Korpus Prava

#4 / Autumn, 2017

Analytics

Tax & Law Journal for Top Executives

Right After Me…

Co-publisher

МГЮА

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Dear readers,

I am so happy to see you reading the pages of our corporate edition titled "Korpus Prava.Analytics".

The subordinated loan in the Russian law was the focal point of our autumn edition. Our specialist Oskin Aleksey reviewed the legal regulation of the subordinated loans and compared the subordinated and traditional crediting. We will follow up on this topic, as the analysis of ongoing changes to the regulatory and legal framework proves the lawmakers' clear intention to improve the regulation of the subordinated instruments in Russia.

In this edition we have consolidated the topical information for the accountants on the expected introductions and disputable situations happening with the taxpayers. The article by the auditor Svetlana Sviridenkova is a kind of an overview of the questions frequently asked by our readers and colleagues.

Certainly, we have not bypassed the issue of application of a concept of actual right to the income in the international tax relations, as it is still one of the most topical subjects in the tax practice.

Our specialists keep on focusing on the issues related to inheritance. Find and read in this edition the article on introduction of the inheritance fund institution in Russia in 2018, which is a reception from the foreign law institutions.

As before, we show respect for any criticism and suggestions from our readers, and any question or feedback from you is always welcomed. Please contact us in any suitable way and we will do as much as we can to take note of all your requests.

Artem Paleev
Managing Partner
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a hot stove

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RECEPTION OF FOREIGN LAW INSTITUTIONS BY THE RUSSIAN LAW AS EXEMPLIFIED BY ESTABLISHMENT OF THE INHERITANCE FUND INSTITUTION IN 2018

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In its developmental stage the law is affected by historical, cultural, social and other factors, which can be both domestic and foreign. The fact that the Russian Civil Law is relatively young, if compared to the foreign legal experience matured over the centuries, somehow explains the strong influence of the foreign law on the Russian legislation, including entrenchment of many foreign legal patterns.

The sequestration institution, which is one of the institutions of the Russian Civil Law, was borrowed from the French Law. The terms of the sequestration agreement (agreement on custody of a disputable item) stipulate that the both parties shall transfer the item to the third party for custody, unless the dispute is resolved. The agency services institution emerged in the Russian Law under the influence of the English Law (Common Law), which facilitated introduction of the jury trial into the Russian legal procedure, which is now the institution of the judicial system. Legislative recognition of the presumption of innocence in the Constitution of the Russian Federation drew together the ideas of freedom and justice in the Russian and Common Law. Another example of direct borrowing of provisions of the Anglo-American Law is the institution to be introduced in the Russian Law in 2018.

In late July 2017 Russian President Vladimir Putin signed a Decree "On Amendments to the Part 1, 2 and 3 of the Civil Code of the Russian Federation" with regard to establishment of a new institution in the Inheritance Law, the Inheritance Law Institution.

What is the Inheritance Fund in the sense of the Law?

The Inheritance Fund is a fund established in pursuance of the citizen's testament and on the basis of his/her property, which manages his/her property acquired in the order of succession in accordance with the fund management terms and in the manner stipulated in the Civil Code. Therefore, after the death the entire inheritable property of the owner is accumulated in the new legal institution, which is a way of management of the mass of the succession.

What should the individual do in order to establish the inheritance fund after his/her death?

The inheritance fund is established by the notary public, if the citizen has mentioned it in his/her testament. It is not enough to make a note on establishment of such fund in the testament. If the testament stipulates for the establishment of the fund, it shall contain the testator's decision on establishment of the inheritance fund, the fund's charter, terms of the fund management. The terms of management, in its turn, should contain the provisions on transfer of all property or part thereof to the third parties, the procedure, the date or the periods of transfer of the property, the type and the size of the property.

What is the process of establishment of the fund after the citizen's death?

The notary public should send an application containing the information on the fund's manager to the authorized body within 3 business days from the date of the inheritance case. When the fund is being established, the notary public shall give him/her a certificate of inheritance. Failing to do so, the fund is established according to the court's judgment and shall be entitled to appeal the notary public's activity.

What will be the rights of the beneficiaries of the inheritance fund?

The beneficiaries are entitled to purchase the property or part thereof in accordance with the terms of the fund management. The rights are inalienable. This being the case, the beneficiaries are not liable for the obligations of the inheritance fund and vice versa. This will ensure safety of the assets in the future.

Where does this institution come from and why is it necessary to introduce it?

Overseas, in particular in the UK, the USA and other countries of the Common Law system this institution is called trust.

IT IS INTERESTING THAT THE TRUSTS INITIALLY APPEARED IN THE MIDDLE AGES, WHEN THE CRUSADERS LEFT THEIR PROPERTY WITH THEIR RELATIVES, SO THAT THEY COULD DISPOSE IT FOR THE BENEFIT OF THE SPOUSES AND KIDS

The trust or trust ownership is a special type of ownership, when the trustor transfers the property to the trustee for management thereof for the benefit of the third party or beneficiary. Establishment of the trust helps to secure the property from the creditors' claims, as well as to decrease the tax burden in some cases. Vesting the assets in the professional management increases the possibility of their effective use.

Russian Civil Law is familiar with this institution. The trust was introduced in 1993 by the Presidential Decree No. 2296 as of December 24, 1993 "On Trusts". As the Decree says the trust is introduced to improve the economic management during the economic reforms and to facilitate institutional transformations in the Russian Federation. Later on the Decree ceased to be effective in view of enactment of Part 2 of the Civil Code in 1996, which contained an article dedicated to the property management. The difference between the trust in the Common Law and the

trust institution in the Russian law is that the founder of the trust ceases to be the owner of the property transferred to the trustee, but the trustor under the trust management agreement still remains the owner of the transferred property.

Moreover, trust relations can be established on the basis of testament. The trust being more confidential in its nature can be an alternative to the testament, for testament execution purposes.

It is hard to say to what extent the inheritance fund institution can be applicable in the Russian legal practice. The goals, for which the Inheritance Fund is being established, currently can be achieved by making a testament or entering into a trust management agreement. Among the drawbacks of the Inheritance Fund one can single out the trustee's abuse of powers or incompetence, as well as the narrow circle of people, who might be interested in such fund (in particular, in the Russian Federation). On the other hand, the property transferred to the fund will be managed professionally, which will allow to preserve it, or probably enlarge, and the successors will be provided an adequate support.

Therefore, the law of each state is not an isolated phenomenon; the legal systems interact with each other. In particular, the Russian law should not stand still and should become wider both with the help of domestic legal experience and certain European legal structures, which have proved to be effective in practical area and applicable in other countries. But the adoption should not be of a thoughtless and chaotic nature, but given an individuality of the domestic legal regulation, keeping it in one's mind that Russian legal culture, legal mentality and legal traditions differ from the west European ones.

WHAT GOOD NEWS COULD THE SECURITIES MARKET BRING TO A TAXPAYER?

Tatyana Frolova
Leading Lawyer
Korpus Prava Private Wealth

For some time now legislators have tried to attract personal savings to the securities market. It may be explained by the fact that Russian companies desperately need financial injections, but many of them have no access to the market of cheap foreign credits.

The Russian investment market requires the so-called "long-term money", therefore, tax allowances for investors are granted only in case of a long-term holding of securities.

