight deck oxygen systems and other components for SSJ aircrafts (total 10 items). Currently these components are 100% imported. Partial localization of the production of fuel systems, fire-protection systems, parts of airliner interior and other parts of aircraft (total 12 items);
- Automobile industry — mainly in the course of producing certain parts of KamAZ, Lada automobiles, particularly electrical equipment;
- Construction — in the course of development of engineering solutions and production engineering.

So far, we can only conjecture whether the beneficial effect of import substitution exceeds all difficulties, which the Russian business faced. Apparently, everyone will answer this question for themselves. We will not assume how many years or decades it will take to achieve all goals. Having survived multiple crises the Russian business got used to waiting.

7. Federal Law No 488-FZ dated 31.12.2014 On Industrial Policy in the Russian Federation.
8. Article 18 of the Federal Law No. 488-FZ dated 31.12.2014 On Industrial Policy in the Russian Federation.
9. Federal Law No. 223-FZ dated 18.07.2011 On Purchases of Goods, Works and Services by Certain Legal Entities.

One of the largest law schools in Russia

МОСКОВСКАЯ ГОСУДАРСТВЕННАЯ ЮРИДИЧЕСКАЯ АКАДЕМИЯ

МГЮА

Moscow State University Of Law By The Name O.E. Kutafin

Non scholae sed vitae discimus.

We do not learn for the school, but for life.

Russia, 123995, Moscow, Sadovaya-Kudrinskaya street, 9,
phone: (499) 244-86-35, (499) 244-88-90, e-mail: msal@msal.ru
www.msal.ru

AML 4.0

Irina Kocherginskaya
Managing Director
Tax and Legal Practice
Korpus Prava

Anti-money laundering and anti-terrorism financing methods and forms (hereinafter — AML) have evolved along with the crimes against which they are aimed. Updating these measures and forms is a task that remains in the agenda of both government and non-government organizations of the world. In June 2015 a new, the 4th AML-Directive (Directive 2015/849) was implemented, which has replaced the previous Directive that had been effective for 10 years. It is reasonable to expect that the EU countries will adapt their legal systems to fit the requirements imposed by the new Directive in the coming years, which will result in determining what the effects of change of AML-Eras were in the European community. It is only possible to say so far that the anti-money laundering measures aimed at preventing financial crimes involve a number of restrictive measures, which can hardly have a stimulating effect on economic development. In this regard, it is very important that the benefits brought by AML outweigh the associated costs and restrictions imposed thereby.

The third AML-Directive (Directive 2005/60/EC) included framework regulations while imposing minimal requirements to unification of the national legislation of the EU-countries. This led to the different countries imposing various requirements to contractors due diligence. As a result, the operating effect of the European AML-Legislation was declining. For instance, it was stipulated that the customer due diligence before acceptance must comprise determination of the customer's beneficiary owner[1]. The majority of states have issued detailed rules of identifying the beneficial owner but very often no such rules applied in relation to beneficiary owners of corporate entities the form of which was unknown to a particular legislation. Thus, generally none of the investors from investment funds owns 25% of shares required to acknowledge their beneficiary status; therefore, the fund administrator was not required to identify the beneficiary owner as there was no such owner.

Introduction of amendments into the third AML-Directive was initiated by the European Commission after the Financial Action Task Force on Money Laundering (FATF) issued new recommendations regarding anti-money laundering and anti-terrorism financing in February 2012. The amendments were aimed at unifying the national AML-Rules and ex-

1. Article 8 of Directive 2005/60/EC.

tending the scope of the Directive to new subjects. The 4th AML-Directive applied to the following obliged entities:

- Gambling organizers;
- Estate agents;
- Persons trading in goods to the extent that payments are made or received in cash in an amount of EUR 10 000 or more[2].

The 4th AML-Directive has codified the risk assessment principle as the basic operating principle of the entities obliged to conduct AML-Procedures. The essence of the principle is to compare the extent of risk and the procedures conducted to prevent illegal actions. In execution of the 2012 FATF recommendations prescribing the concerned entities to arrange the identification, assessment, monitoring and AML-risks management processes[3], the 4th AML-Directive introduces the centralized three-tier risk assessment system[4] (Fig. 1).

