Korpus Prava

#3 / Autumn, 2016

Analytics

Tax & Law Journal for Top Executives

Round 1: CRS vs FATCA

Co-publisher

CRS: Draft Law Overview

FATCA: The US Tax Octopus and Its Worldwide Tentacles

Russia VAT Overtakes Modern Times

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Dear readers,

The autumn has come, the last leaves are falling off, and the weather does not always bring joy... The warmth, a cup of hot tea and interesting reading become more and more attractive for us.

Just like the leaf fall every autumn strikes by the variety of colors, the next issue of "Korpus Prava.Analytics" presents its readers a palette of relevant legal information.

This autumn issue is dedicated to CRS and FATCA. Due to the multilateral agreement of the competent authorities on the automatic exchange of financial information, starting from December 31, 2018, the automatic exchange of tax information will be based on the Standard for Automatic Exchange of Information on Financial Accounts (Common Reporting Standard (CRS)) developed by the OECD. This standard specifies content and technical details of the information exchange process. In the pages of our magazine, you will learn about some significant changes that are to be developed and introduced in the legislation of the Russian Federation this year.

Irina Otrokhova, our lawyer, tried to give the reader a basic understanding of the principles of tax information exchange within FATCA, as well as to familiarize with the existing models of intergovernmental agreements and mechanisms of tax information transfer. Is there any chance to hide information about oneself?

We continue to acquaint you with the innovations in the Russian legislation. Yana Karausheva, our junior lawyer, will tell how the Russian VAT keeps up with the time, what new rules of VAT taxation are to emerge in 2017 and what consequences they have for foreign organizations.

Why there is a need to introduce new legal constructions of contracts in the Russian Federation legislation, including the constructions of an option contract? How life insurance abroad can help you in Russia? Why Hong Kong is a new haven for Russian mutual funds? We are pleased to provide you answers to these difficult questions.

Enjoy your reading and see you in the pages of "Korpus Prava.Analytics"!

Artem Paleev
Managing Partner
Korpus Prava


a hot stove

Founder and Publisher

Korpus Prava
Law & Tax

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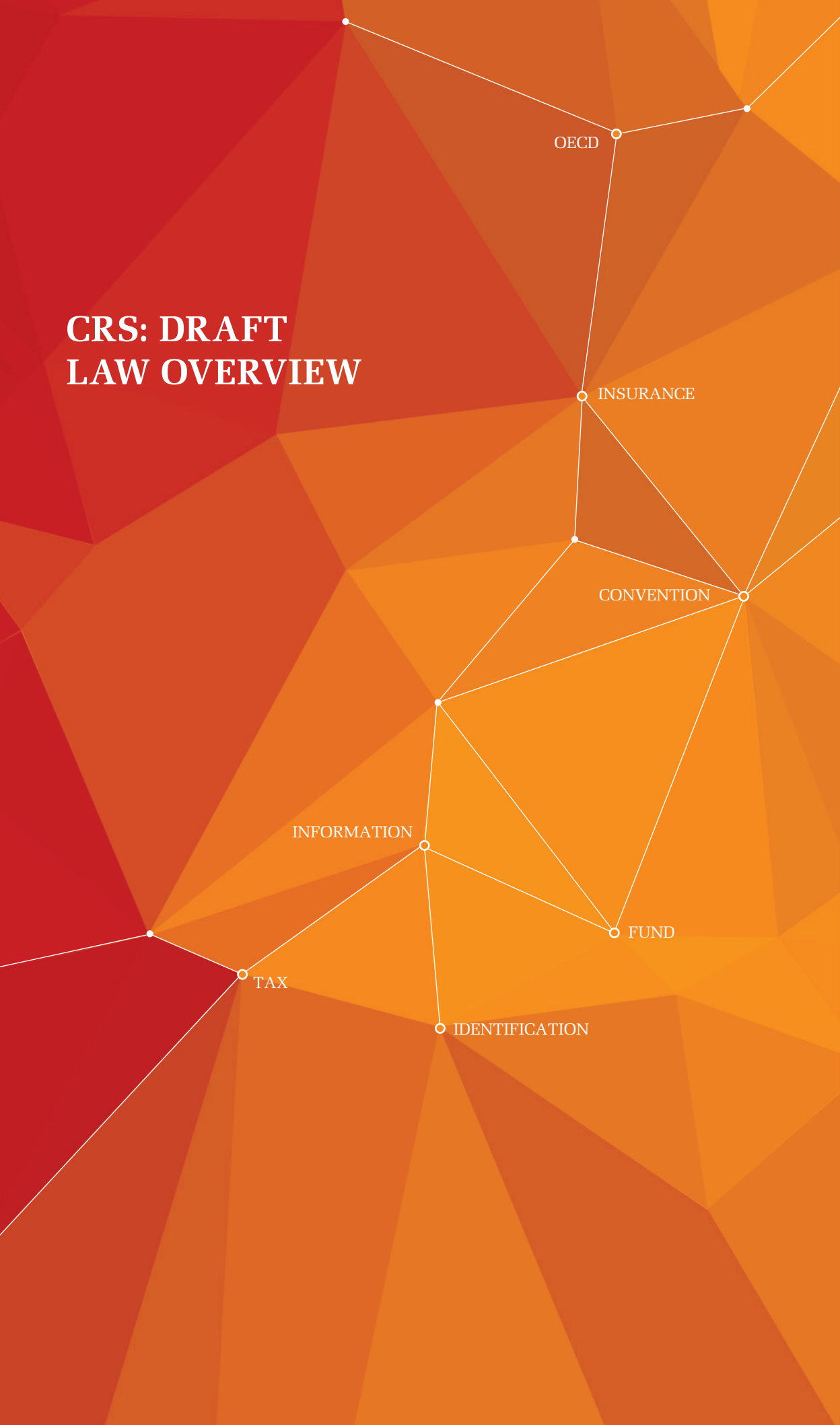
CRS: DRAFT LAW OVERVIEW



Anna Senchenko
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On November 4, 2014, Russia has ratified the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters. The Convention, which entered into force in the territory of the Russian Federation on July 1, 2015, provides a legal basis for all kinds of tax information exchange among its members:

- on request;
- proactive;
- automatic.

The Convention includes Article 6, allowing the parties to exchange information automatically, which allegedly is important for the administration or enforcement of laws relating to the taxes, to which the Convention applies. At the same time, in accordance with the Convention such automatic exchange requires a separate agreement between the competent authorities of the parties. Multilateral agreement of the competent authorities on the automatic exchange of financial information (hereinafter, the Multilateral Agreement) constitutes such agreement.

The implementation in practice of the Multilateral Agreement means that the automatic exchange of tax information will be based on the Common Reporting Standard developed by the OECD, which establishes the content and technical details of the information exchange process.

In implementing the obligations under the Convention, accession to the Multilateral Agreement shall begin from December 31, 2018.

In connection with the accession to the Multilateral Agreement, in the current year the Russian Ministry of Finance in conjunction with relevant agencies will develop and introduce the necessary changes to the legislation.

The Multilateral Agreement is a framework agreement, which validity begins after the entry into force of the relevant local legislation with regard to the requirements for the protection of personal data and confidentiality of information.

The local legislation of the Russian Federation shall set the following requirements with regard to:

- Identification procedures;
- Reporting to the Russian Federal Tax Service;
- Responsibility for violation of requirements of the Standard;
- Availability at the financial institutions of forms of documents aimed

at compliance with the requirements of the Standard.

The draft federal law "On Amendments to Part One of the Tax Code of the Russian Federation (in connection with the implementation of the international automatic exchange of information on financial accounts documentation for international groups of companies)", published on September 6, 2016, has been developed to ensure compliance of the Russian Federation with the conditions of the Multilateral Agreement.

If adopted, the draft law will come into force in the part relating to the exchange of information from January 1, 2017, which allows the Russian Federation fulfilling the requirements of the Standard from the year 2018.

The draft law establishes the obligation of the financial market organization in connection with the automatic information exchange to submit to the Federal Tax Service:

- information on clients, beneficiaries and (or) persons directly or indirectly controlling them — tax residents of foreign states;
- financial information on these persons;
- other information related to the agreement executed between the client and the organization of the financial market for the provision of financial services.

The draft law establishes the following list of organizations related to financial market organizations:

- credit institution;
- the insurer, operating on voluntary life insurance;
- professional participant of the securities market, performing brokerage and (or) securities management and (or) depository activities;
- administrator under the trust agreement;
- private pension fund;
- equity investment fund;
- investment fund, mutual fund and private pension fund management company;
- clearing organization;
- managing partner of the investment company;
- other organization or entity without legal personality, which within the framework of its activities receives money or other property from clients for storage, management, investment and (or) execution of other transactions to the benefit of the client, either directly or indirectly at the cost of the client.

Financial information includes the following information:

- on transactions, accounts and deposits of clients;
- on the amount of the insurer's obligations under the contract of voluntary life insurance to clients of financial organizations or beneficiaries;
- on the amount and value of property held by the financial market organization in accordance with the agreement on brokerage services or trust management in the organization of the financial market;
- on the value of property accounted by the organization of the financial market, carrying out depository activities;
- on pension accounts;
- on the obligations of clearing organizations;
- on payments and transactions in connection with accounts and deposits, contracts of voluntary life insurance, trust management (including those certified by the issuance of an investment unit), agreements on brokerage and custody services, pension agreements, agreements with clearing organizations and other agreements, under which the financial market organization receives money or other property from clients for storage, management, investment and (or) execution of other transac-

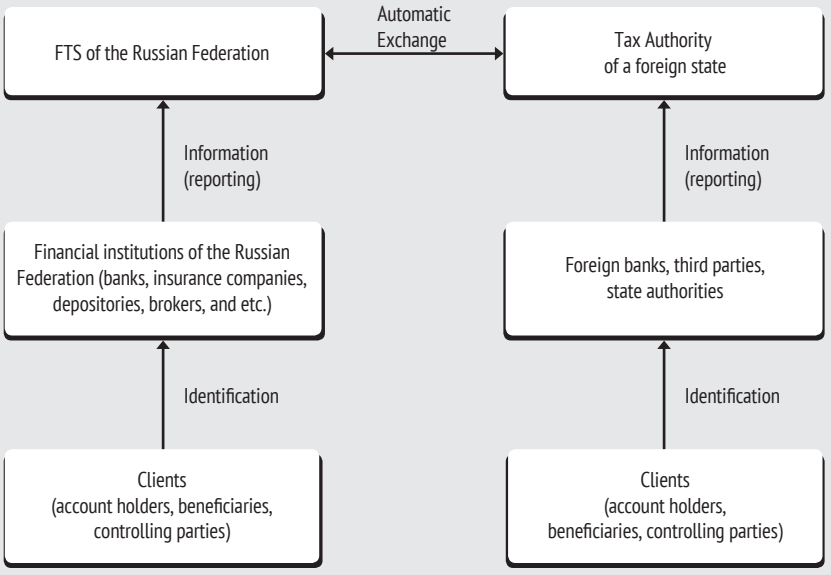

Fig. 1

tions in the interest of the client, either directly or indirectly at the cost of the client.