Thus, one of the innovations introducing tax exemption of income from securities transactions is an implementation of a minimum holding period of securities.

This allowance is applied subject to the following conditions:

- Shares and bonds should be listed on the stock exchange;
- Securities should be bought after January 1, 2014;
- Holding period of securities should be not less than three years;
- Securities should be sold at a profit;
- Securities should not be accounted on the taxpayer's investment account.

Provided all these conditions are fulfilled, a taxpayer shall be granted a personal income tax allowance which equals profit from securities sales.

But nothing is perfect, as the legislation sets out amount limitations. A profit subject to tax exemption may not exceed 3 million roubles multiplied by the number of full years of securities holding.

Example. Shares were bought in February 2014 and sold in April 2017.

The amount of 9 million roubles can be subject to tax exemption.

If the profit exceeds this sum, the remaining sum is due to taxation. For each year of securities holding the amount exempted from taxation grows by 3 million roubles.

Considering the terms for the application of this allowance, it may be granted for the first time in the upcoming 2018, if securities were bought in 2014 with a profit gain in 2017.

One more innovation is individual investment accounts aimed at increasing attractiveness of investments in stock market instruments for private investors by granting tax deductions.

Individual investment account is an internal balance account aimed at a separate accounting of individual client's

money, securities, obligations under contracts entered into on behalf of the said client. It is opened and managed in accordance with Article 10.3 of the Federal Law On the Securities Market. Any professional participant on the securities market is entitled to manage such contract. Each client may open only one such account.

Opening of such accounts for individuals is stimulated by the right to an investment tax deduction for the amount they has paid in (not exceeding 400 thousand roubles), or the amount they will get after closing the account.

Two types of tax deductions are stipulated for an individual investment account. Whereas a taxpayer may choose only one type of tax deduction. Combination of both types is impossible throughout the whole validity period of a contract for managing an individual investment account.

The first type of an investment tax deduction:

> A TAXPAYER IS ENTITLED TO A TAX DEDUCTION FOR A PERSONAL INCOME TAX IN THE AMOUNT OF MONEY DEPOSITED TO AN INDIVIDUAL INVESTMENT ACCOUNT DURING THE TAX PERIOD (SUB-PARAGRAPH 2 PARAGRAPH 1 ARTICLE 219.1 OF THE TAX CODE OF THE RUSSIAN FEDERATION).

The second type of an investment tax deduction:

> UPON THE TERMINATION OF THE VALIDITY PERIOD OF A CONTRACT FOR MANAGING AN INDIVIDUAL INVESTMENT ACCOUNT, AFTER AT LEAST THREE YEARS, A TAXPAYER IS ENTITLED TO A TAX DEDUCTION FOR A PERSONAL INCOME TAX IN THE AMOUNT OF INCOME RECEIVED FROM OPERATING TRANSACTIONS WITH AN INVESTMENT ACCOUNT, I. E. ALL PROFIT WILL BE EXEMPTED FROM TAXATION (SUB-PARAGRAPH 3 PARAGRAPH 1 ARTICLE 219.1 OF THE TAX CODE OF THE RUSSIAN FEDERATION).

It's important to remember that upon closing of an individual investment account earlier than three years all income tax deductions received must be repaid.

There are several limitations related to individual investment accounts for individuals:

- An individual is entitled to have only one contract for managing an individual investment account; in case a new contract is executed, the previous contract shall be terminated within a month;
- Under a contract for managing an individual investment account a client is allowed to transfer only money to a professional participant on the securities market;
- An aggregate amount of money that may be transferred under such contract during a calendar year shall not exceed 400,000 roubles.

An individual is entitled:

- To claim money and securities accounted on his/her individual investment account or their transfer to another professional participant on the securities market who is a party to a contract for managing an individual investment account;
- To terminate a contract for managing an individual investment account (brokerage agreement or securities trust agreement) of one type and enter into a contract for managing an individual investment account of a different type with the same or a different professional participant on the securities market.

In turn, a professional participant on the securities market shall enter into a contract for managing an individual investment account only in case an individual states in writing that he/she has no other contract for managing an individual investment account with another professional participant on the securities market or that such contract will be terminated not later than in one month.

Upon termination of a contract for managing an individual investment account a professional participant on the securities market shall submit information on an individual and his/her individual investment account to a professional

participant on the securities market with whom a new contract is executed.

Calculation, charging and payment of a personal income tax for transactions with securities accounted on an individual investment account are carried out by an agent as of the termination date of a contract for managing an individual investment account, unless a contract is terminated with a transfer of all assets accounted on an individual investment account to a different individual investment account in the name of the same individual. If a contract is terminated with a transfer of all assets accounted on an individual investment account to a different individual investment account in the name of the same individual, for the purposes of tax base calculation an opening date of a terminated (initial) contract shall be deemed an account opening date.

A tax agent qualified as an income source for transactions accounted on an individual investment account shall notify a tax authority at its location on the opening or closing of this account within three days from the date of the relevant event.

One more easement of a tax burden for individuals is personal income tax exemption of coupon payments for corporate marketable bonds denominated in roubles and issued from January 1, 2017 to December 31, 2020.

It should be mentioned that previously interests on government treasury bills, bonds and other government securities of the former USSR, member states of the Common state and constituent entities of the Russian Federation, as well as bonds and securities issued pursuant to the resolution of local representative bodies, were exempted from taxation.

Now the legislation equaled taxation of payments for government and corporate loans, but one should remember that a major peculiarity of this allowance is the fact that the bond issue date is the date of their state registration.

Therefore, when determining whether this or that bond is covered by this law, one should consider the date of its state registration. The registration date and the placement date may differ by several months. For example, registration may have taken place at the end of 2016, but the placement may have begun at the beginning of 2017. Such bond is not covered by the law.

Furthermore, it should be mentioned that personal income tax redemption is provided for the income received from discount only upon redemption.

As for the coupon income, tax exemption is provided for a coupon that does not exceed a discount rate increased by 5%.