The new AML-Directive pays a significant attention to cooperation of national financial intelligence units. An obligation to ensure a regular exchange of information related to individuals or legal entities involved in criminal activities, even if the type of a wrongful act is not yet determined at the time of the request, has been imposed on the EU member states[5]. The principle of equivalence of an investigation pursued upon the request of financial intelligence of the other EU member state to the investigation pursued at the national level id enshrined[6]. It has been established that the differences in definitions of financial crimes contained in national laws cannot impede the information exchange. The developers of the 4th AML-Directive tried to level any national differences which may hinder a united anti-money laundering front.

Tax crimes as they are defined in national laws and which entail a deprivation of liberty for not less than 6 months are included into the list of predicate offences, i.e. offences preceding the AML crimes[7]. This means that the subject of AML-legislation, which knows or has grounds to suspect any operation in entailing a tax crime must refrain from performing it. At the same time, it must submit a report on a potential tax crime to the national financial intelligence unit and provide all available relevant information. The third AML-Directive drew a veil over tax crimes by overshadowing them with corruption and drug dealing. However, a so-called carousel fraud, when goods are repeatedly sold from company to company and each time VAT on operation is charged but not paid,

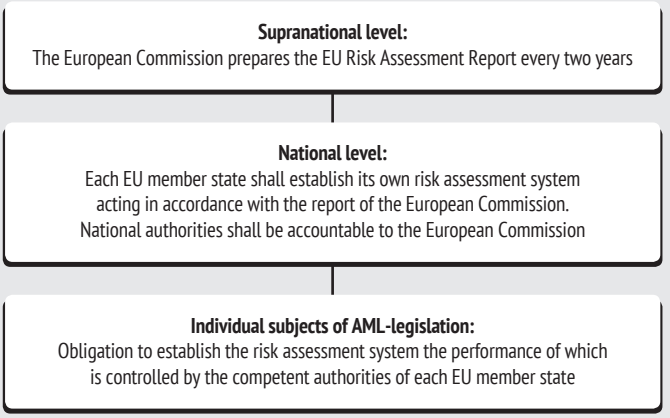


Fig. 1.

2. Article 1 (3) of Directive 2015/849.
3. Art. 2 Interpretive Notes to the FATF Recommendations 2012.
4. Article 6–8 of Directive 2015/849.
5. Article 53 of Directive 2015/849.
6. Article 53 (5) of Directive 2015/849.
7. Article 3 (4f) of Directive 2015/849.

is listed in FATF[8] among other predicate offences[9]. In pursuance of the FATF recommendations entities selling goods for cash have been included into the list of subjects of AML-Legislation.

Perhaps the biggest innovation of the 4th AML-Directive which will affect the largest number of participants in the economic process is the introduction of the centralized system of beneficial ownership information storage. An obligation to arrange the storage of this information in trade register or any other central register so that the information about beneficial owners be accessible to any interested person or entity has been imposed on the EU member states[10]. A study on the actual implementation of the third AML Directive performed by Deloitte in 2012 stated that one of the problems that the subjects of AML-Legislation deal with during the customer due diligence is a lack of publicly available information[11]. Respondents to a survey conducted by Deloitte showed that trade registers of many countries do not contain transparent information on the real owner of the customer. Among other initiatives regarding the improvement of AML-Legislation efficiency a creation of central registers of beneficial owners has been mentioned[12]. The developers of the 4th AML-Directive have followed the recommendations directly given by those who had to work with it. Now all subjects of AML-Legislation shall submit information on beneficial owners of each customer to authorized state bodies, in turn the latter must make this information accessible to all interested persons or entities including public authorities of other EU member states. The rules on personal data protection have been done away with a stroke of the pen — personal data processing in the course of AML-Legislation has been considered a matter of public interest[13], which lifts a ban on the processing of such information without the consent of a personal data subject.

The similar register shall be introduced with regard to beneficial owners of trusts. Trustees shall disclose information on settlor of the trust, beneficiaries, protectors (if any) and other natural persons exercising control over the trust[14] to the subjects of AML-Legislation. Competent authorities of the EU member states shall be granted the right of access to such information and in cases when establishment of the trust results in tax consequences the information must be accumulated in a central register[15].