The procedure and terms for the provision of information by the financial market organization and its structure will be established by the Government of the Russian Federation in coordination with the Bank of Russia.

Measures for the establishment of tax residency of clients, beneficiaries and persons, directly or indirectly controlling them will be defined in accordance with the normative legal act of the Government of the Russian Federation.

The draft law establishes liability of financial market organizations:

- in the amount of 500000 rubles for violating the order, volume and (or) the timing for the provision of information;
- in the amount of 300000 rubles for violating the procedures for the establishment of tax residency of clients, beneficiaries and persons, directly or indirectly controlling them.

At the same time, in case of failure to provide the requested information by the client of the financial market organization, the draft law establishes the right for this organization:

- to refuse to sign the agreement on the provision of financial services with such person;
- to terminate unilaterally the agreement on the provision of financial services.

Thus, the draft law defines the list of financial institutions subject to its requirements, the list of persons subject to the information exchange, the concept of financial information subject to the submission to the FTS by financial market organizations. The draft law also establishes the rights and obligations of financial institutions and their clients, defines the role and functions of the FTS in the process of information exchange and establishes liability for failure to comply with the requirements established by the draft law.

Currently, the draft law is in the process of public debate and anti-corruption expertise.

Most likely, the text of the draft law will be repeatedly updated and adjusted in the course of approval, and at the mo-

ment it is at the initial stage of approval, however, with high confidence we can say that in one form or another the draft law will be adopted and the described provisions, perhaps with some adjustments, will come into force in 2017.

In addition to the considered draft law, a large package of regulations detailing the specifics of information collection for sharing is to be developed, and a technical solution for the exchange of information is to be implemented. Special attention shall be paid to the safety of personal data.

Banks and financial institutions will be required to ensure the functioning of all procedures required in accordance with the CRS, namely, to implement the procedure of identification of new and existing clients and to establish a reporting system on the financial operations of foreign clients to the Russian tax authorities.

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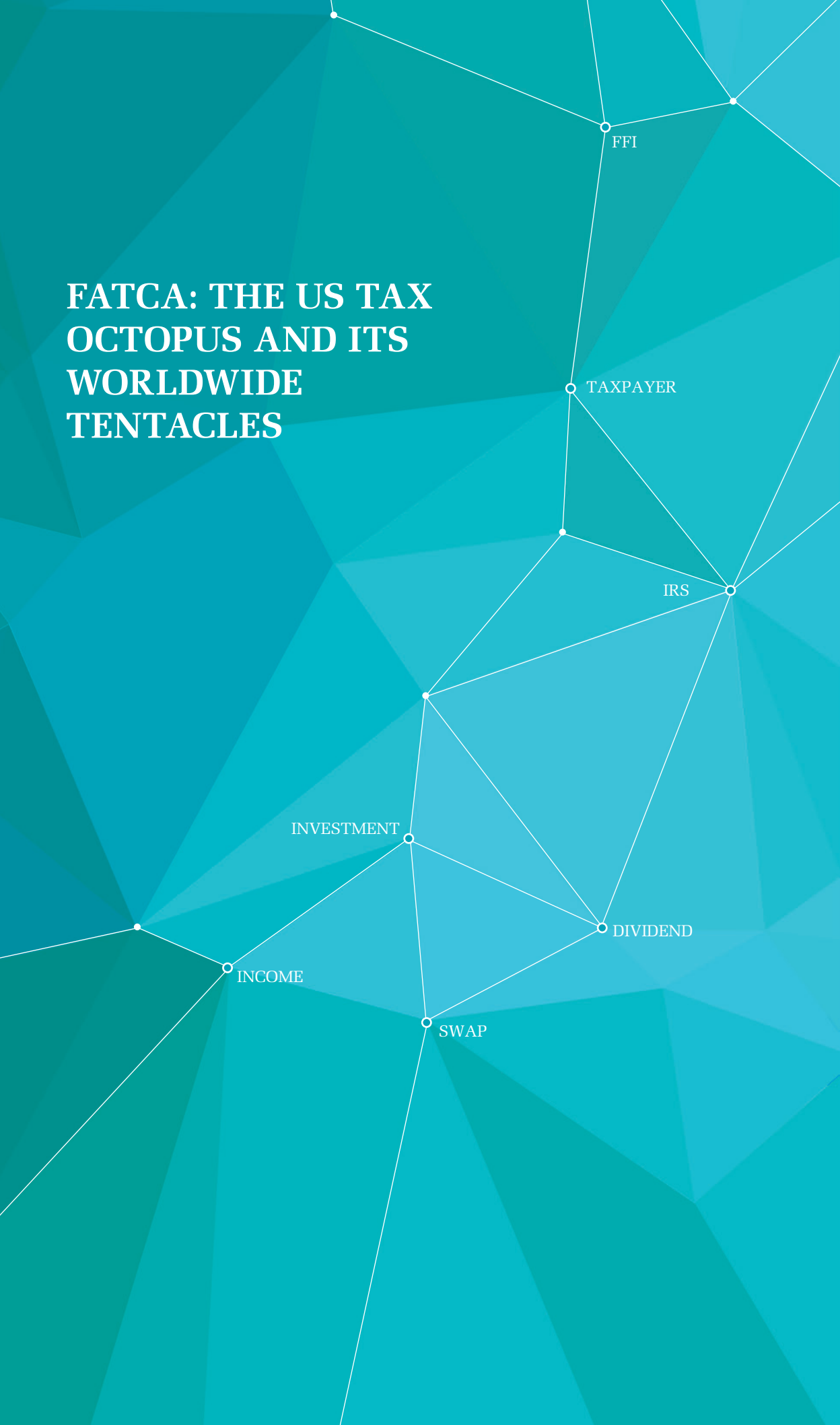
FATCA: THE US TAX OCTOPUS AND ITS WORLDWIDE TENTACLES



Irina Otrokhova
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What is FATCA?

The US Foreign Account Tax Compliance Act (FATCA) is no longer news. The Act was issued in 2010, and after that it survived several revisions and came into legal force on July 01, 2014. The Act was amended even after it had become legally effective, and foreign states one by one began signing tax information exchange agreements.

ALL FOREIGN FINANCIAL INSTITUTIONS (FFI), IRRESPECTIVE OF THE COUNTRY OF THEIR REGISTRATION AND ACTIVITIES, ARE CHARGED WITH THE OBLIGATION TO IDENTIFY THE US TAXPAYERS AMONG THEIR CLIENTS

According to FATCA, all Foreign Financial Institutions (FFI), irrespective of the country of their registration and activities, are charged with the obligation to identify the US taxpayers among their clients and inform the US Internal Revenue Service (IRS) about them. If a client of a financial institution is a person counteracting performance of FATCA requirements (for example, does not provide full information required by FATCA and necessary for determining, whether such client is the US taxpayer), FATCA requires to withhold 30% of income from the American source (interest, dividends, royalties and etc.), transferred to such person, and to transfer the withheld funds to the US Internal Revenue Service (IRS).

For the purpose of acquiring information on taxpayers, the US government has signed the International Governmental Agreements (IGA) with many countries. Two models of international governmental agreements have been developed — Model 1 and Model 2. Model 1 is more commonly used and stipulates exchange of information between tax authorities of the states that have signed the agreement and the US Internal Revenue Service (IRS). That is, Foreign Financial Institutions (FFI) must collect information about the clients being the US taxpayers and transfer it to the tax authority of their state. Model 2 stipulates transfer of information about the US taxpayers directly to the US Internal Revenue Service (IRS). There is also the third

tax information transfer mode that obliges Foreign Financial Institutions (FFI) to adhere to FATCA requirements even in those states, which have not signed the agreement. Such regulation affected, for instance, the Russian Federation, where for the purposes of adherence to FATCA requirements Federal Law No.173-FZ "On Peculiarities of Performance of Financial Transactions with Foreign Citizens and Legal Entities, on the Introduction of Amendments to the Code of the Russian Federation on Administrative Offences, and on the Annulment of Certain Acts of Legislation of the Russian Federation" dated June 28, 2014 has been issued. At present, the agreements within the framework of FATCA have been signed by more than 60 states.

The Main Point of Regulation

While elaborating FATCA, the American lawmakers tried to leave no chance to their taxpayers to hide information about them by defining so-called US Persons. Information about the US Persons, their accounts, as well as any other obtained financial information should be transferred to the US Internal Revenue Service (IRS). For the purposes of FATCA, the following persons shall be recognized as the US Persons:

- US citizens;
- US residents;
- any legal entities (or any other entities),which are established / registered in the USA, in any US state or in the District of Columbia, or which are established / registered / acting according to the legal acts of the USA, any US state or the District of Columbia;
- trusts, if according to applicable legal acts or statutory documents the US court is authorized to issue decrees or make judgments concerning virtually all issues related to trust administration, and one or more US persons are authorized to hold control over all significant decisions of the trust;
- the property of a deceased person, who was the US citizen or resident.

It should be noted that this list is not complete. Foreign Financial Institutions (FFI) must collect a variety of information to determine, whether the client has the status of the US Person. Even if the client has the US telephone number, he/she must inform the financial institution thereof.

The definition of a Foreign Financial Institution (FFI) is the next key moment of the FATCA law.

The following organizations shall be regognized as Foreign Financial Institutions (FFI) for the purposes of FATCA:

- Organizations that carry out banking activities or any other similar activities (Depository Institutions);
- Organizations that carry out custody activities (activities concerning accounting and storage of financial assets — Custodial Institutions);
- Investment Organizations (Investment Entities);
- Specialized Insurance Organizations (Specified Insurance Company);
- Companies being the members of a holding structure of financial institutions.

The abovementioned Foreign Financial Institutions (FFI) must be registered with the US Internal Revenue Service (IRS), where they are assigned a registration number for FATCA purposes (GIN). The report on the US taxpayers should be submitted once a year to the national tax service or to the US Internal Revenue Service (IRS), depending on the mode of submission of tax information.

Notwithstanding the fact that the report is to be submitted only with respect to the US taxpayers, Foreign Financial Institutions (FFI) must collect information on all their clients, including individuals and legal entities that are not the US Persons.