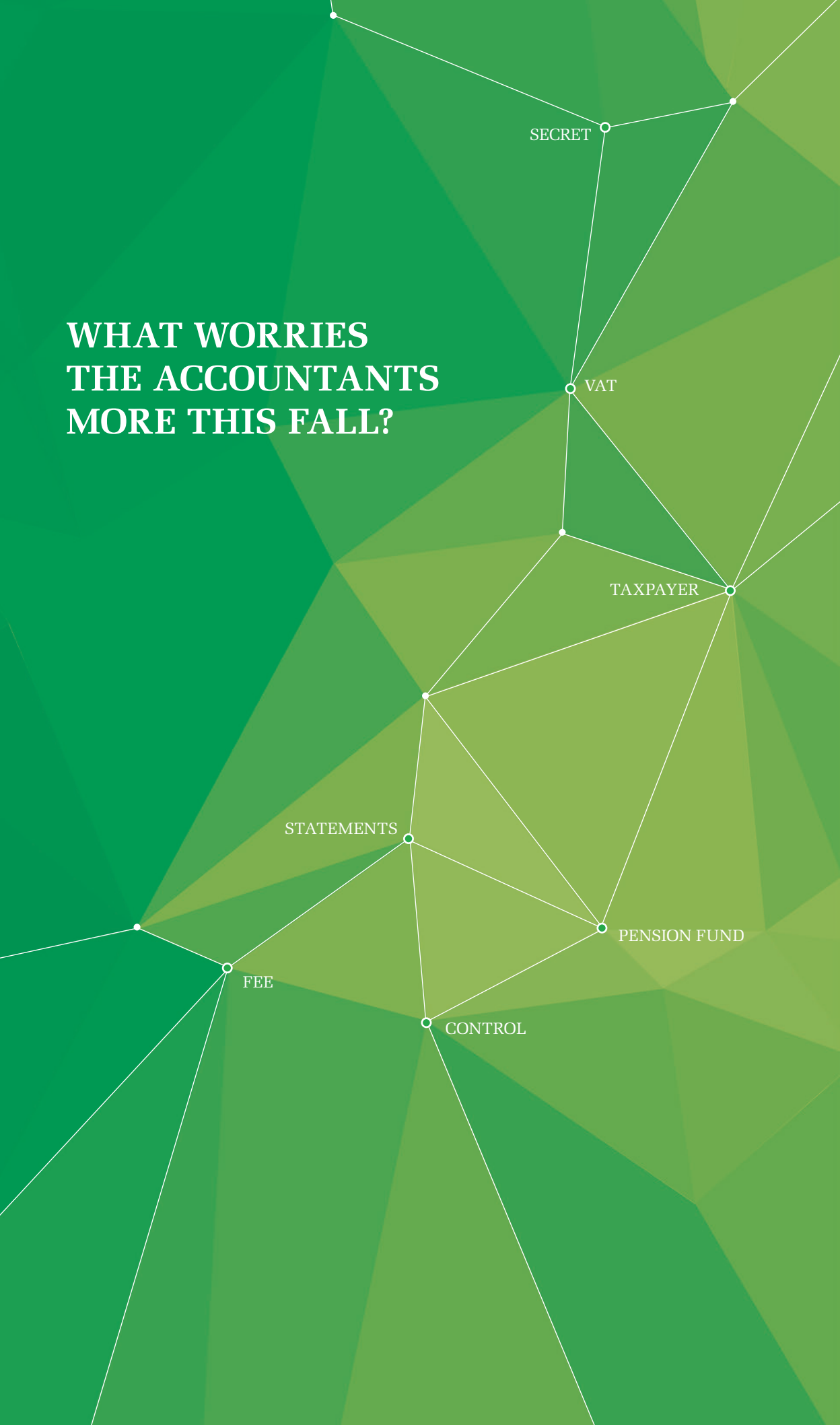
Now a discount rate equals a key interest and amounts to 8.5%, i. e. a coupon for more than 13.25% will be taxable at the rate of 35%. Coupon income interest is calculated par value.

It should be noted that the law comes into force 30 days after its official publication, but not earlier than on the first day of a new tax period for a personal income tax.

Therefore, coupons discharged in 2017 are taxable at the rate of 13%, but all the payments receivable by investors under the bonds of 2017 starting from January 1, 2018 to the redemption of the bond, are exempted from taxation. The bond may be redeemed after December 31, 2020, and all its coupons will be fully deposited on an investor's account without 13% deduction.

Thus, bond income will be taxable pursuant to the regulations regarding interest income from bank deposits, and this situation definitely makes sense.

WHAT WORRIES THE ACCOUNTANTS MORE THIS FALL?



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Last summer brought a lot of questions on planned legal developments and taxpayer's actions in disputable situations.

This article covers the most frequently asked questions by our clients and colleagues.

Are auditors the spies hired by tax authorities?

Nowadays articles in professional magazines and on the Internet are riddled with similar headings, and this fact scares not only the business community, but also accountants. Word of mouth even spread the rumors that from 2018 auditors will have to "report" revealed violations to tax authorities.

All the above mentioned is far from reality.

The draft law approved in the first reading on June 23, 2017 removes the term "audit secret" from Article 82 of the Tax Code of the Russian Federation, which prohibits collection and use of information classified as the audit secret during tax inspections.

Simultaneously, tax authorities are granted the right to receive documents from auditors certifying calculation and payment of taxes and duties by a taxpayer.

Under a new draft law documents may be requested from an auditor in case they haven't been submitted by a taxpayer and only in accordance with:

- A resolution of the head (deputy head) of the superior tax authority;
- A resolution of the head (deputy head) of the federal executive authority responsible for control and monitoring of taxes and duties during a tax inspection;
- A request of the authorized authority of a foreign state in cases stipulated by international treaties of the Russian Federation.

Thus, according to the law, a responsible taxpayer who has submitted all the information required by tax authorities shall have no fear of the audit secret cancellation.

At the moment, the legislation on audit still contains the term "audit secret".

The audit secret includes any information and documents obtained and/or prepared by auditors for service rendering, except for:

- Information disclosed by the person to whom the services were rendered;
- Information on the execution of the audit agreement;

- Information on the amount of the auditor's fee.

Moreover, disclosure of the audit secret is one of the reasons for cancellation of an auditor qualification certificate. Auditors will not risk their right to auditor practice in order to comply with the new draft law, considering that liabilities for the failure to disclose information have not been established yet.

All the above mentioned facts prove that the draft law On the Cancellation of the Audit Secret in its current form is not practically applicable, as it contradicts the main law on audit.

It's most likely that by 2018, legislators will fail to ensure fulfillment of the draft law produced with great pains, therefore, there is no need to "hide" information from auditors.

I would also like to add that the auditor community is outraged not less than the business community and keeps fighting against the audit secret cancellation, because the audit secret is one of the pillars supporting audit activities.

Adjustment invoice: helper or additional problem?

Despite the fact that adjustment invoices have been used for quite some time now, numerous accountants have difficulties with their execution and filing of tax returns on VAT.

Let us begin from the cases when it's required to issue an adjustment invoice.

The seller shall issue an adjustment invoice if after the sale of goods (works, services) under the agreement between the seller and the buyer:

- The price of goods (works, services) specified in an original invoice increases or decreases;
- The amount of goods (works, services) specified in an original invoice increases or decreases;
- Both the price and the amount of goods (works, services) specified in an original invoice change;
- The buyer, who has no liabilities for paying VAT or is exempted from them, returns part of goods.

An adjustment invoice is issued and delivered to the buyer within five calendar days from the issue of a supporting document for making amendments.

An adjustment invoice provides acceptance of tax deductions on VAT, if there is a document (contract, agreement, and other documents) in accordance thereto an adjustment invoice has been issued.

Errors in adjustment invoices that do not prevent tax authorities from identifying the seller, the buyer of goods (works, services), their cost, tax rate and tax amount charged from the seller during the tax inspection are not deemed as the reason for refusal in acceptance of tax deductions.

A taxpayer shall consider the increase in the price of shipped goods (performed works, rendered services) when determining the tax base for the tax period where the documents providing for the issue of adjustment invoices were prepared.

Thus, an adjustment invoice is issued only upon approval of the changes by the parties in writing.

There is no need to adjust VAT tax base for the period of the initial sale of goods (works, services), if there is an agreement on changes of the price and the amount of goods (works, services) executed as of the current date.

There is no need to issue an adjustment invoice in case of the incorrect sale of goods (works, services) during the earlier tax period.