Central registers shall be established within two years from the effective date of the 4th AML-Directive[16]. During this time, the EU member states must develop and adopt the necessary legal acts, texts, which will be immediately delivered to the European Commission. The latter has assumed a responsibility to prepare a report on assessment of efficiency of interconnected central registers of beneficial owners in all EU member states[17]. By virtue of this report the further legislative initiatives will be developed.

Thus, this summer the EU set a course for unification of AML-Procedures in its member states. It has been decided to improve the efficiency of these procedures by making the information on beneficial owners publicly available. As envisioned by legislators, this measure would help to avoid the cases of deliberate disclosure of false or corrupted information about the customer. The prohibition of personal data processing without the consent of the personal data subject has been sacrificed to Europe-wide anti-money laundering and anti-terrorism financing. What consequences it would entail for jurisdictions providing the establishment of trusts, and for a legal status of the trust in general, will become clear in the next 2 years. It is obvious so far that anti-money laundering in the

8. FATF Typology Report on Trade Based Money Laundering (23 June 2006), p. 1 and p. 25.
9. More information on carousel schemes: http://www.hmrc.gov.uk/manuals/vatfmanual/VATF23540.htm
10. Article 30 (5) of Directive 2015/849.
11. European Commission Final Study on the Application of the Anti-Money Laundering Directive, p. 69.
12. European Commission Final Study on the Application of the Anti-Money Laundering Directive, p. 69.
13. Article 43 of Directive 2015/849.
14. Article 31 of Directive 2015/849.
15. Article 31 (4) of Directive 2015/849.
16. June 26, 2015.
17. Article 30 (10), Article 31 (9) of Directive 2015/849.

form defined in the 4th AML-Directive has come into conflict with the very meaning of the trust structure aimed at preserving the confidentiality of the beneficial owner.

Common law states such as the United Kingdom and Ireland known by their long tradition of establishing trusts will have to implement the imperative norms of the 4th AML-Directive into their legislation anyway. The British Prime Minister D. Cameron has explicitly stated in his letter to the Overseas Territories dated April 25, 2014 that "beneficial ownership and public access to a central register is key to improving the transparency of company ownership and vital to meeting the urgent challenges of illicit finance and tax evasion"[18]. To which the Bermuda Finance Minister replied without prejudice: "If we agree to a public register while our competitors around the world do not, we will put ourselves at a distinct disadvantage, severely damaging our economy"[19]. It is obvious that implementation of norms of the 4th AML-Directive is contrary to economic interests of a number of states; what policy they will pursue in the current situation is a matter of time.

Another fundamental change concerns AML-Procedures performed in respect of customers from non-EU countries. The third AML-Directive provided a possibility of a simplified customer due diligence in case their states apply AML-Procedures equivalent to the procedures applied in the EU[20]. Each EU member state approved so-called "white" lists of states with equivalent AML-Legislation. Each state had different lists and, in view of the said frameworkness of the Third AML-Directive, mostly the simplified customer due diligence was rather conventional. The 4th AML-Directive totally changes the approach: now a unified list of third countries shall be formed by AML-Legislation underdevelopment criterion ("black" list) and approved by the European Commission for the entire European Community[21]. We can see that this has been a trend toward centralization.

The simplified customer due diligence procedure has been rethought. The Third AML-Directive contained a number of conditions subject to which the customer due diligence automatically became optional:

- Customer — a company whose securities are traded on a regulated market of the EU;
- Customer — a company from third country which underwent listing procedure and observes requirements to disclosure of information, equivalent to the EU requirements;
- Customer — a beneficial owner of a pooled account, administered by a Notary Public or an independent person of other legal profession from an EU state (or from third state if its applicable AML-Legislation is equivalent to the EU norms);
- Customer — a national public authority;
- Customer — a pension or other fund that provides retirement benefits to employees if contributions are made through deductions from workers' wages and rights of the depositor are not subject to cession;
- Customer using only electronic money to settle accounts[22].