If the Companies are not Foreign Financial Institutions (FFI) or US Persons, for the purposes of FATCA they will be classified as Non-Financial Foreign Enti-

ties (NFFE). Non-Financial Foreign Entities (NFFE) are divided into passive (Passive NFFE) and active (Active NFFE). The main criterion for determining a non-financial entity as the active one, for the purposes of FATCA, is determining the type of income received by it. A company will be classified as Active Non-Financial Foreign Entity (NFFE), if less than 50% of income of the non-financial entity for the preceding calendar year or any other reporting period constitutes passive income and less than 50% of assets of the non-financial entity for the preceding calendar year or any other reporting period are the assets held for the purposes of acquiring passive income.

FOREIGN FINANCIAL INSTITUTIONS (FFI) MUST BE REGISTERED WITH THE US INTERNAL REVENUE SERVICE (IRS), WHERE THEY ARE ASSIGNED A REGISTRATION NUMBER FOR FATCA PURPOSES (GIN)

The US tax legislation contains the following definitions of passive income:

- dividends;
- interest;
- income equivalent to interest, and income acquired from the pool of insurance agreements, if the amounts acquired completely or partially depend on pool profitability;
- rent and royalty (except for the rent and royalty received in the course of active operating activities carried out, at least partially, by the entity's employees);
- annuities;
- excess of proceeds over expenses related to the sale or exchange of property generating income described in paragraphs above;
- excess of proceeds over expenses from transactions with exchange commodities (including futures, forwards and similar transactions), except for the following transactions: i) if such transactions are hedging transactions, and ii) transactions with such commodities are the principal activities of the company;
- excess of income from foreign currency transactions (foreign exchange gains) over expenses related to foreign currency transactions (foreign exchange loss);
- contracts, the value of which is pegged to the basic asset (nominal), for example, derivatives (e.g., currency SWAP, interest SWAP, options);
- redemption amount under an insurance agreement (or loan amount secured by an insurance agreement);
- amounts received by an insurance company for the account of reserves for carrying out the insurance activities and annuities.

In order to determine the type of income of a Non-Financial Foreign Entity (NFFE), it is necessary to refer to national legislation.

Foreign Financial Institutions (FFI) must also collect information on controlling persons of non-financial foreign entities. For the purposes of FATCA controlling persons shall mean individuals that exercise control over an organization. Such persons shall include beneficiaries, including cases when trust agreements are available. When controlling persons are legal entities (e.g., by funds), information about individuals exercising control over such legal entities (for instance, about directors) is requested.

Foreign Financial Institutions (FFI) collect information by sending request for the completion of special forms (Self-Certification Form), as well as special forms of the US Internal Revenue Service (IRS). It should be noted that the volume of the information provided depends to a great extent on the fact, which exactly Self-Certification Form a financial institution

sends. The purpose of a financial institution is to collect the complete volume of information for submission of reports in conformity with FATCA; this however, the Self-Certification Form is elaborated by a financial institution independently. For example, some banks send a detailed form containing the glossary with necessary definitions for the purposes of classification under FATCA, allowing a client to make classification personally. In a number of cases, upon classifying a client as an Active non-financial foreign entity according to FATCA, information on controlling persons is not requested. There is a great number of opposite examples, when banks request information on beneficiaries and the type of income received by a company and after that perform classification by themselves.

The FATCA mechanism is more clearly shown in the following diagram (Fig. 1).

The FATCA legislation has been already distributed worldwide. Its effect extends even to those countries that did not sign the International Agreement (IGA). Surely, first of all it affects the US Persons, but all other persons also have to provide information about them, thus, proving their noninvolvement with the USA. In this article we tried to give the reader the basic understanding of principles of the tax information exchange under FATCA; however, the law itself contains more detailed description of financial institutions, taxpayers' accounts, information on which is subject to submission, as well as description of principles of classifying non-financial entities. By becoming a client of a financial institution, in the most common case — a bank client, either in Russia or abroad, the reader may encounter the requirements of FATCA law face to face. Even not being the US Person, it is necessary to provide exact and authentic information when completing the forms. In practice, the forms for providing the information may contain too much or, which is more often, too little information for understanding one's exact status within the framework of FATCA. In such cases the best option is to refer to specialists. A

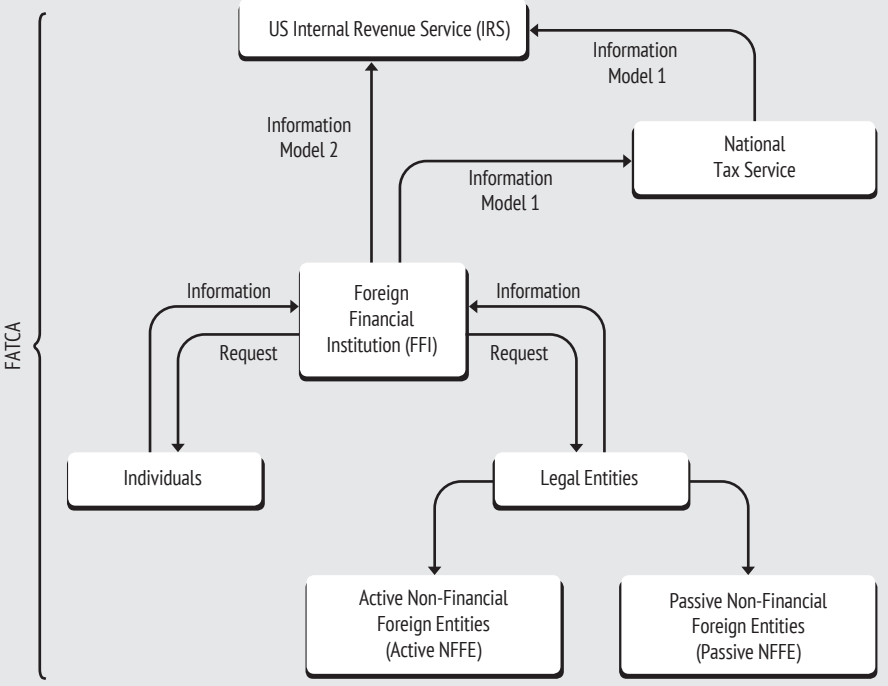

Fig. 1

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PRIVATE WEALTH

HONG KONG: A NEW HARBOR FOR RUSSIAN MUTUAL INVESTMENT FUNDS

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Korpus Prava

For a long time, closed-end mutual real estate investment funds have been an effective legal tool of tax planning, which taxpayers used to defer profit tax or to avoid profit tax completely on quite legitimate grounds. Thus, today there is a quite common practice, when real estate located in the Russian Federation is transferred to the assets in trust of the closed-end mutual investment fund, and nonresident companies, which have bilateral agreements on the avoidance of double taxation with the Russian Federation allowing them to exempt income from the mutual investment funds at the source of payment in the Russian Federation, act as shareholders.

For a long time, companies registered in Cyprus were the most popular for the purposes of participation in the considered scheme. This was due to the fact that under the bilateral agreement on the avoidance of double taxation executed with Cyprus, income from mutual real estate investment funds was recognized as other income subject to taxation only in Cyprus (article 22 of the Agreement). And in accordance with the national law of the Republic of Cyprus, transactions with equities of investment funds are not subject to income tax in the Republic of Cyprus.

However, after Cyprus signed the Protocol to the agreement on the avoidance of double taxation (came into force on April 2, 2012 and became effective from January 1, 2013), Cyprus lost its reputation of an attractive and effective jurisdiction, which could be used for the purposes of structuring ownership of Russian real estate through mutual investment funds. The case is that in accordance with article 3 of the Protocol, income acquired through real estate trusts, mutual real estate funds or similar collective investment forms, established, first of all, for investments into real estate, are equaled to income from real estate. It means that income of a shareholder being the resident of the Republic of Cyprus acquired in the form of interim payment on equities of the mutual real estate investment fund, and also at redemption or sale of such equities is subject to taxation in the territory of the Russian Federation as income from real estate (i.e. at the rate of 20% according to subclause 10 clause 1 article 309 and subclause 1 clause 2 article 284 of the Tax Code of the Russian Federation). It is also confirmed by regulatory authorities in their clarifications (letter of the Ministry of Finance of the Russian Federation No. 03-08-05 dd. January 28, 2011).

After Cyprus receded from its leading positions, Russian business owners were concerned with finding an appropriate jurisdiction, which would be able to replace Cyprus properly, for registration of a shareholder of the Russian mutual investment fund.

For more than five years, the choice balanced among such European countries as Malta, Ireland, Bulgaria and Switzerland. However, none of the said jurisdictions could repeat the success of Cyprus and provide similar tax advantages. The use of the mentioned jurisdictions, certainly, optimized taxation of income from Russian mutual investment funds, but didn't bring it to naught as easily as it was with Cyprus. It is fair to say that in such conditions for some business owners it was more profitable and easier to transfer equities of the fund to an individual being the tax resident of the Russian Federation and pay 13% without creating a foreign infrastructure of their business.

However, the black streak was surely to give way to the white one, and it finally happened. On January 18, 2016 the Russian Federation signed the agreement on the avoidance of double taxation with Hong Kong. The agreement was ratified on July 3, 2016 and shall apply to legal relations from January 1, 2017.

The agreement with Hong Kong expressly answered many questions of Russian business owners, including the question which jurisdiction to use at registration of a shareholder of the Russian mutual real estate investment fund.

This article provides analysis of jurisdictions, which for some time could be seen as an alternative to Cyprus (to various extents of conventionality) prior to execution of the agreement with Hong Kong, and also reveals advantages of Hong Kong.

It should be said that at analyzing and choosing the most favorable residency country for a future shareholder of the Russian investment fund, first of all, the following criteria should be taken into the account:

- this country should have the agreement on the avoidance of double taxation executed with the Russian Federation;
- the agreement on the avoidance of double taxation should stipulate possibility of qualification of income from mutual real estate investment funds in the Russian Federation as other income and absence of need for their taxation in the country of the source of payment of income (in the Russian Federation);
- there should be low tax rates on the tax on profit from such income in the country of residency of income recipient.

It should be also pointed out that in this article by speaking about income from mutual investment funds we imply income in the form of interim payments on equities regularly received by a shareholder.

Luxembourg

The Russian Federation has also signed with the Great Duchy of Luxembourg the Protocol introducing amendments to the existing Agreement on the Avoidance of Double Taxation between the countries, similar to amendments introduced in Cyprus. It came into force almost simultaneously with the Cyprus protocol (30.07.2013). According to the Protocol, income received from equities of mutual funds, established, first of all, for investments in real estate, is equaled to income from real estate. Therefore, income of a shareholder being the resident of the Republic of Luxembourg received from participation in the mutual real estate investment fund in the Russian Federation is subject to taxation in the territory of the Russian Federation as income from real estate (i.e. at the rate of 20%).