The Federal Tax Service has no idea what happened last year

The transfer of insurance contributions management from non-budgetary funds to the Federal Tax Service has become an overwhelming problem for the business community.

For the last 9 months of 2017 taxpayers received numerous letters demanding to pay the arrears for insurance contributions, which had already been paid in 2016.

This happened to the most responsible payers of contributions who paid

insurance contributions for December 2016 before the end of the year out of fear of confusion. Unfortunately, the reverse happened and payments to the fund made in December 2016 got lost upon the data transfer.

The obvious question is "What to do next?"

Unfortunately, there is no magical solution at the moment. Each tax payer in this situation goes its way from the Federal Tax Service to the Pension Fund of the Russian Federation in search of its money.

As a rule, the procedure goes as follows:

- A tax payer receives a statement on budget settlements indicating outstanding debt and addresses tax authorities to solve the problem;
- Tax authorities reply that data uploading from the Pension Fund of the Russian Federation failed, and that a tax payer has to file an application to the Pension Fund of the Russian Federation on another data uploading;
- A tax payer files an application to the Pension Fund of the Russian Federation on another data uploading;
- The Pension Fund of the Russian Federation replies with the refusal due to technical malfunctions, prohibition of another data uploading or any other reasons.

Everything goes on a loop, when a tax payer delivers refusal letters and explanations from the Pension Fund of the Russian Federation to the Federal Tax Service and back, but with no result in the end.

The Federal Tax Service may even issue a document confirming validity of the data submitted by a tax payer, but a statement on budget settlements will still indicate outstanding debt.

Officially, in March the Federal Tax Service issued the letter (Letter of The Federal Tax Service No. 3H-4-1/4593@ dated 15.03.2017) which explained that in case a tax payer disagrees with the calculated balance as of 01.01.2017, he shall address his regional fund as the Federal Tax Service did not manage insurance contributions before 01.01.2017. Tax authorities are entitled to make amendments to record cards on budget settlements only after submission of updated data by the Fund.

Numerous tax payers have already suffered from sanctions in the form of penalties, fines and even withholding of "phantom" outstanding debts from bank accounts by tax authorities.

Unfortunately, one cannot prevent debiting of bank accounts.

This situation resembles peculiar budget "advancing". The budget is replenished with the funds that tax payers would have paid in several months.

If tax authorities are clearly unwilling to comply with tax payers' requests, there are only two ways to solve this problem:

- To file a complaint to the superior tax authority or the Ministry of Finance of the Russian Federation;
- To file a lawsuit.

Fine for improper statements

The following question has been urgent for a long time:

Will the documents be deemed undelivered if they are filed to the Federal Tax Service in an improper form?

It is not infrequent that tax authorities refuse to accept statements from tax payers, because statements and documents were sent in the form of an ordinary letter with copies of basic documents attached thereto. Refusal to accept documents leads to the fine charged by the inspection for a failure to report information to a tax authority.

In 2017, a company filed a complaint on the said matter to the superior tax authority. The Federal Tax Service issued the resolution (Resolution No. CA-4-9/18214@ dated 13.09.2017) cancelling the fine and explaining that this fine shall be charged for a failure to report information, but not for reporting information in an improper format.

The Federal Tax Service clarified that provisions of the Tax Code contain

no indication of the fact that statements submitted in an electronic form, but in an improper format, shall be deemed undelivered.

Let us recall that under the current legislation, statements on VAT shall be submitted only in an electronic form (via telecommunications channels), as VAT tax returns shall be filed to tax authorities only in an electronic form.

Due to the facts mentioned above, a tax payer is entitled to submit requested statements and required documents by sending an ordinary e-mail (via telecommunications channels) with copies of the documents attached without any fines charged for reporting information in an improper format.

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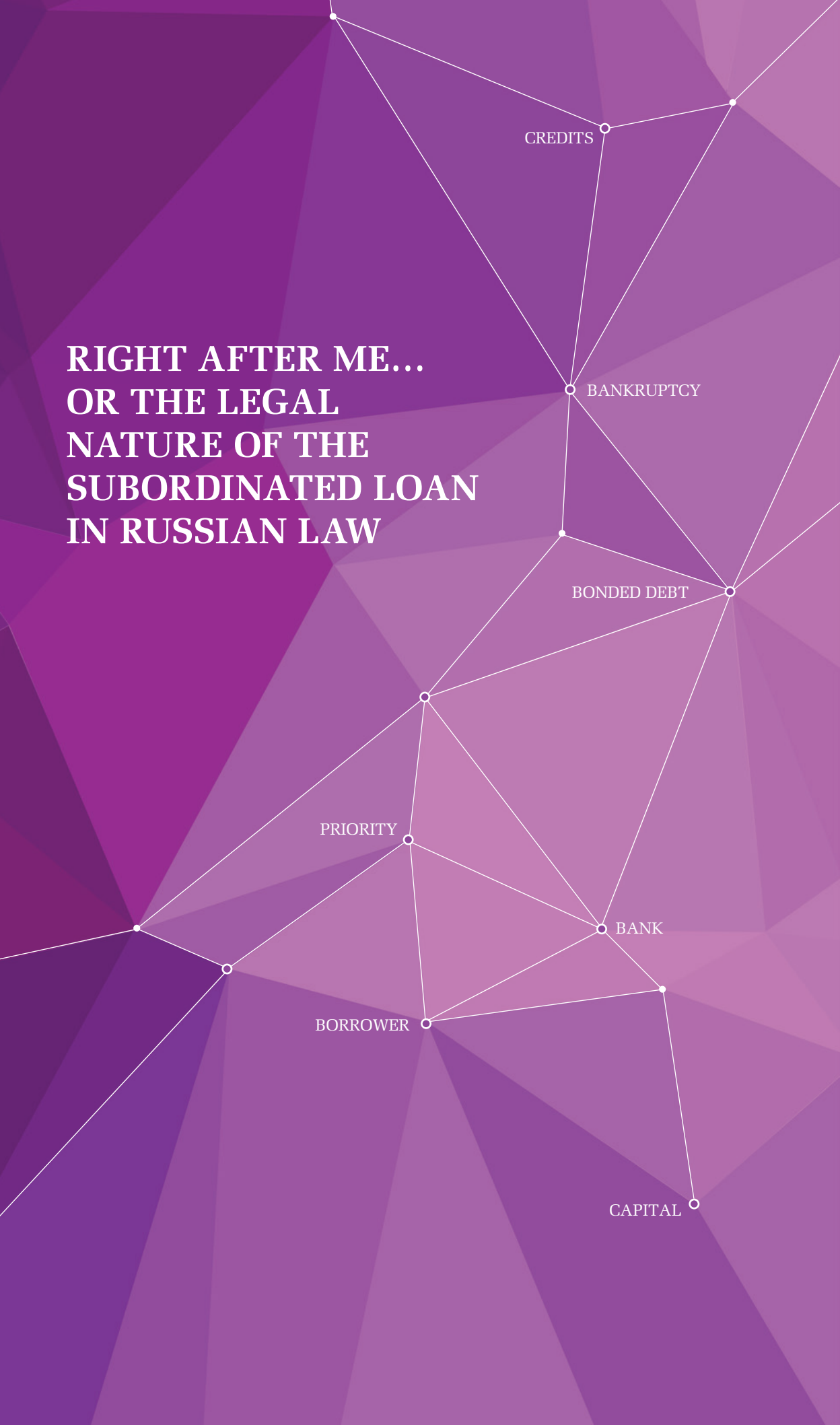
RIGHT AFTER ME… OR THE LEGAL NATURE OF THE SUBORDINATED LOAN IN RUSSIAN LAW



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Literally, the subordinated debt means a debt subordinated to other credits, which is ranked lower than other credits in case of debtor's liquidation or bankruptcy.