All these conditions have been transferred to the 4th AML-Directive but the availability thereof does not mean that the customer due diligence is not required. They appear as signs of a potentially low risk upon availability of which the subject of AML-legislation may apply the simplified customer due diligence measures[23] in the new Directive, but not quite ignore it. The final decision on the application of the standard or simplified

18. https://www.gov.uk/government/publications/prime-ministers-letter-on-beneficial-ownership/prime-ministers-letter-to-the-overseas-territories-on-beneficial-ownership.
19. http://www.ft.com/cms/s/0/d26ddcca-7161-11e4-818e-00144feabdc0.html#axzz3nb71IwGz
20. Article 11 (1) of Directive 2005/60/EC.
21. Article 9 of Directive 2015/849.
22. Article 11 (2), (5) of Directive 2005/60/EC.
23. Article 15 (1) of Directive 2015/849.

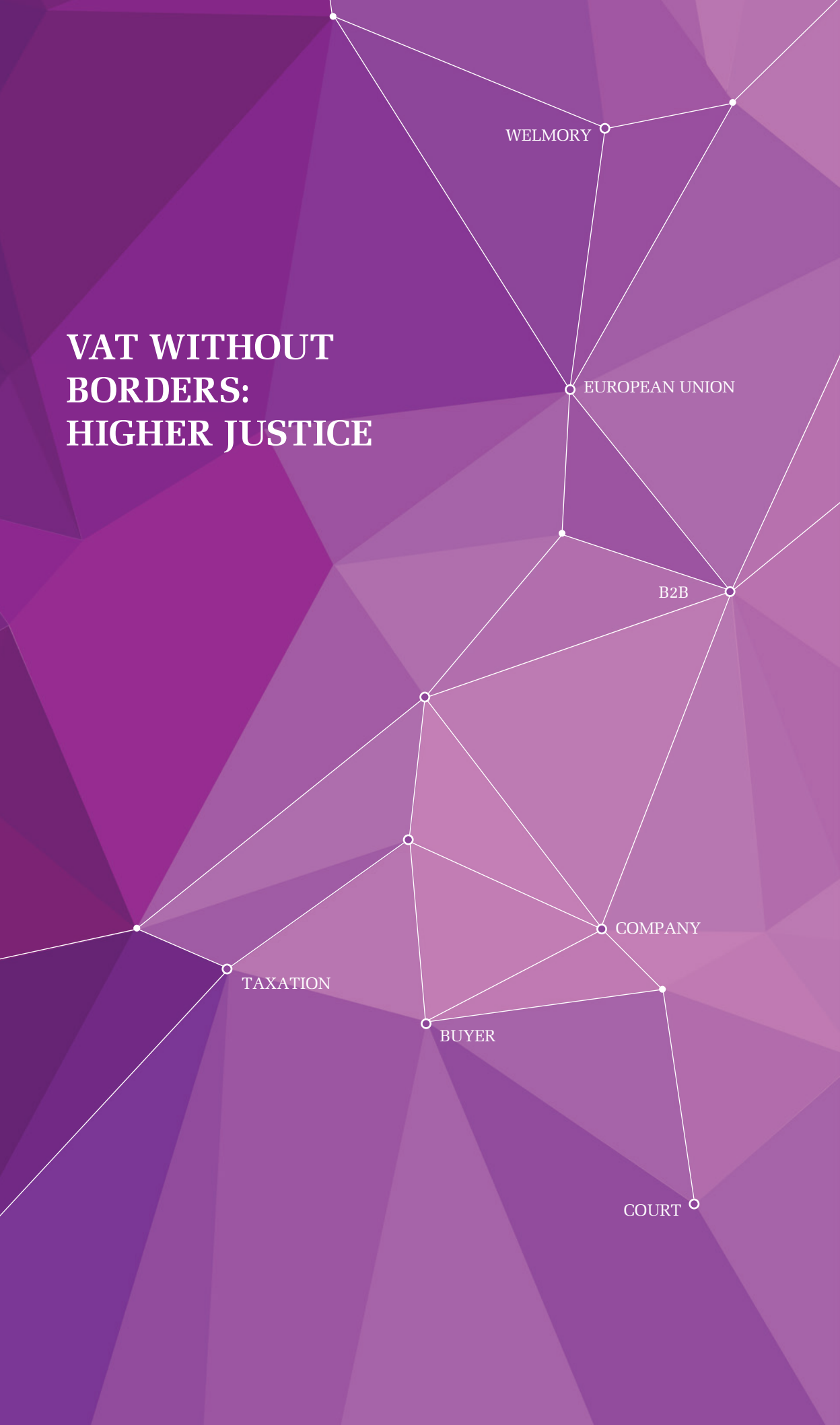
customer due diligence measures must be based on an intuitive risk assessment carried out on a number of factors.