The United Kingdom

The United Kingdom is a quite attractive country for the purposes of taxation. Thanks largely to the fact that it has bilateral agreements on the avoidance of double taxation with more than one hundred countries. Companies registered in England are often used as an effective tool for minimizing taxes.

According to the provisions of the current Convention on the Avoidance

of Double Taxation between the countries dd. 15.02.1994, unlike previously considered jurisdictions (Cyprus and Luxembourg), income received from the ownership of equities in the real estate investment fund in the United Kingdom are not expressly recognized as income from real estate.

However, article 21 "Other Income" of the current Convention has a clause, which stipulates that payments from trusts or property inherited due to the death cannot be recognized as other income. In view of the said clause, at first sight it seems impossible to qualify interim payments on equities of investment funds as other income. However, in fact everything is rather different. The term "trust" is a notion of the English law, and the Russian legislation has no such definition. Under the English law, the trust represents an obligation of some trustee to manage property transferred under his/her control for the benefit of third parties (fund beneficiaries), which may include the trustee him/herself and the party entrusting management of the property. In accordance with the Russian legislation, a mutual investment fund is a separate property complex consisting of property transferred by the trustor (trustors) in trust of the management company, provided such property is unified with the property of other trustors, and from the property acquired during such management, and the share in the title for such property is certified by the security issued by the management company (article 10 of Federal Law No. 156-FZ "On Investment Funds" dd. 29.11.01). As we can see, the terms "trust" and "mutual investment fund" are not identical in their legal nature. Moreover, at application by the Russian Federation of the Convention any term not defined in it has the meaning assigned to it in the law of the Russian Federation (clause 2 article 3 of the Convention).

In relation to the abovementioned, we believe that interim payments on equities of the mutual real estate investment fund located in the Russian Federation in favor of the shareholder being the resident of the United Kingdom must be qualified as other income in the country of residency of the shareholder (in the United Kingdom). Profit tax rate in the United Kingdom is relatively low in comparison to other European countries (France, Belgium, Italy, Spain, Germany and other), however, it is much higher than the profit tax in the Russian Federation, equaling from 20% to 25% (the rate amount varies depending on the size of annual net profit of the company).

It should be noted that at present time many experts claim that it is possible to optimize the "Mutual Investment Fund in the Russian Federation — shareholder in the United Kingdom" scheme by using as a shareholder of such form of a legal entity a Limited Liability Partnership (LLP), which members are residents of an offshore zone (for example, British Virgin Islands). According to some experts, it will allow significantly optimizing taxation of the shareholder's income (Fig. 1).

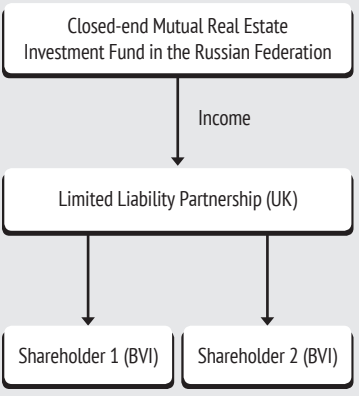

Fig. 1

In the United Kingdom a special feature of such form of a legal entity as LLP is that under the British law income of LLP is not subject to taxation, if its members are not residents of the United Kingdom, do not carry out any activity there, and the commercial activity of the partnership is not carried out in the territory of the United Kingdom, and there are no sources of its income there. In such case members of the partnership must pay taxes in the state of their residency, and given that in the territory

of the British Virgin Islands there is no corporate tax or income tax for individuals, it results in the allegedly tax free organization scheme for the receipt of income from the Russian mutual real estate investment fund.

However, in our opinion, in practice such scheme cannot be implemented due to the following reasons. Within analyzed circumstances, LLP will not be recognized as the resident of the United Kingdom, thus, provisions of the Convention on the Avoidance of Double Taxation shall not apply to it, and therefore income of a shareholder of the Russian mutual real estate investment fund shall be subject to taxation at source of payment in the Russian Federation (clause 6 article 309 of the Tax Code of the Russian Federation). Thus, the use of such form of a legal entity as LLP does not fit the financial activity with the countries, where there is a tax at source of payment, including the Russian Federation.

Netherlands

There is also an Agreement on the Avoidance of Double Taxation executed between Russia and the Netherlands simultaneously with the Protocol to it. Based on the provisions of such Agreement, income received by the Dutch shareholders from the Russian mutual real estate investment funds may be qualified as other income subject to taxation only in the territory of the Kingdom of the Netherlands. In such case, there is no taxation at source of payment in the Russian Federation. In the Netherlands the profit tax rate is differentiated as it depends on the annual size of the net profit of the company and equals 20% (if the annual net profit of the company is less than €200000) or 25% (if the size of the annual net profit exceeds €200000).

In accordance with the provisions of the Agreement on the Avoidance of Double Taxation, it is impossible to qualify such income as dividends because the protocol stipulates that the term "dividends" includes profit transferred from Russia and received by the resident of the Netherlands from participation in joint enterprise with Russian and foreign investments, which for tax purposes is considered a corporate entity or a legal entity (which according to the Russian law does not include the mutual investment fund).

Malta

Governments of the Russian Federation and Malta has signed the Convention on the Avoidance of Double Taxation and Prevention of Tax Evasion in respect of income taxes in Moscow on December 15, 2000, however, until now the Convention has not been ratified by the Russian Federation and has not come to effect (comes to effect in 30 days from the date of the last notice on the fulfillment of national procedures by the Parties).

The Convention on the Avoidance of Double Taxation executed between the Government of the Russian Federation and the Government of Malta does not provide details on the procedures for the taxation of income received from Russian mutual investment funds. Therefore, such income should be also qualified as "other income", which according to the provisions of the Convention is subject to taxation only in the state of residency of the party receiving such income (i.e. in Malta). The profit tax rate in Malta is one of the highest in Europe and equals 35%.

In Malta imputation tax system is applied, and it stipulates possibility of tax refund equaling from 2/3 to 6/7 of the paid tax.

For example, income received from investments is allocated by Maltese companies as dividends. The tax paid by a Maltese company is subject to refund provided such dividends are allocated from income assigned to a foreign account, on which such income accrues. Income assigned to a foreign account means income received outside Malta, for example, dividends, income from capital investments and other. Income from participation in the mutual real estate investment fund is not directly specified, but in our opinion, it will be also accounted on the foreign account of a Maltese company.

Tax refund is calculated based on the tax paid above the required amount in accordance with bilateral agreements on the avoidance of double taxation, unilateral tax reliefs and agreements on the reduction of the income tax within the Commonwealth of Nations. It means taxes paid abroad may also be taken into the account at calculation of the tax refund provided the general tax refund does not exceed the tax amount paid in Malta. If calculated under the flat rate FRFTC, tax refund is calculated on taxes paid in Malta.

If a Maltese company requests the flat rate FRFTC, which under the Maltese tax law is one of the 4 forms of relief from double taxation, any tax refund shall be limited by 2/3 of Maltese taxes, which results in maximum effective tax rate of 6.25%.

Switzerland

Previously, the Agreement with Switzerland was unclear in respect of payments on equities in the mutual real estate investment funds as taxable or exempt income, and also unclear in respect of applied rate of tax at source. Such ambiguity was in a way eliminated by the Protocol to the Agreement, which was signed on September 24, 2011 (came into force on November 9, 2012).

As a result of negotiations between Russia and Switzerland, unlike Protocols to the Agreements on the Avoidance of Double Taxation between Russia and Luxembourg and Cyprus, it was resolved to leave the definition of "income from real estate property" unchanged in respect of taxation of income from mutual investment funds established for investments mainly in real estate property. This is good news for taxpayers because such type of income as income from mutual real estate investment funds is no longer subject to unlimited taxation in the country of origin of such income. In contrast, after the Protocol came to force, such income is deemed dividends subject to taxation at source under applicable rates of 5% from the total amount of dividends (if the company receiving dividends owns at least 20% of assets of the mutual real estate investment fund, and the foreign capital invested in the fund exceeds two hundred thousand Swiss francs) or 15% of the total amount of dividends (in all other cases). It should be noted that any payments on equities of the investment funds (not being real estate funds), acquiring more than 50 percent of their income due to shares, are now deemed dividends.

Article on methods of eliminating double taxation (article 23 of the Agreement) stipulates method of exclusion of double taxation for all types of income taxable in Russia for Swiss residents. If a Swiss company receives income, which in accordance with the provisions of the Agreement may be taxable in Russia, the tax amount in respect of such income subject to payment in Russia may be deducted from the tax charged in Switzerland. Regarding federal taxation in Switzerland, dividends received by a Swiss company are included in the tax base (the effective tax rate on the federal level is 7.8%). Thus, withheld tax at source in the Russian Federation may be accounted at calculation of tax in Switzerland. However, it should be noted that in Switzerland on the level of cantons a company must also pay taxes, and also in certain conditions may have tax benefits and discounts (depending on the canton).

Denmark

The Convention on the Avoidance of Double Taxation executed between the Russian Federation and Denmark (Convention dd. 08.02.96) allows to qualify income of a Danish company from interim payments on equities of the mutual real estate investment funds in the Russian Federation as other income subject to taxation only in Denmark (article 21 of the Convention). However, such state as Denmark is by no means famous for the low profit tax rate, at present time the profit tax rate in Denmark equals 22%. At the same time, the law of Denmark provides opportunity to register and use in their activity companies with zero tax rate. It refers to companies of K/S type, which every year become more popular among business people. Companies of

K/S type represent a partnership consisting of at least two founders, one of which has the status of the General Partner, and other founders have the standard status (Limited Partners).

Danish K/S companies with foreign founders, which do not carry out any commercial activity in Denmark, are not tax residents of Denmark. According to the Danish tax law, K/S company is not regarded as a separate subject of taxation (due to this, K/S company is not assigned with a taxpayer's number in Denmark), and taxes on profit received by K/S company are paid by founders (General Partner and Limited Partner) at place of their residence pro rate to shares owned by them in K/S partnership.

However, another circumstance is also important: as K/S companies are not taxpayers in Denmark, they accordingly are not subject to cross-border agreements on the avoidance of double taxation executed by Denmark. Thus, income of a Danish K/S company from participation in the Russian mutual investment fund shall be subject to tax at source of payment in the Russian Federation.

At the same time, the Danish law gives opportunity to Danish holding companies to transfer dividends received abroad further to their parent company in countries, which have tax agreements executed with Denmark, without any taxation. Given that under the agreements on the avoidance of double taxation there is preferential treatment for the transfer of dividends to Denmark from many countries, a Danish holding company is an efficient tool for using it as a founder of resident companies in other countries (including Russia). However, such scheme is attractive, as it was mentioned before, for the allocation of dividends received abroad. But under the Russian law interim payments on equities of mutual investment funds cannot be recognized as dividends, as it was noted previously.