Such form of crediting is used worldwide by those, who are closely tied with the borrowing entity, but for one reason or another prefer to loan the funds rather than investing them in the borrower's authorized capital (by purchasing the borrower's shares). The subordination of the subordinated loan to other (regular) credits stipulates their higher riskiness, and therefore higher rates of return. Higher rate of return, in its turn, allows for such credits to be used for speculation purposes on the stock market.

The subordinated loan in Russia means a way of long-term monetary investment made in form of credit (deposit, loan, bonded debt), which the lending institution attracts to replenish its supplementary capital.

Previously, the definition of subordinated loan was stipulated in the by-laws, in particular in the Provision on the Methods of Measurement of Equity Capital of Lending Institutions (approved by Regulation No. 215-П of the Bank of Russia as of February 10, 2003).

However, the detailed definition of the subordinated loan (credit, deposit, bonded debt), as well as the legal regulation of such instruments has been formalized in Russian legislation not so long ago, namely concurrently with the approval of the Federal Law No. 432-FZ as of December 12, 2014 "On amendments to certain legislative acts of the Russian Federation and on declaration of some legislative acts (provisions of the legislative acts) of the Russian Federation as null and void", which has introduced relevant amendments to the Law on Banks and Banking Activity, as well as to the Law on Insolvency (Bankruptcy).

At present the subordinated loans are legally regulated by the Law on Banks and Banking Activity, the Law on Insolvency, Provision on the Methods of Measurement of Equity Capital of Lending Institutions (Basel III). The subordinated loan (deposit, credit) agreements or terms of bonded debts are subject to the Rules of Civil Code of the Russian Federation on loan, credit, bank deposit or gift with due account of the aforementioned peculiarities.

As set forth in the applicable Russian legislation[1] the subordinated loan

1. Article 25.1 of the Federal Law No. 395-1 as of December 2, 1990 (as amended as of June 18, 2017) "On Banks and Banking Activity".

(deposit, credit, bonded debt) means a loan (deposit, credit, bonded debt), which at the same time meets the following criteria:

1. A lending institution only can act as a borrower.
2. The period of credit (deposit, loan) and the maturity of obligations should be not less than five years or there is no maturity date.
3. The terms of credit (deposit, loan) or bonds issue stipulate that the following actions can be done only with the consent of the Bank of Russia:
   - Full or partial early repayment of credit (deposit, loan) or part thereof, as well as early payment of interest thereon or redemption of bonds;
   - Termination of credit (deposit, loan) agreement and (or) making amendments to the existing agreement.
4. The terms of granting a loan (terms of bond issue) should not significantly differ from the market terms of granting of similar loans.
5. The terms of granting a loan (terms of bond issue) should contain a provision that if a lending institution is insolvent the claims under such loan shall be discharged upon settlement of claims of all other creditors.

The distinctive feature of the subordinated loan agreement is the absence of any collateral from the borrower.

This being the case, the subordinated loan agreement may contain a provision on the right of a lending institution to refuse from payment of any interest under the subordinated loan (deposit, credit, bonded debt) agreement unilaterally without any subsequent penalties.

The main thing, which distinguishes the subordinated loan from other loans, is the ability to perform one of the following actions, if certain conditions occur:

- Termination of lending institution's obligation to repay the amount of principal debt and to pay the interest and penalties accrued;
- To exchange or convert creditors' claims under subordinated loans into ordinary stock (shares in the authorized capital) of the lending institution.

The aforementioned actions are permissible, if the capital adequacy ratios of the lending institution become lower than the level specified in the relevant normative act of the Bank of Russia. Such actions are applicable upon the Bank of Russia's approval of the Plan of Engagement of the Bank of Russia in the measures to prevent the bank's insolvency or approval by the Bank Supervision Committee of the Bank of Russia of the Plan of Engagement of the State Corporation Deposit Insurance Agency, which stipulate financial assistance from the Bank of Russia and Financial Aid Agency.

At the same time, termination of the bank's obligation under the subordinated loan agreements or exchange (conversion) of the creditors' claims under the subordinated loans is one of the terms of provision of financial assistance by the Bank of Russia to the lending institution in case of critical situation in the bank.

The distinctive feature of legislative regulation of the subordinated loans is that the claims thereunder, if the lending institution is declared insolvent, are discharged only upon discharge of claims of all other creditors[2].

Find in the table below the main differences between subordinated and regular loans.

A particular attention should be drawn to the fact that the legislative provisions (including those stipulating an option of unilateral termination of obligations on the subordinated loans by the lending institutions, as well as those setting the priority of creditors in case of insolvency of such organizations) became effective on December 23, 2014. Nevertheless, paragraph 8 of Article 15 of the Federal Law No. 432-FZ as of December 22, 2014 reads that these provisions have a retroactive force and extend to the relations started before the law has come into force.

This means that the legal position of the creditors of financial institutions (holders of bonds, deposits, lenders)

2. Article 189.95 of the Federal Law No. 127-FZ as of October 26, 2002 "On Insolvency (Bankruptcy)".

Borrower	Lending institution
Credit period	Not less than 5 years
Collateral	None
Priority of liens in case of borrower's bankruptcy	The claims of the subordinated creditor are discharged last of all
Repercussions, if the capital adequacy ratio of the lending institution is decreased	• Termination of the bank's loan repayment obligation, or • Conversion of claims into the regular stock of the bank.
Possibility of early repayment of loan/ amendments to the agreement	Only upon the Bank of Russia's approval

under the subordinated products issued before the date of the law, has significantly deteriorated and endangered.

This being the case, when the legislative framework regulating the flow of subordinated financial instruments came into being, the banks had already been terminating their obligations arising out of such agreements unilaterally (Trust, Uralsib, Peresvet, Yugra, upcoming amortization of debts under the subordinated obligations in Binbank and Otrkitie).

Meanwhile, Russian legal practice has not yet seen any positive outcomes of claims filed against the banks terminating their obligations under the subordinated products either from the individual lenders (Determination of the Supreme Court of the Russian Federation as of May 23, 2017 on the case No. 24-КГ17-3, Ruling of Nikulinskiy District Court as of July 4, 2017 on the case No. 2-4121/17, etc.) or from the institutional lenders (Ruling of Arbitral Court of North-Western Okrug as of July 29, 2016 on the case No. A56-36949/2015, Ruling of Arbitral Court of North-Western Okrug as of July 29, 2016 on the case No. A56-25411/2015).

It is obvious that the subordinated lending is rather a risky business for the junior creditor for several reasons:

- In case of bankruptcy of a lending institution, the subordinated creditors' claims are discharged last of all, upon discharge of the claims of other creditors;
- The bank may unilaterally terminate its indebtedness to the subordinated creditors.