The 4th AML-Directive is characterized by three main trends:

- Centralization and strengthening of the European Commission control over AML-Procedures conducted in each EU state;
- Implementation of the risk assessment principle which requires decisions based on analysis of the entire available information and eliminates the automatic use of certain procedures;
- Creation of an open database of beneficial owners despite the confidentiality of such information.

It remains to be seen how it will operate. We will be able to see the process of formation of a new AML-Era in the European Union. A

VAT WITHOUT BORDERS: HIGHER JUSTICE



Yana Karausheva
Lawyer Assistant
Tax and Legal Practice
Korpus Prava (Russia)

This article continues a series of publications about the system of imposition of value-added tax in the European Union. This issue is dedicated to a number of court decisions adopted by the highest judicial authority of the European Community regarding VAT imposition in 2013–2015.

The unified legislation requires unified application of legal norms within the entire united community, therefore the highest judicial authority — the Court of Justice of the European Union (hereinafter — the CJEU) — is placed at the top of judicial system of the European Union, which is authorized to interpret legal acts of the European Union and make final decisions on legality thereof[1]. Over the last years, the majority of decisions of the CJEU have been made as preliminary rulings, which empower any national court to submit any issue that it cannot resolve independently to the Chamber[2]. Formally, the decisions of the CJEU do not have a binding effect but in practice they are often effective not only for the parties to the dispute but also for third parties[3]. Below is a review of several decisions of the CJEU adopted over the recent years, which may have a significant influence on some aspects of VAT imposition in the European Union.

A Cyprus company Welmory Ltd. (hereinafter — Ltd) ran an online auction and sold packets of bids, i.e. the right to place higher bids for goods than the previous bids. In 2009, Ltd concluded a cooperation agreement with a Polish company Welmory spz. o.o. (hereinafter — Welmory), in the course of which Ltd undertook to run the Polish version of the online auction. For that purpose, the technical resources and personnel of Welmory were to be used. On its part Welmory undertook to render services regarding leasing of servers and demonstration of goods on the website. Goods were sold at the auction on behalf of Welmory. Therefore, the income of the Polish company included two parts: payment for the sold goods and remuneration for rendered services from Ltd. In 2010, the Cyprus company acquired 100% of shares of the Polish company. While issuing an invoice for the services Welmory decided that the place of a B2B operation was the customer's location, i.e. Cyprus (as part of the mechanism of VAT deduction

1. Article 267 of the Treaty on the Functioning of the European Union (Treaty of Rome, 1958).
2. Lang et al (Eds), CJEU— Recent Developments in Value Added Tax 2014, p. 9.
3. C. Baudenbacher, The Implementation of Decisions of the ECJ and the EFTA Court, Texas International Law Journal, Vol. 40, 2005, p. 397.

from the source). The Polish tax authority disagreed therewith having decided that the customer of services rendered to the Cyprus company by the Polish company was Welmory establishment in Poland, therefore the Polish VAT shall be subject to deduction[4] (Fig. 1). The issue on whether the permanent establishment shall be established, if the company uses technical and human resources of the counterparty, located in the other European Union member state in the course of its economic activities was submitted to the CJEU for review.

While identifying the signs of permanent establishment, the Court stated in its decision dated 16.10.2014 that it should be characterized by a sufficiently long and continuous existence and availability of the necessary infrastructure. In the current case this infrastructure must have provided an opportunity to receive and use the services rendered to the permanent establishment exactly in Poland.