The Russian Federation and a number of other countries have also executed agreements on the avoidance of double taxation, which at present time came to force and are applied to tax relations of the parties. Moreover, texts of the Agreements with such countries as Latvia (Agreement dd. December 20, 2010), Lithuania (Agreement dd. June 29, 1999), Ireland (Agreement dd. April 29, 1994), Bulgaria (Agreement dd. June 8, 1993), Romania (Agreement dd. September 27, 1993), and Moldova (Agreement dd. April 12, 1996) contain quite similar to each other provisions, according to which income of a shareholder being not a resident from participation in the Russian mutual real estate investment fund should be qualified as other income and should be subject to taxation in the state of residence of the shareholder (income recipient). Only profit tax rates applied in the said countries differ. Thus, the profit tax rate in Latvia and Lithuania equals 15%, in Ireland — 12.5% for trade companies (25% for other), in Bulgaria — 10%, in Romania — 16%, and in Moldova — 12% accordingly.

Hong Kong

As it was mentioned before, from January 1, 2017 the agreement on the avoidance of double taxation executed between the Russian Federation and Hong Kong comes to force, and under such agreement payments from the Russian mutual investment funds in favor of the Hong Kong shareholder shall not be subject to tax at source in the Russian Federation. Regarding taxation in the territory of Hong Kong, corporate tax (profit tax) rate in Hong Kong equals 16.5%. However, only profit received from sources in Hong Kong, so called onshore profit, is subject to profit tax. Therefore, income on the investment equity of the Russian mutual investment fund shall not be subject to taxation in the territory of Hong Kong.

For the purposes of systematization of provided information, special features of taxation of income of companies being residents of the abovementioned countries from participation in the Russian mutual real estate investment fund can be represented in the following table 1.

As it is seen from the carried out analysis of bilateral agreements on the avoidance of double taxation executed between the Russian Federation and other countries, and also from the provided summary table, Hong Kong is the most

Table 1. Special features of taxation of income of shareholders being not residents from participation in the Russian mutual real estate investment fund

No.	Country of registration of a shareholder	Information on the existence of the Agreement on the Avoidance of Double Taxation	Qualification of income from the mutual real estate investment fund under the agreement	Place of taxation of income from the closed-end mutual real estate investment fund / tax rate
1	Malta	Convention dd. 15.12.00 (not enforced)	Other income	Malta / 35% (tax refund from 2/3 to 6/7)
2	Republic of Cyprus	Agreement dd. 05.12.98 (enforced); Protocol dd. 07.10.10 (enforced)	Income from real estate property	Russian Federation / 20%
3	The Great Duchy of Luxembourg	Agreement dd. 28.06.93 (enforced); Protocol dd. 21.11.11 (enforced)	After the Protocol came to force — income from real estate property	Russian Federation / 20%
4	The Kingdom of the Netherlands	Agreement dd. 16.12.96 (enforced)	Other income	Netherlands / 20% or 25% (depending on the annual amount of the net profit)
5	The Swiss Confederation	Agreement dd. 15.11.95 (enforced); Protocol dd. 24.09.11 (enforced)	Dividends	Russian Federation / 5% or 15%; Switzerland (effective rate at the federal level 7.8%)
6	The United Kingdom of Great Britain and Northern Ireland	Convention dd. 15.02.94 (enforced)	Other income	Great Britain / 20%–25%
7	Latvian Republic	Agreement dd. 20.12.10 (enforced)	Other income	Latvia / 15%
8	Lithuanian Republic	Agreement dd. 29.06.99 (enforced)	Other income	Lithuania / 15%
9	Ireland	Agreement dd. 29.04.94 (enforced)	Other income	Ireland / 12.5% or 25%
10	Republic of Bulgaria	Agreement dd. 08.06.93 (enforced)	Other income	Bulgaria / 10%
11	Romania	Agreement dd. 27.09.93 (enforced)	Other income	Romania / 16%
12	Republic of Moldova	Agreement dd. 12.04.96 (enforced)	Other income	Moldova / 12%
13	Denmark	Agreement dd. 08.02.96 (enforced)	Other income	Denmark / 22%

No.	Country of registration of a shareholder	Information on the existence of the Agreement on the Avoidance of Double Taxation	Qualification of income from the mutual real estate investment fund under the agreement	Place of taxation of income from the closed-end mutual real estate investment fund / tax rate
14	Hong Kong	Agreement dd. 18.01.16 (not enforced)	Other income	Hong Kong / 0%

efficient and single option jurisdiction for optimization of taxation of income from mutual real estate investment funds in Russia.

Please, be aware that within the framework of this article we did not consider special features of structuring business using foreign companies related to current requirements of the tax law of the Russian Federation (in particular, requirements on the disclosure of information and taxation of controlled foreign companies, the concept of the actual income recipient) and upcoming automated information exchange (CRS). That is why at making final decision on structuring your business, we recommend you to request preliminary explanations and consultations of experts. A

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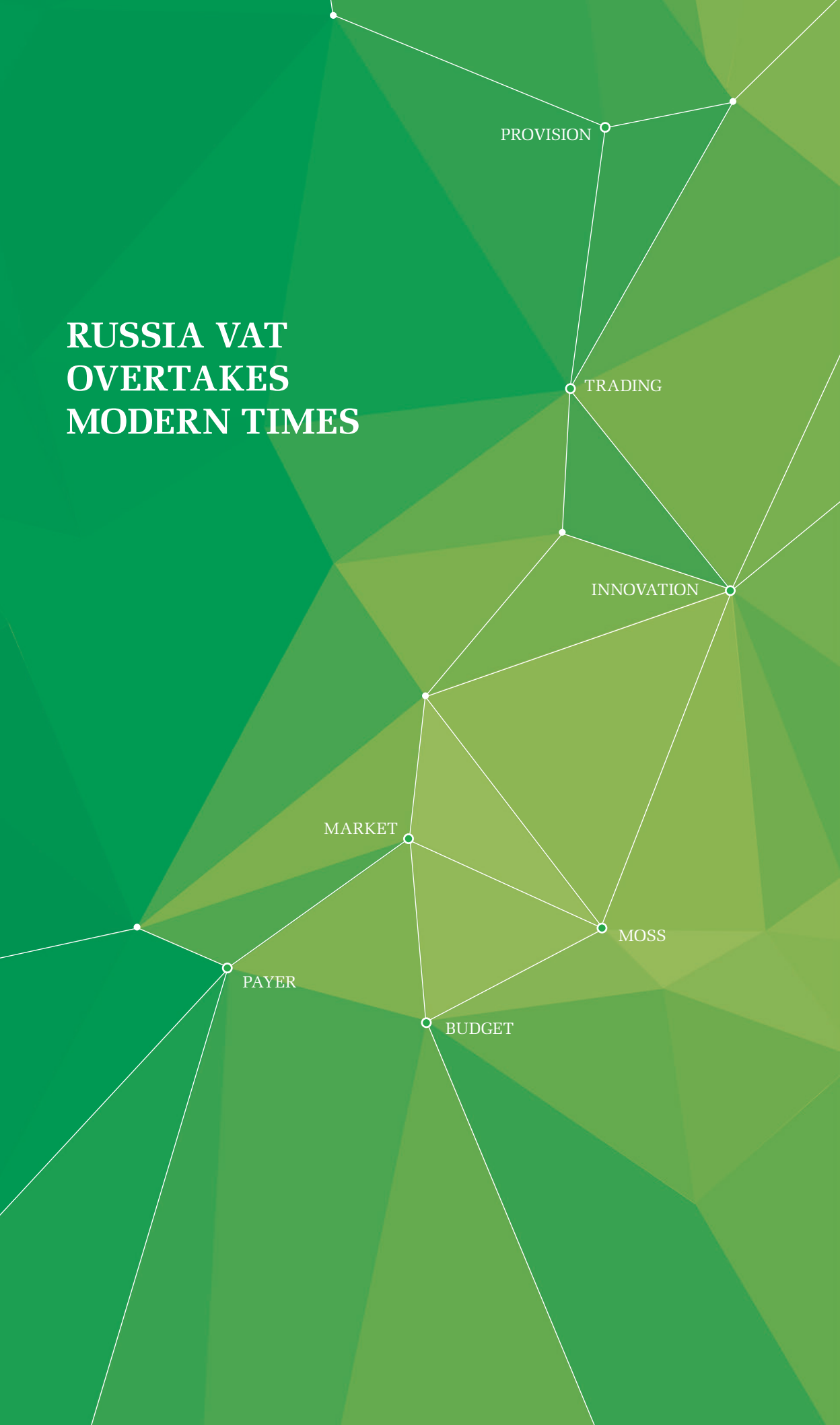
RUSSIA VAT OVERTAKES MODERN TIMES



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Since January 1, 2017, new rules for VAT taxation of foreign entities that provide services to individuals in electronic form or through the Internet (hereinafter, the e-services) come into effect. According to the amendments to the Tax Code of the Russian Federation[1], if a buyer of such services is in Russia, a place of their implementation will be Russia. The list of e-services includes:

- provision of rights to use computer programs and databases, including access to computer games;
- provision of rights to use information in the electronic form (for example, musical works, e-books and other electronic publications, audiovisual and graphic files);
- provision of trading platforms;
- provision of services for search and (or) submission of information on potential buyers to the customer;
- provision of domain names, and web hosting services;
- provision of advertising services on the Internet;
- information storage and processing;
- website administration services.

It should be noted that the sale of goods (works, services) through the Internet, if they are delivered without the use of the global network, is not included in this list[2]. Online stores will exist in the old way.

There are 4 conditions, and compliance with any of them implies the recognition of Russia as the place of services:

- the Russian Federation is the place of residence of the buyer;
- location of the bank, where the account is opened, which the buyer uses to pay for the services, or the operator of electronic money, through which the buyer pays for the services, — in the territory of the Russian Federation;
- the network address of the buyer, used when purchasing services, is registered in the Russian Federation;
- international country phone code used to purchase or pay for the services is assigned to the Russian Federation[3].

1. Federal Law N 244-FZ "On Amendments to Part One and Two of the Tax Code of the Russian Federation" dated 03.07.2016.
2. Paragraph 1 of Article 174.2 of the Tax Code of the Russian Federation, as amended by Federal Law N 244-FZ dated 03.07.2016.
3. Subparagraph 1 of Article 174.2 of the Tax Code of the Russian Federation, as amended by Federal Law N 244-FZ dated 03.07.2016.