Nevertheless, the subordinated financial products have been rather of a high demand until recently. In most cases this is explained by the high interest rates the subordinated creditors get in return for the funds.

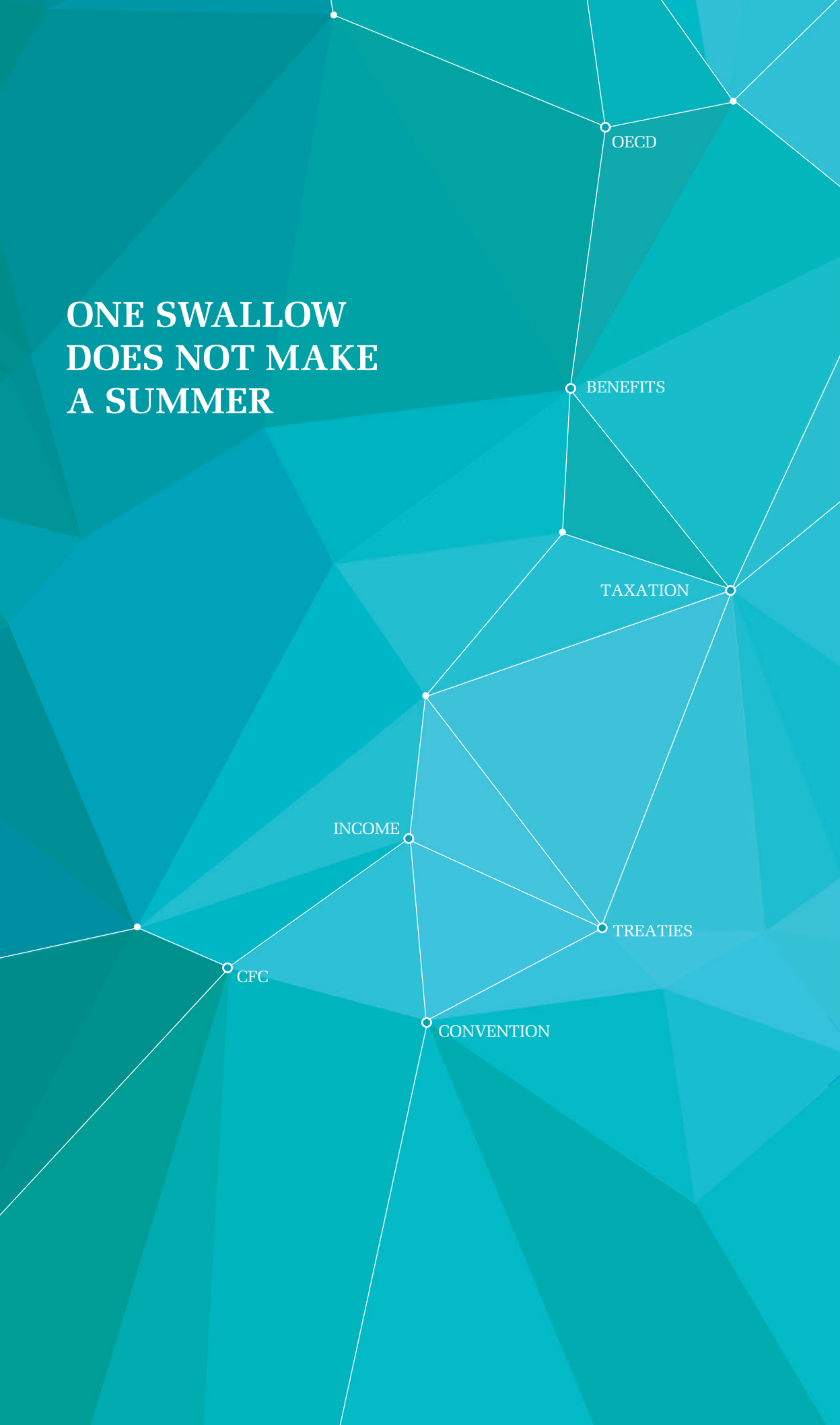
Summarizing the above, it is worth to mention that the analysis of ongoing changes in the normative and legal framework indicates a clear intention of a legislator to improve the regulation of subordinated instruments in Russia. Measures taken are timely as never before in the light of existing economic situation, which forces the financial market participants to attract additional sources of financing.

It goes without saying that the subordinated lending is a good tool for the participants of the banking sector, as it allows the banks:

- To attract additional long-term financing;
- To increase additional capital of the bank without dilution of shares of its owners;
- To plan the long-term business projects of the bank efficiently.

But it is evident that the existing legal support of the creditors is insufficient, which will be an obstacle for distribution of subordinated financial products on the banking services market.

ONE SWALLOW DOES NOT MAKE A SUMMER



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Nowadays one of the most burning issues of the tax practice is the concept of an actual right to income in international tax relations.

Not long ago in order to justify the application of preferential tax rates or tax exemption stipulated by the Double Taxation Conventions Russian companies acting as tax agents submitted certificates of tax residency issued by the relevant counterparty or shareholder, and tax authorities did not go any further than that. However, global tendencies of fighting tax evasion are becoming more and more common in Russia. Since 2015, Russian tax residents have operated under the legislation on controlled foreign companies. Moreover, next year automatic information exchange on financial accounts is to be launched, which serves as a control instrument allowing tax authorities to trace automatically financial flows of their tax residents.

Recently, tax authorities carried out numerous tax inspections, which revealed illegal application of international treaties in cases when foreign companies are not qualified as actual income recipients. Such conclusions are supported by courts, including the Supreme Court of the Russian Federation[1].

The definition and regulations regarding determination of an actual income recipient were added to the legislation of the Russian Federation by the Federal Law dated 24.11.2014[2], and a wide-spread application of the said regulations by the Russian tax authorities took place a couple of years ago. Therefore, tax payers often refer to the fact that this regulation is relatively new, and thus, the business requires some time to adjust to new circumstances. However, many people tend to forget that a possibility to apply provisions of the Model Convention and statements thereto as an interpretation source is based on general interpretation rules for international treaties set out in the Vienna Convention on the Law of Treaties (1969).

1. Ruling of the Supreme Court of the Russian Federation No. 307-КГ16-7111 dated 05.08.2016 in case No. A13-5850/2014, decision of the Arbitration court of Moscow District dated 25.01.2017 in case No. A40-442/2015, dated 27.05.2016 in case No. A40-116746/2015, dated 04.10.2016 in case No. A40-241361/2015, decisions of the Ninth Arbitration Court of Appeal No. A40-36068/15 dated 01.07.2016, No. A40-113217/2016 dated 07.02.2017, dated 04.08.2015 in case No. A40-12815/15, decisions of the Arbitration Court of Far Eastern District dated 31.05.2016 in case No. A04-6181/2015, decisions of the First Arbitration Court of Appeal dated 04.05.2017 in case No. A11-6602/2016, decisions of the Seventh Arbitration Court of Appeal dated 25.04.2017 in case No. A27-16584/2016.
2. Federal Law No. 376-ФЗ dated 24.11.2014 On Amendments to Parts One and Two of the Tax Code of the Russian Federation (Concerning Profit Taxation of Controlled Foreign Companies and Income Taxation of Foreign Companies).