However, the Court has not given a decisive answer about whether the permanent establishment of Welmory has been established, having noted that the issues about the fact, namely the availability of signs of permanent establishment, must be reviewed by the national court. According to the Court, if the equipment (server, software) necessary for the operation of the Cyprus company, which is the access of the Polish company to the online auction and the sale of auction applications to Polish buyers, was located outside Poland the permanent establishment was not established. However, the Court has not provided a universal rule in this decision. Nevertheless, the decision affects all economic entities of the European Union which:

- Effect taxable operations in a European Union member state different from their location and do not consider them as operations leading to establishment of a permanent establishment;
- Render services on the provision of infrastructure for conducting business in any other European Union member state without which the

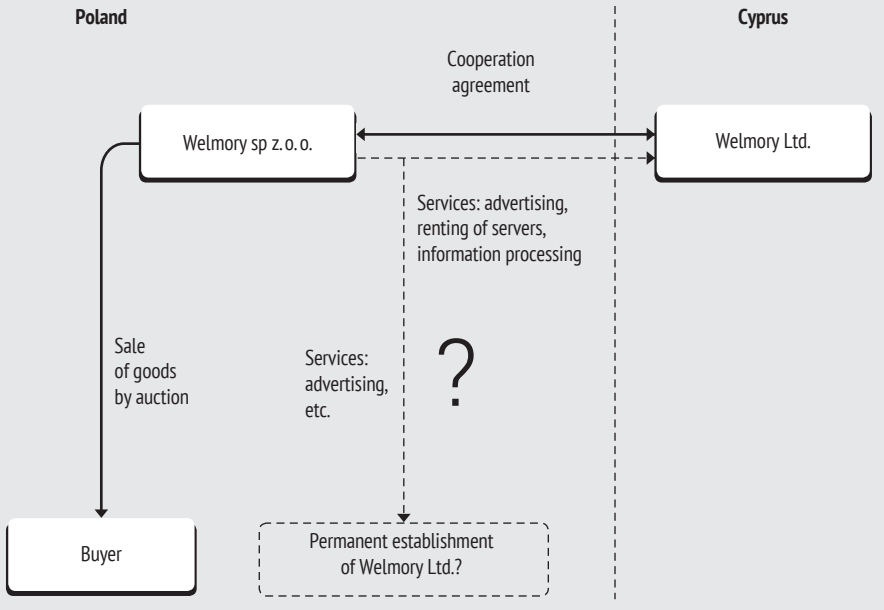


Fig. 1.

4. Welmory, C 605/12.

customer could not have carried out its activities.

Following the decision on Welmory case, it is likely that the national courts and tax authorities will review their position on permanent establishments and the said economic entities might face a duty to pay input VAT in the state where their earlier presence did not matter for the purposes of taxation.

In July 2015, the CJEU issued a decision on two united cases C-108/14 and C-109/14 related to the right to withhold VAT by a holding company. Larentia + Minerva mbH&Co. KG (hereinafter – Larentia + Minerva) rendered administrative and consulting services to two subsidiary companies. Larentia + Minerva reduced the payable tax amount by the amount of input VAT paid in the cost of services for fund raising necessary to acquire the shares of these subsidiary companies. Marenave Schiffahrts AG (hereinafter — Marenave) incurred expenses including VAT in the amount of € 373 347.57 connected with the increase of share capital. In the same year, the Company acquired the shares of 4 shipping partnerships, which it had been rendering management services to. Marenave deducted € 373 347.57 in full as input VAT from the VAT amount payable for the rendered services. In both cases, the German tax authority acknowledged the right of a partial deduction only.

According to the principles of VAT imposition in the European Union, VAT shall be deducted from entities carrying out economic activities[5]. Acquisition of equity stake in enterprises and ownership thereof is not an economic activity by itself[6] and subsequently does not entitle to deduct the amounts of input VAT. Larentia + Minerva and Marenave carried out mixed activities: VAT-free (acquisition of shares of subsidiary companies) and VAT-taxed (services rendered to these subsidiary companies). Therefore, the CJEU raised an issue on what proportion the amount of deduction of input VAT for the services of capital procurement for the purchase of shares must be determined if the holding company subsequently renders taxable services to the subsidiary companies.

The CJEU determined that expenses regarding acquisition of shares of subsidiary companies by the holding company, which is their managing company and thus conducts economic activities, must be charged to expenses incurred in connection with taxable activities. VAT included in the cost of these expenses may be deductible in full.