New rules for determining the place of sale mean that in the nearest future a lot of foreign entities that provide electronic services to individuals in the territory of Russia will fall under the Russian VAT taxation. The Federal Law dated 03.07.2016 regulates the administrative procedures for tax registration of foreign providers of electronic services, as well as the procedure for cooperation with the Russian tax authorities through the personal account of the taxpayer. There are two "channels" provided for cash inflows from new taxpayers:

- a foreign entity that directly sells the service to an individual is obliged to submit reports on VAT (if such entity is not a direct service provider, and operates under the commission or agency contract, it is recognized as a tax agent);
- a Russian entity or an individual entrepreneur, selling the relevant services to a foreign organization under the agency or commission contract, will have to act as a fiscal agent for the calculation and payment of VAT from electronic services[4].

The tax base is defined as the cost of services, taking into account the amount of tax based on actual sales prices. Since the amount of tax is deemed to be included in the cost of services, the effective tax rate is set at 15.25%, not 18% of the tax base. Foreign entities, which become VAT payers in Russia, will not be entitled to deduction of the input VAT, applied to them at acquisition of goods in Russia or actually payable at import of goods to Russia[5].

These innovations actualize the issue of VAT exemption of transactions involving the transfer of non-exclusive rights to use computer programs and databases on the basis of a license agreement. Currently, there are no official explanations from the Russian state authorities as to which electronic services provided by foreign (or Russian) entities fall under this exemption, and which do not. Let us take, for example, computer games. The Federal Law dated 03.07.2016 expressly states that the right to use the computer game and its other features is the right to use the computer program. Formally, it is enough for the right holder (licensor) to provide the consumer with the introduction text of the license agreement before using the program: clickwrap and browse-wrap agreements, to meet the requirements of the Tax Code of the Russian Federation. However, the sales of the gaming products industry are so impressive that it is more and more annoying for the Russian tax service to provide benefit to the cash flow, which gains momentum year by year. For example, in the proceedings of "Mail.Ru Games" against the Russian Federal Tax Service[6], which ended in September 2015 with the defeat of the Internet company, this rule of VAT exemption has been radically revised. "Mail.Ru Games", as the copyright of free online games, sold additional functionality to the game (weapon or armor for the hero). Proceeds from such sale amounted to about 1.6 billion rubles and was included in the non-taxable transactions as the transfer of rights to the computer under the licensing agreements. The tax inspectorate charged additional VAT on that amount. The court, in turn, came to the conclusion that "consumers had an idea that the purchased additional functionality to the game was the service for the organization of the game process" and so the operation cannot be exempt from VAT on the said grounds. This case shows how ambiguous and shaky is the qualification of such services within the current legal regulation, which clearly delays in its development and does not meet the requirements of the modern market of Internet services.

Foreign entities and their tax agents, being taxpayers from January 1, 2017, will be subject to significant tax risks associated with the described gap in the regulation of the taxation of electronic services. Those who decide to take advantage of the right to benefits could be potentially in a situation similar to the one of "Mail.Ru Games". The Federal Law dated

4. Subparagraphs 3,9,10 of Article 174.2 of the Tax Code of the Russian Federation, as amended by Federal Law N 244-FZ dated 03.07.2016.
5. Paragraphs 5, 6 of Article 174.2 of the Tax Code of the Russian Federation, as amended by Federal Law N 244-FZ dated 03.07.2016.
6. Case N A40-91072/14.

03.07.2016 armed the Tax Code with quite non-virtual weapons and armor.

It is established that a foreign entity will be forced to withdraw from tax accounting in Russia, if this entity:

- provided false information when registering;
- failed to pay VAT, penalties or interest within 12 months from the date of expiry of the payment deadline;
- failed to provide the requested documents to the tax authority within 3 months from the date of expiry of the deadline;
- failed to submit a tax return[7].

Forced de-registration will mean the impossibility for a foreign entity to legally sell its services on the Russian market. VAT penalties and arrears, as a result of which a foreign entity may be de-registered, have no limitation period and are subject to renewal in case of re-registration[8]. However, the taxpayer shall not be able to use a personal account in the year after de-registration, even in case of re-registration. These measures will encourage foreign taxpayers to comply with the applicable Russian law requirements: costs associated with penalties will not allow ignoring the demands of the tax authorities.

Nevertheless, VAT at the buyer's location is no news at all for foreign entities in the Russian market of Internet services. It is not the first time when Russian lawmakers have adopted the foreign experience and implemented it in the domestic law. In the EU, similar rules for determining the place of sale of electronic B2B services operate from January 1, 2015. The company selling e-services to an individual being the resident of the European Union is obliged to pay VAT on the transaction in the country of its residence. It does not matter whether the service provider itself is a resident of the EU or not. For the convenience of taxpayers and tax authorities, a system of remote tax payment - mini One Stop Shop (MOSS) has been developed and implemented. The entity, registered as a VAT payer in any EU state, receives access to the MOSS system in this country and files through it VAT returns on electronic B2B services rendered in all other states of the European Union. The entity, which is not a EU resident, may at its discretion choose the state of the European Union for VAT registration and access the MOSS. Payment for the declared amounts by general payment is sent to the tax authority of the country of registration, which hereinafter independently distributes due amounts among the tax authorities of other states. Thus, the taxpayer is exempt from registration in every EU state, where it sells the specified services. The MOSS system acts as a certain pan-European hub of tax payments, centralizing the collection of VAT on electronic services.

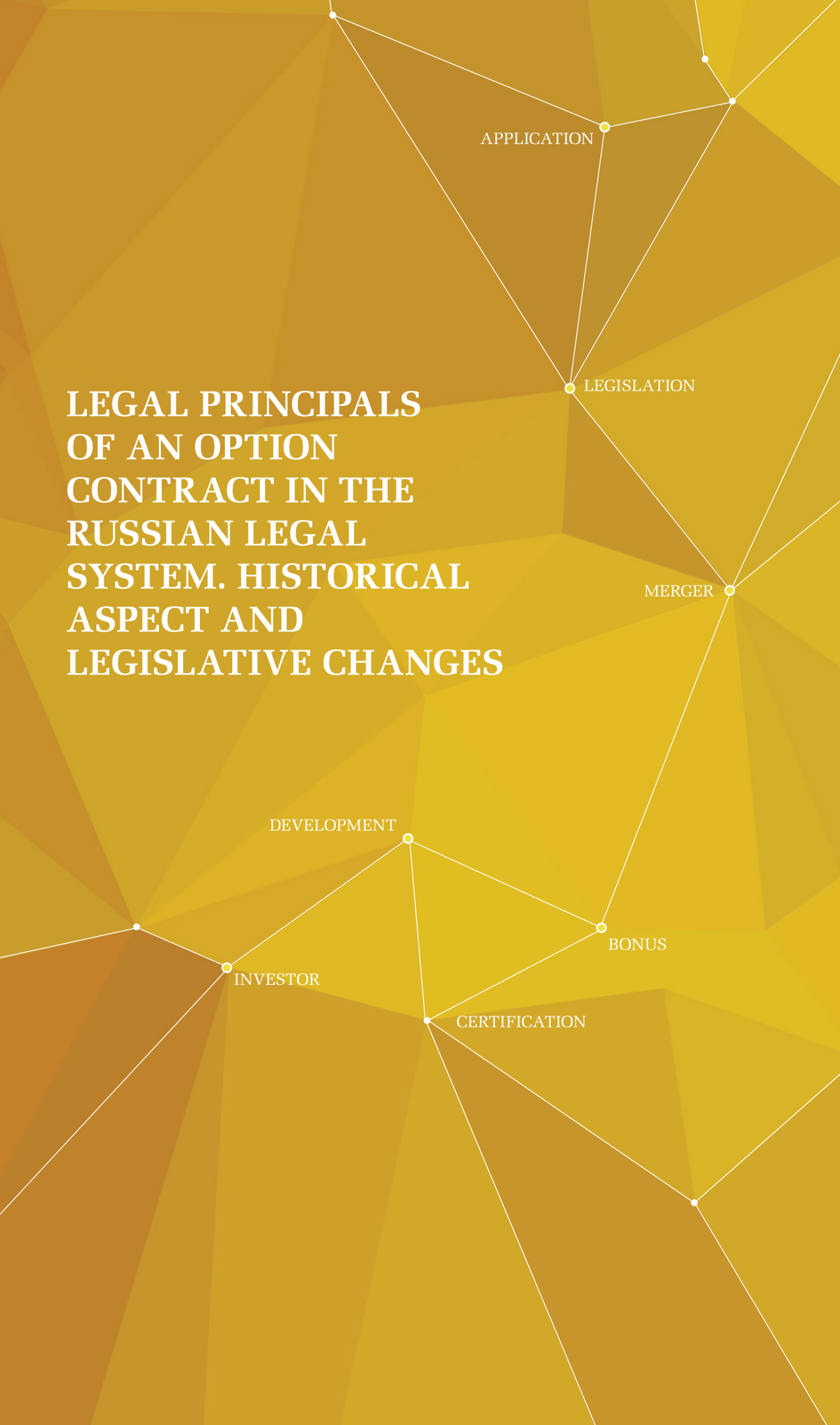
Unlike Russian, the EU legislation does not provide benefits for VAT payment on the transfer of rights to the software under the license agreement, and therefore there is a priori no debate on what kind of electronic services fall within this definition. It is possible that in order to avoid legal disputes similar to the dispute of "Mail.Ru Games" against the Russian Federal Tax Service, the domestic legislator will choose the way of cancellation of the problematic regulation. Otherwise, from January 1, 2017 the number of such lawsuits may increase significantly.

To sum up, it should be noted that the introduction of an obligation for foreign entities to pay VAT on electronic services meets global trends and brings the Russian legislation in line with the modern events. For the majority of "new" VAT payers, this obligation is not unusual: foreign entities will have to use the already gained experience in the Russian territory.

In recent years, the Russian tax legislation faced changes of "a foreign origin". Let us hope that the Russian tax authorities will successfully apply the world experience, and the mechanism will work effectively. And each time the application installed on the mobile device will bring its penny to the budget.

7. Paragraph 5.5 of Article 84 of the Tax Code of the Russian Federation, as amended by Federal Law N 244-FZ dated 03.07.2016.
8. Paragraph 1.1 of Article 59 of the Tax Code of the Russian Federation, as amended by Federal Law N 244-FZ dated 03.07.2016.

LEGAL PRINCIPALS OF AN OPTION CONTRACT IN THE RUSSIAN LEGAL SYSTEM. HISTORICAL ASPECT AND LEGISLATIVE CHANGES



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Under constant development of economics and modern business relations it became urgent to introduce new legal constructions into Russian legislature (which includes the constructions of option contract). Worldwide practice shows that this type of contracts has been constantly used both in business and private life.

Thus, an extensive practice of option contract application has its own peculiarities in the Anglo-American legal system. For example, there is no such legal institution as "irrevocable offer" due to automatic consideration provisions in the legal relations of the Anglo-American legislation (Consideration).