According to Article 31 of the Convention, "… the treaty shall be construed with good faith pursuant to the general meaning applied to the terms of the treaty in their context, as well as regarding objectives and purposes of the treaty…". Articles 31–33 of the Convention define basic (for example, contractual context or any further agreement between the parties regarding the interpretation of the treaty) and additional (for example, preparation materials and circumstances of the treaty execution) interpretation sources as interpretation sources for international treaties.

The Plenum of the Supreme Court of the Russian Federation by Resolution No. 5 dated 10.10.2003 On Application by General Courts of Generally Accepted Principles and Regulations of the International Law and International Treaties of the Russian Federation recommends to apply international acts in cases of interpretation difficulties with generally accepted principles and regulations of the international law and international treaties of the Russian Federation. Resolution No. 8654 dated 15.11.2011 issued by the Presidium of the Supreme Arbitration Court of the Russian Federation defines the Model Convention as "framework document, which stipulates general principles and ways to avoid double taxation".

Therefore, the Model Convention and Statements thereto may serve as an additional interpretation source for international treaties, as the case may be.

Article 10 "Dividends", Article 11 "Interest", Article 12 "Royalties" of the Conventions set out preferential taxation rates for the income payable to foreign companies which are applied solely in cases when a recipient of the income (resident of the country acting as a party to an agreement) is an actual recipient (beneficial owner) of this income in accordance with OECD statements to the Model Convention.

Conventions are executed in order to stimulate economic cooperation between countries. The generally accepted principle of the international law concerning bona fide performance of treaties (pacta sunt servanda) recognized among others in Article 26 of the Vienna Convention does not grant tax benefits stipulated by international double taxation conventions when parties to a cross-border transaction abused the right, including profit gaining solely or mainly from tax benefits (beneficial taxation conditions) when performing a cross-border transaction.

Moreover, in 2014 the Russian Ministry of Finance clarified that in order to identify a person as an actual income recipient (beneficial owner) this person shall be a direct beneficiary, i. e. a person that gains benefits from the received profit and determines its further economic development. If an income recipient acts as an intermediary on behalf of another person that actually gains benefits from the relevant profit, granting of tax benefits (reduced rates and exemptions) in the country acting as a source of income paid to a foreign person, contradicts aims and objectives of international conventions[3].

The current legal practice of identifying a person with an actual right to income and determining a right to apply regulations of international conventions allows to say that tax benefits are granted only to those companies that possess economic presence in the country of residence, have wide powers to dispose of their income and use their income for foreign company business activities (gain economic benefits from their income).

In such disputes tax authorities study and analyze the following factors:

- Independence of decision-making by directors of foreign companies;
- Powers of income disposal;
- Performance of entrepreneurial functions,
- Factors of carrying on business (personnel, office, general administrative expenses);

3. Letter of the Ministry of Finance of the Russian Federation No. 03-00-P3/16236 dated 09.04.2014 On granting of benefits stipulated by international double taxation conventions.

- Gaining economic benefits from their income (use in business activities);
- Bearing commercial risks concerning assets;
- Types of cash flows (presence or absence of legal or actual obligations for further income transfer);
- Consistency of transit payments for income transfer from a resident participant of the convention to a person with no benefits under the convention.

For the purposes of an objective and full analysis of company business activities, tax authorities shall not only study transactions of income transfer under dispute, but also pay attention to economic activities of the group in general.

Verification of an actual right to income or its absence is based on the additional information on cash flows between the companies of the group submitted by foreign jurisdictions, as well as reports from the companies. Tax authorities and courts accept commercial data bases, open registers of foreign companies, information from public sources as an evidence of the fact that an income recipient was not a true beneficiary of the received income.

In order for a tax authority to refuse granting benefits under the agreement, it may prove that a direct income recipient is not an actual income recipient and determine no ultimate beneficial income owner. Therefore, if a tax authority has established that a foreign person is not an actual income owner, one shall apply tax rates stipulated by the legislation of the Russian Federation on taxes and duties. If a tax payer (tax agent) submits a documented confirmation of a true beneficiary before the resolution of a tax inspection, tax authorities will consider this circumstance when establishing validity of preferential taxation.

One may obviously argue that the Russian Federation is not OECD member, or that the concept of an actual income recipient has been introduced to the Russian tax law quite recently. However, one should consider Article 29 of the Conventions "Limitation of Benefits", which stipulates that a resident of the Contracting State shall not be entitled to any tax reduction or tax exemption set out in the Convention regarding the income received from the other Contracting State, if the main purpose or one of the purposes for creation or existence of such a resident proved to be benefits granted under the Convention, otherwise unavailable.

THERE IS NO MONEY, BUT YOU HANG IN THERE!

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On July 30, 2017 the law that came in force tightening the procedure for bringing controlling parties to subsidiary liability (Federal Law No. 266-ФЗ dated 29.07.2017).

The current legislation of the Russian Federation allows bringing parties controlling the debtor to subsidiary liability in certain cases of company's insolvency.

However, pursuant to the general rule the director general and the shareholder (holding more than 50% of shares in the authorised capital) shall be considered parties controlling the debtor[1]. In particular cases the court may identify other persons as controlling parties (chief accounting officer, chief financial officer, other officers, or the actual beneficiary, in case the director/founder of the debtor claims that he/she is a nominal beneficiary and reveals the information on the actual beneficiary[2]).

Application period for bringing to subsidiary liability equals three years from the date when a person entitled to file such application learned or had to learn the relevant causes for bringing to subsidiary liability, but not later than three years from the date the debtor was recognized a bankrupt (discontinuance of bankruptcy proceedings or return of the bankruptcy petition to a competent authority), and not later than ten years from the day when actions and/or omissions deemed as causes for bringing to subsidiary liability took place[3].

Cause 1

Subsidiary liability for failure to settle fully creditors' claims due to actions and/or omissions of controlling parties.

Causes for bringing to liability

In case of failure to settle fully creditors' claims due to actions or omissions of a party controlling the debtor, such party shall bear subsidiary liability for the debtor's obligations[4]. Until proven otherwise, full settlement of creditors' claims is deemed impossible due to actions or omissions of party controlling the debtor under at least one of the following circumstances:

- Significant damages were caused to creditors' property rights due

1. Paragraph 4, Article 61.10 of Federal Law No. 127-ФЗ dated 26.10.2002 On Insolvency (Bankruptcy).
2. Paragraph 9, Article 61.11 of Federal Law No. 127-ФЗ dated 26.10.2002 On Insolvency (Bankruptcy).
3. Paragraph 5, Article 61.14 of Federal Law No. 127-ФЗ dated 26.10.2002 On Insolvency (Bankruptcy).
4. Paragraph 1, Article 61.11 of Federal Law No. 127-ФЗ dated 26.10.2002 On Insolvency (Bankruptcy).

to the performance of one or several debtor's transactions (performance of such transactions by order of this person) by this person or on behalf of this person, or upon approval of this person;