If the holding company incurred expenses regarding the acquisition of shares of several subsidiary companies but renders management services only to some of them, input VAT may be partially deductible. The Court ruled to divide the input VAT related to economic (management and consulting services) and non-economic (shareholding) activities of the taxpayer. Criteria for determining economic and non-economic activities to which the input VAT is related are left to the discretion of national executive authorities and courts. The specified decision of the CJEU confirmed that the holding company should be entitled to deduct the VAT amounts paid in the cost of expenses regarding the acquisition of shares of subsidiary companies. The input VAT shall be subject to partial deduction if the holding company renders VAT-free services (supply services) to subsidiary companies.

According to the established practice, service operations effected between the head office and a branch within the European Union shall be tax-free[7]. In case C-7/13 the Court reviewed an issue whether the specified principle is applied if the branch is a member of a VAT group in the European Union member state where it is located. Skandia America Corp. (hereinafter — SAC), a company registered in the USA, purchased IT-services for Skandia group all over the world. Subsequently the purchased services were distributed to one of the group-branches, Skandia Sverige in Sweden, which was a member of the local VAT group. The goal of Skandia Sverige was to

5. Article 4 of the Sixth Directive of the Council of the European Union 77/388/EEC.
6. Portugal Telecom, C 496/11, EU:C:2012:557.
7. FCEBank, C-210/04.

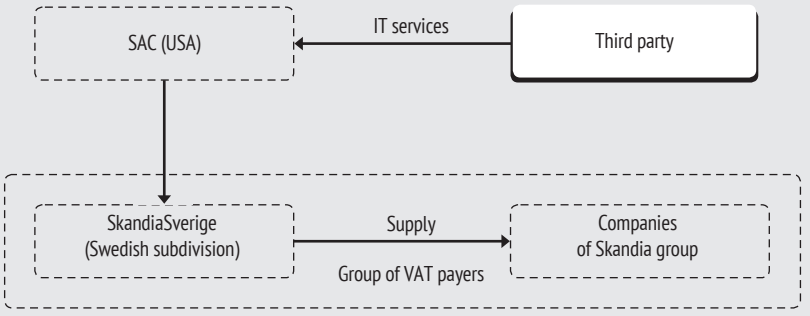


Fig. 2.

use these services in order to receive the final IT-product, which was subsequently delivered to various Skandia group companies — both to those included in the VAT group in Sweden and to those, which are not. Sweden tax authority has registered SAC as a separate legal entity as the VAT payer in Sweden and has charged tax additional payable on IT-service operations between SAC and Skandia Sverige. Skandia Sverige appealed against this decision.

ILLEGAL USE OF PAYMENT SHALL NOT CHANGE THE CLASSIFICATION OF THE OPERATION AS A TAXABLE SUPPLY OF GOODS

The CJEU determined that in a situation when a company, located outside the European Union (or in any other European Union member state), renders services to its branch, which is a member of a local VAT group like Skandia Sverige, the services must be deemed rendered to the group of VAT payers in general as a united economic entity. The head office and the branch must be viewed as one legal entity and the services must be deemed rendered to an independent counterparty — the VAT group, therefore the operation between SAC and Skandia Sverige was deemed taxable. The CJEU confirmed the position of the tax authority. The obligation to pay the tax on this operation was imposed to the buyer — the VAT group as a tax agent as the supplier is located outside the European Union.

The decision on Skandia case will probably have an impact on taxation of all operations between the head office and the branch in the EU member states. Before adopting this decision, the majority of the EU member states had not considered the operations between the head office and the branch as liable to VAT. Now a number of economic operations carried out within a single company are under the threat of being considered taxable. The consequences may be the following:

- Additional VAT amounts payable if the deductibility of input VAT is limited;
- Obligation to issue additional invoices and submit additional reporting;
- Requirement for registration of a separate subdivision of the company as the VAT payer in the country of location thereof.