The legal construction of option contract had not been provided by russian civil legislation, although similar constructions were mentioned in some legal regulatory acts, for example:

Russian civil legislation used to have no direct provisions for the option contracts, although similar legal constructions were mentioned in a number of legal acts. For instance, Legal Act #2383-1, dated 20.02.1992, on Commodity Exchange and Exchange trade (no longer in force) contained the term "option agreement" to describe the assignment clause for the transfer of rights and obligations at a later date in respect of exchange commodities. The Directive of the Central Bank of the Russian Federation # 3565-U, dated 16.02.2015, on Entrepreneurial Financial Instruments and the Federal Act # 39-FZ, dated 22.04 1996, on Securities Market also contained the term "option contract" and "issuer's option", respectively.

Additionally, in practice when similar legal constructions were required, a variety of legal mechanisms analogous to those of option contract were applied. Typically, legal mechanism of the preliminary contract was used to replace the option contract, even though legal implications of the preliminary contract were substantially different.

Preliminary contact is a model that is typically used, but it was completely different from option in the matter of the legal consequences. Following are the main differences between the option contract and the preliminary contract:

1. A preliminary contract compels to make, not to perform, the basic/main contract in the future while an optional contact implies fulfillment of its obligations.
2. The subject matter of preliminary contract is to conclude the main contract on the terms and conditions

stipulated by the preliminary contract. The purpose of the option contract is to obtain the right to acquire some assets during the established period in the future.

3. Under the preliminary contract both parties are obliged to enter into the main contract in a certain period of time. Under the option contract it is the Seller (Optioner) who is solely obliged to enter into the main contract while the Buyer (Optionee) has the right to enter into the main contract at his discretion.
4. The preliminary contract excludes any payments in contrast to the option contract that is pecuniary.

Irrevocable offer was another legal mechanism widely used to substitute for the option contract. Despite all the similarities with the option contract, the irrevocable offer constitutes more of a base of the option contract, its "skeleton". Application of this legal mechanism was bound up with a number of legal risks.

Federal Act # 42-FZ, dated 08.03.2015, amended the Civil Code of the Russian Federation by adding two more articles in respect of the option to enter into a contract (Article 429.2) and the option contract (Article 429.3).

The aforementioned amendments that were introduced into the Civil Code led to the problem of differentiation between the two models. To choose the right mechanism one should gain the understanding of their legal nature (Fig. 1).

Under Article 429.2, the option to enter into a contract is an agreement

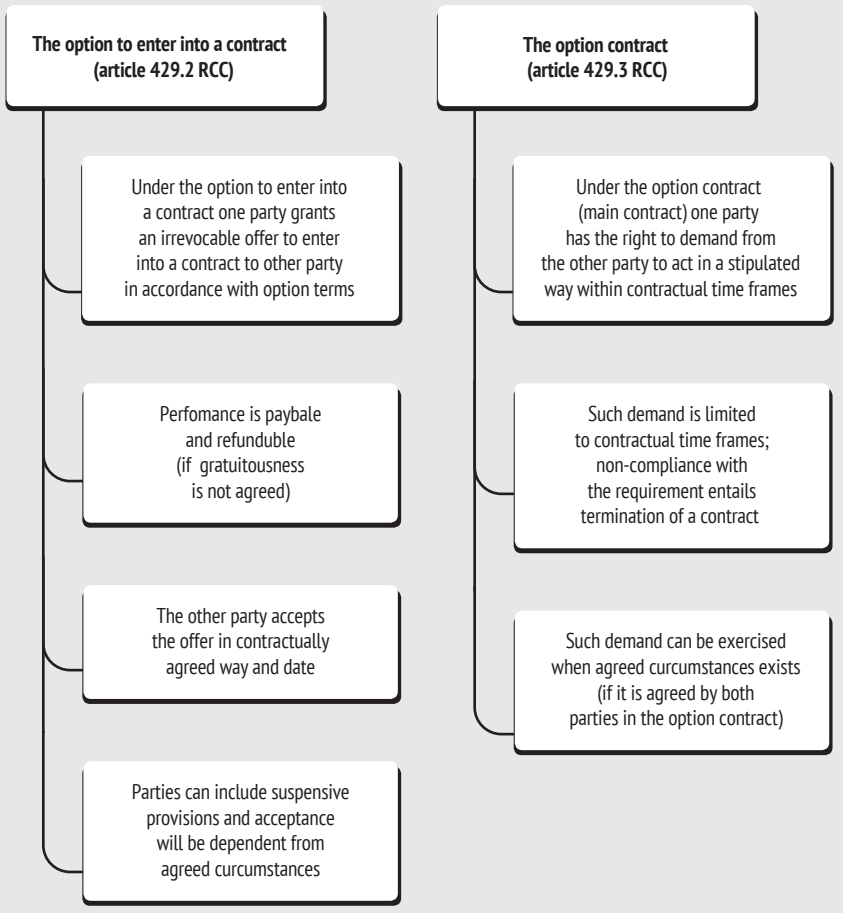


Fig. 1. Main aspects of two Models in Russian Law

under which one party grants an irrevocable offer to enter into a contract and the other party pays the option price. The last provision is an optional clause.

Terms and conditions of the main/basic contract must be integrated into the agreement and such agreement must be concluded in the same form as the main contract. Modern legislation provides for suspensive conditions for the option that depend on the will of the parties.

Special attention should be paid to additional regulations of cession (assignment) under the option: direct legislative provisions set forth the general right of cession (assignment) under the option agreement as well as the right to prohibit such cession (assignment) if a corresponding provision is included into the agreement. Cession (assignment) is also prohibited if it is readily apparent from the essence of the option agreement.

The right of cession (assignment) under the option contract has a very important practical meaning. Failure to include the provision that prohibits cession (assignment) under the option may put one of the parties at a disadvantage (the subject matter of this legal issue will be discussed in section 2 of the article).

The second model — the option contract — is set forth in Article 429.3. Under the option contract (main contract), one party has the right to demand from the other party to act in a stipulated way. Such demand is limited to contractual time frames. Option contract has been covered by the legislator rather briefly. Thus, general rules in respect of obligations contained in the civil legislation should be applied to the option contract.

Option Contract Formation and its Peculiarities with Respect to Shares/Fractions of the Legal Entities

Options are usually used in two forms: Call, which gives the optionee the right to demand from the optioner to sell or convey assets to him at the agreed price and Put, which gives the optionee the right to demand from the optioner to buy or receive assets at the agreed price (Fig. 2).

The most vivid examples of option contracts formed in respect of shares/fractions of the legal entities:

- investment agreements (direct investment and strategic investment) and contracts to formate;
- merger/acquisition;
- loan liabilities;
- bonus award contracts, personnel incentive contracts and other in.

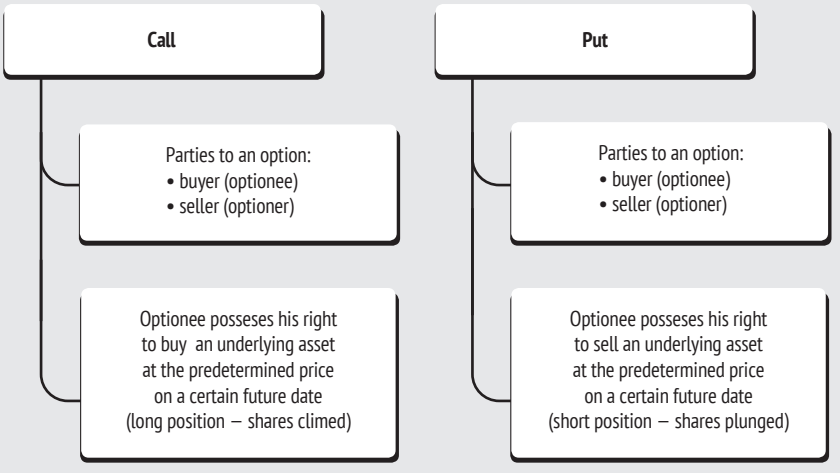


Fig. 2. Call and Put

In case of usage of the model "the option to enter into a contract"(article 429.2 Civil Code), it is crucial to keep in mind the following conditions.

1. Time Clause (Terms)

Parties to a contract practically always specify the agreed period of time. Nevertheless, if such condition is not specified, it equal one year, unless this contradicts the legal nature of the contract or business turnover.

Russian legislation does not provide for legal classification of the time limits under the option contract, still based on the legal experience of foreign jurisdictions option contracts can be divided into two types:

- "American option" (the right can be exercised any time within the term of the option contract).
- "European option" (the right can be exercised on the exact contractually agreed date).

As we can clearly see the model of "European option" contains more privileges for the optionor/grantor and "American option" is more preferable for the Optionee.

2. Option price

One party pays "option price" to opposite party for the right to demand in future. Consequently, payment is made for entering into such an agreement and is not applicable for future payments under the main/basic contract. This payment is not reversionary, that`s why it is usually named "risk fee".

3. Suspensive clause

Penal option is the common example of suspensive conditions used in case of shareholder` agreement breach, changes in management structure, etc.

4. "Covenants" or "restrictive" conditions

The aforementioned problem of cession (assignment) is extremely unfavorable for the Optionee (Buyer) especially when a considerable share holding is sold to a third party without prior notice to the Optionee (Buyer). To overcome this problem an additional restrictive clause ("Covenant") can be included into the contract to restrain the Optioner (Seller) from cession (assignment). Failure to add this clause can put either party at disadvantage. It is a matter of economic relationship between the parties to the contract if to prescribe the restrictive clause: once the Optioner (Seller) is sure of the Optionee's (Buyer's) financial stability, he is not interested in the change of the parties that can cause new risks.

The option contract might contain a clause according to which the Optinee's (Buyer's) consent will be required for the Optioner (Seller) to proceed with the following changes: to amend the articles of association, to enter into a non-arm's length transaction, to dispose of significant assets, to alter share capital etc.

5. Subject matter

The law requires the subject matter of the main contract to be described in such manner that will help to identify the subject at the time of irrevocable offer's acceptance (paragraph 4 article 429.2 RCC).

Options in stock and shares relations become more complicated due to the need of notorial deed. The legislator stipulated that option contractual forms shall be equal to basic/main contract form. In case of the declared type of option this legal requirement (notorial form) is mandatory under article 21 Federal Act # 14-FZ, dated 08.02 1998, on Limited Liability Companies) in terms of transfer of shares in part or in whole to company members or third parties. Consequently, option agreement is subject to notoriety certification; non-compliance with the requirement entails nullity of a contract in accordance with paragraph 3 article 163 RCC.