In accordance with normal practice, theft of goods shall not be considered a delivery for the VAT purposes. In case C-494/12 the Court of Justice of the European Union was asked a question

8. Article 14 (1) of Directive 112/2006/EC.

whether the supply of goods should be deemed taxable, if the payment was effected by a stolen credit card. Dixons Retail plc. (hereinafter — Dixons), the British electrical equipment retailer, concluded agreements with banks under which Dixons undertook to accept credit cards issued by these banks as means of payment from the client, and the banks undertook to pay the cost of goods purchased by this card to the retailer. After declaring and payment of VAT Dixons applied for refund of VAT amounts on sales in the amount of £1.9 mln., the payment of which had been effected by stolen credit cards, from the budget. The application was based on presumption that the person who used the credit card as a result of fraud could not provide a legal consideration for the goods, thus the operation was equated with theft. Dixons position was that the supply had not been performed in this situation, therefore, VAT shall not be imposed on this operation. HM Revenue & Customs refused the recovery.

The CJEU decided in disfavor of Dixons. The Judicial Chamber decided that the statutory definition of supply of goods as a transfer of a tangible asset to the other person/entity, which results in enabling that person/entity to dispose of it as owner[8], carries objective but not subjective signs. The definition of supply is used regardless of the objectives of participants of the operation or the results thereof[9]. Illegal use of payment shall not change the classification of the operation as a taxable supply of goods: Dixons delivered the goods to the buyer voluntarily and for remuneration. The fact that the seller received the payment for goods not directly from the buyer but from a third person cannot change the amount of payable tax.

9. Optigen and Others, C 355/03 and C 484/03.

About the Company

Korpus Prava was established in 2003 in Moscow, Russia. Together with our offices in Russia, Cyprus, Malta, Latvia and Hong Kong we offer clients a truly international service. Our highly qualified and friendly staff is available to provide to the clients a flexible, reliable and efficient service.

The mission of the Company is to raise the business value of the client and bring down risks.

Korpus Prava offers services in:

- Legal and tax consulting
- Transformation of financial statements to IFRS
- International tax planning
- Project consulting
- Corporate services
- Capital transactions / M&A
- Tax disputes
- Economic disputes and bankruptcy
- Real estate transactions
- Intellectual property
- Financial Consulting

Korpus Prava is a member of the Institute of Professional Auditors (НП ИПАР), Franco-Russian Chamber of Commerce (CCIFR) and Cyprus Fiduciary Association (CFA).

The Company is ranked in the leading international directory Legal 500 and the Top 50 law firms in Cyprus.

Korpus Prava is the organizer of the International Conference Eurogate, seminars, workshops and round tables devoted to business restructuring, tax optimization and changes in the legislation.

Since 2004, the Company publishes tax and legal journal for business owners and managers “Korpus Prava. Analytics”. The Company traditionally presents annual tax and legal reviews.

The specialists of Korpus Prava are regularly published in leading media such as “Big Consulting”, “Accounting, Tax, Law” (“Учет, налоги, право”), “Chief Accountant” (“Главбух”), “Business and Life” (“Экономика и жизнь”), “Your tax lawyer” (“Ваш налоговый адвокат”), “FBK” (“ФБК”) and other professional publications.

Contacts

Korpus Prava (Russia)

B. Nikolovorobinsky per., bld. 10
109028 Moscow, Russia
Kommunisticheskaya street, 40, office 602,
630007 Novosibirsk, Russia
+7 (495) 644-31-23
russia@korpusprava.com

Korpus Prava (Cyprus)

Griva Digeni, office 102,
3101 Limassol, Cyprus
+357 (25) 58-28-48
cyprus@korpusprava.com

Korpus Prava (Hong Kong)

Silver Fortune Plaza, Level 19,
Office 1901, 1 Wellington Street
Central, Hong Kong
+852 (39) 72-56-17
hongkong@korpusprava.com

Korpus Prava (Latvia)

E. Birznieka-Upisha Str. 20a,
Office 722
LV-1011 Riga, Latvia
+371 (6) 72-82-100
latvia@korpusprava.com

Korpus Prava (Malta)

Pinto House, 95, 99, 103,
Xatt l-Ghassara ta' L-Gheneb
Marsa, MRS 1912, Malta
+356 (27) 78-10-35
malta@korpusprava.com

Tax & Legal Practice:
Irina Kocherginskaya — kocherginskaya@korpusprava.com

Audit Practice:
Igor Chaika — chaika@korpusprava.com

Corporate Services:
Dmitry Popov — popov@korpusprava.com

Business Development Division:
Aleksandra Kaperska — kaperska@korpusprava.com