Another legal innovation provided for in item 11 of article 21: regulates that the disposal of shares (in pursuance of the option to enter into a contract) could be executed by notorization, this notor-

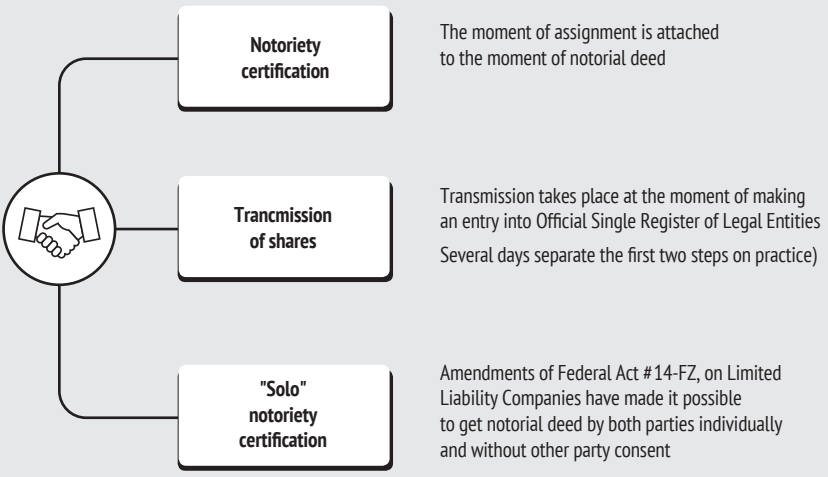


Fig. 3. Special features of options in LLC stock and shares relations

ization can be done individualy without consent of other party.

Such manner is more favorable for seller and provides more secure to buyer. Buyer can exercise his right individually and without any consent (it`s particularly significant in case of long term options).

Options are often applied by strategic investors: during purchase period seller holds his share, which will be sold afterwards on demand by buyer.

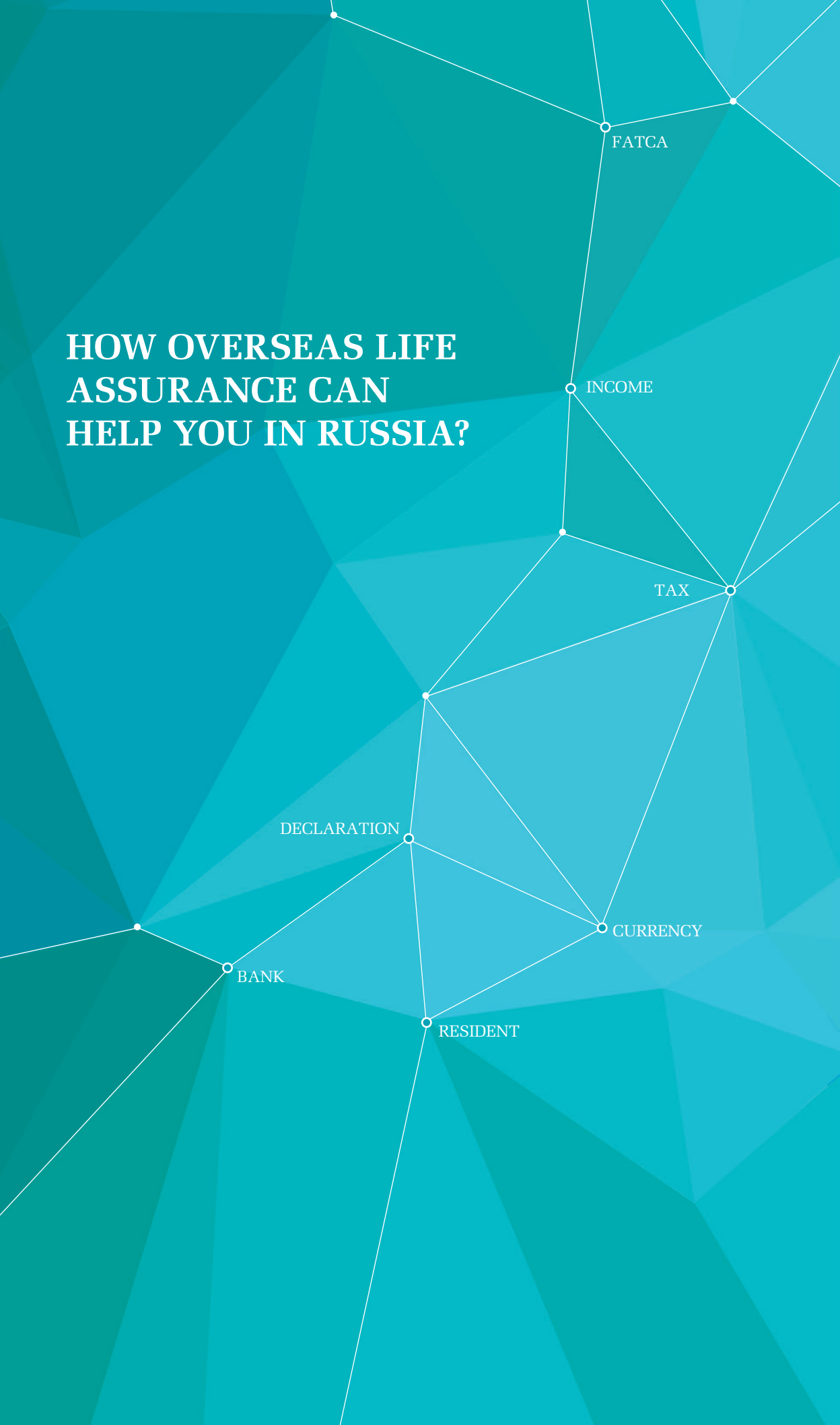
Stock option is a widely spread instrument with some peculiarities in investment field. In this case option is a derivative security, that have derived nature: the security derives its value from underlying assets expressed in the form of securities identified with generic characteristics.

The term "security option" refers to equity security granting its holder the right to buy a certain quantity of shares within a specified period and/or depending on the circumstances determined in security at determined price. "security option" is a registered security.

Attribution of "security option" to investment securities is a controversial point. We hold the opinion that due to the legal nature of option it can not be referred to investment securities, because it creates a right, not an obligation to buy equities (an exchange assets). Moreover, performance takes place only on demand (by option holders). The right to buy securities on its own terms is only a legal prerequisite to investment, but not the investment in principle, implicated inputs with the purposes of property and non-property rights emergence.

On the basis of the above it can be concluded that the introduction of option as a legal notion was of great demand in Russian Law. Option can be used in different fields and relations by various types of contracting parties unless it contradicts the law. The lack of listed restrictions is the doubtless advantage of option model, providing an opportunity to create new legal relationships based on it. A

HOW OVERSEAS LIFE ASSURANCE CAN HELP YOU IN RUSSIA?



Michael Barry
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deVere group

Many Russian residents have assets held outside of Russia for a number of legitimate reasons, mainly for financial planning purposes and the need to diversification away from the Russian rubble. The Russian government has become more aware of such assets and also in recent years more hungry to ensure that tax is paid on these assets by residents who are subject to income tax on their world-wide income, especially in view of the effect of reduced government income due to low gas & oil prices.

Following the Amnesty reporting 2015 rules (voluntary declaration by physical person's assets & bank accounts) and subsequent extension until 30 June 2016 many residents are thinking about declaring such assets. The amnesty exempts an individual from criminal, administration and tax sanctions on assets declared.

It is important with FATCA and common reporting standards that individuals consider the implications of what they invest in not only in terms of performance, diversity and liquidity but they should also consider taxation. Russia has signed up to the Common Reporting Standard Regime from 2017 ready to commence reporting in 2018 meaning that other signatories will report to the Russian Revenue Service assets held abroad by Russian residents.

In addition, many Russians have accumulated wealth within Russia. The local currency is volatile and Russia is an emerging market in which the peaks and troughs can be extreme.

An overseas life assurance policy may be a suitable asset to hold as a long term investment for a number of reasons. The payment of funds from within a Russian bank to such an overseas policy is a lawful transfer of funds abroad under Russian law. This can be done as a lump-sum investment or regular payment for savings purposes.

It appears an overseas life policy with a small amount of life cover (traditionally 1%) is an allowable asset to be held and typically although investment led such policies are classed as life assurance in the main jurisdictions of Isle of Man, Guernsey and Mauritius.

The overseas jurisdictions mentioned have high levels of regulation and most jurisdictions either offer a policyholder protection scheme or insist that assets are held by an independent custodian.

Another fairly unique feature of such products is that they separate legal ownership and beneficial ownership of the underlying assets. The insurance company owns the underlying investments

chosen by the investor which means the assets grow free of taxation in the country where the insurer is based, this is generally known as gross roll up and offers tax-deferral meaning assets should grow more quickly as there is no annual taxation on the insurer. In most countries an insurance policy is also known as non- income producing meaning there is no annual taxation on the interest or dividends within the policy. The policyholder is the beneficial owner of the life policy and therefore will only suffer taxation in Russia when benefits are taken from the policy. In Russia any profits or gains made when taken will generally be subject to taxation at the investment rate of 13%.

Other advantages of life policies include the ability to change the assets within the policy when an individual's circumstances change. So without changing the underlying structure assets can be switched to suit changing circumstances and requirements. As mentioned in the beginning of the article, an overseas life policy allows for diversification and can allow for many assets to be selected including mutual funds, cash, structured notes and shares on a recognised stock exchange. Assets can also be held in different currencies to enhance diversification and performance.

Virtually all overseas life policies are considered portable which means should an individual move to another jurisdiction, then depending on the new country of residence, most of the benefits described above remain.

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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
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- International tax planning
- Project consulting
- Corporate services
- Capital transactions / M&A
- Tax disputes
- Economic disputes and bankruptcy
- Real estate transactions
- Intellectual property
- Financial Consulting

The company is mentioned in the rankings of the leading international directory "Legal 500" that is completely and comprehensively overtaking the global scope of legal services.

Korpus Prava was nominated as the best legal firm in Russia according to the authoritative magazine "The Lawyer"; it takes one of the leading positions amongst Top 50 legal firms in Cyprus, and it has also been recognised as the best international legal firm for tax planning in Cyprus. Korpus Prava Private Wealth Practice has taken fifth place in Private Banking and Private Wealth sector in Russia, in the category of Succession Planning Advice and Trusts according to the annual rankings of Private Banking Russia Survey 2016 of the prestigious magazine "Euromoney" (as of February, 2016).

Korpus Prava is a member of Cyprus Fiduciary Association (CFA) and Franco-Russian Chamber of Commerce and Industry (CCIFR). It takes part in the development of business community, business presentations and the exchange of professional experience.

Our certified specialists conduct seminars and consultations for accountants and the representatives of company financial services; they act as experts, and they are published in popular financial publications.

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