- By the determination date of supervision introduction (or by the appointment date of the temporary administration for the financial organization), accounting records and/or statements, that shall be maintained (issued) and kept in accordance with the legislation of the Russian Federation, are missing or contain no information prepared under the legislation of the Russian Federation on the issues stipulated by the legislation of the Russian Federation, or the said information is corrupted and hinders application of bankruptcy procedures, including formation and disposal of bankruptcy assets;
- Claims of third-priority creditors under the outstanding principal amount resulting from the law violation punishable by criminal, administrative or tax prosecution of the debtor or its officials that act or acted as its sole executive body, according to the court order that came into force, including payment request of the debt revealed during proceedings in these cases, do not exceed fifty percent of the total amount of third-priority creditors' claims for the outstanding principal amount that are registered in the list of creditors;
- By the determination date of supervision introduction (or by the appointment date of the temporary administration for the financial organization), documents which shall be kept in accordance with the legislation of the Russian Federation on joint-stock companies, on securities market, on investment funds, on limited liability companies, on state and municipal unitary companies and legal acts adopted thereunder, are missing or corrupted;
- As of the initiation date of bankruptcy proceedings no obligatory entry has been made into the Unified State Register of Legal Entities under the federal law or misleading information has been entered in accordance with the documents submitted by this legal entity;
- Failure to settle creditors' claims resulted from actions and/or omissions of a party controlling the debtor, but bankruptcy proceedings were terminated due to the absence of money to cover legal expenses for the bankruptcy case, or return of the bankruptcy petition to a competent authority;
- The debtor was qualified for insolvency for a different reason rather than actions and/or omissions of a party controlling the debtor, which later performed an action and/or omission that aggravated the debtor's financial state.

In case of failure to settle fully creditors' claims due to actions or omissions of several parties controlling the debtor, such parties shall jointly bear subsidiary liability.

Terms of release from subsidiary liability

A party controlling the debtor whose actions and/or omissions lead to failure to settle fully creditors' claims shall not bear subsidiary liability, if it proves absence of its fault in failure to fully settle creditors' requirements. Such persons shall not bear subsidiary liability if they acted under conditions of civil-law transactions, reasonably and in good faith on behalf of the debtor, their founders (members), complying with creditors' property rights, and if they prove that their actions prevented a more significant damage to the creditors' interests.

Extent of subsidiary liability

Extent of subsidiary liability for a party controlling the debtor shall equal the total amount of creditors' claims that are registered in the list of creditors' requirements, creditors' requirements filed

after the closure of the list, and creditors' claims for the current outstanding payments due to insufficient assets of the debtor. Extent of subsidiary liability for a party controlling the debtor is subject to reduction, if it will be able to prove that the amount of damage incurred to the creditors' property rights through this person's fault is significantly less that the amount of claims subject to settlement at the expense of this person with significant control over the debtor.

Cause 2

Subsidiary liability for failure to file (untimely filing of) the debtor's application.

Causes for bringing to liability

Director's obligations: Debtor's director shall file the debtor's application to the arbitration court as soon as practicable, but not later than one month from the date of one of the following circumstances[5]:

- The settlement of claims made by one or several creditors causes inability of the debtor to fulfill in full its financial obligations or obligations for mandatory and/or other payments to other creditors;
- The debtor's body duly authorized under its incorporation documents to pass resolutions on the debtor's liquidation has decided to file the debtor's application to the arbitration court;
- The execution upon the debtor's property will significantly hinder or prevent business activities of the debtor;
- The debtor meets the criteria for insolvency and/or property insufficiency;
- Due to insufficient funds there is more than three-month outstanding severance pay, wages and other payments to an employee or former employee in the amount and manner stipulated by the labour legislation.

Founder's obligations: unless the debtor's director files the debtor's application to the arbitration court within the abovementioned period and remedies irregularities causing legal action within 10 calendar days from the termination of this period, the founder shall demand convocation of the extraordinary general meeting of the debtor's members to resolve on filing the bankruptcy petition to the arbitration court, which shall be held not later than ten calendar days from the notification of its convocation. The general meeting of members (sole member) shall resolve on filing the self-bankruptcy petition to the arbitration court, unless these irregularities are remedied as of the date of the meeting.

Failure to file the debtor's application to the arbitration court (convene the meeting to resolve on filing the debtor's application to the arbitration court or pass such resolution), as cases may be, in the specified period shall be punishable by the subsidiary liability of the director and the founder[6].

Upon violation of the said obligation by several persons, these persons shall be held jointly liable.

Terms of release from subsidiary liability

In case failure to settle creditor's claims and failure to file the self-bankruptcy petition to the arbitration court have no causal connection, a controlling party may be released from subsidiary liability. However, the person (persons) brought to liability shall be responsible for proving the absence of such causal connection.

Extent of subsidiary liability

Extent of liability shall equal the amount of debtor's obligations arising after the end date of the period set out for filing an application by the director (1 month from the relevant circumstances) and convocation of the meeting by the founder (1 month + 10 days), and before

5. Paragraphs 1, 2, Article 9 of Federal Law No. 127-ФЗ dated 26.10.2002 On Insolvency (Bankruptcy).
6. Paragraph 1, Article 61.12 of Federal Law No. 127-ФЗ dated 26.10.2002 On Insolvency (Bankruptcy).

the initiation of the debtor's bankruptcy proceedings[7].

Extent of liability under this article shall not include those obligations that arose before the claimant in bankruptcy learned or had to learn the causes for obligations stipulated by Article 9 of the current Federal Law, except for requests for obligatory payments and requirements under obligatory contracts for the debtor's counterparty.

Cause 3

Liability (indemnification) for violation of bankruptcy legislation.

Causes for bringing to liability

In case of violation of the bankruptcy legislation by the debtor's director or founder, the said persons shall reimburse the losses incurred due to such violation.

Thus, if the debtor filed the debtor's application to the arbitration court while being able to fully settle creditors' claims, or the debtor took no measures to appeal against unreasonable claims of the applicant or creditors' claims in the bankruptcy case, parties controlling the debtor shall be held liable for the losses ensuing from the initiation of bankruptcy proceedings or unreasonable acceptance of creditors' claims.

The same principles apply in cases when the debtor fails to appeal against unreasonable creditors' claims filed before or after the initiation of bankruptcy proceedings, beyond bankruptcy proceedings.

The summary is represented in the table below.

Liability causes for parties controlling the debtor

Director General	Founder
1. Failure to fully settle creditors' claims due to actions and/or omissions of a controlling party	
• Execution of the transaction by the Director General that caused significant damage to creditors' property rights; • Failure to fulfill (improper fulfillment of) an obligation to keep accounting records and statements; • Claims of third-priority creditors under the outstanding principal amount resulting from the law violation punishable by criminal, administrative or tax prosecution of the director, exceed 50% of the total amount of third-priority creditors' claims; • Failure to fulfill an obligation to keep/prepare documents which shall be kept in accordance with the legislation of the Russian Federation on limited liability companies; • As of the initiation date of bankruptcy proceedings no obligatory entry has been made or misleading information has been entered into the Unified State Register of Legal Entities.	• Approval or execution of the transaction on the founder's behalf that caused significant damages to creditors' property rights.

7. Paragraph 2, Article 61.12 of Federal Law No. 127-ФЗ dated 26.10.2002 On Insolvency (Bankruptcy).

2. Failure to file (untimely filing of) the debtor's application

- Failure to file the bankruptcy petition wiмthin one month from the date of the circumstances causing a legal action.
- Failure to hold the general meeting of members (in case of failure to file an application by the director) within 10 calendar days from the termination of the period set out for the director to file an application.

3. Liability (indemnification) for the violation of bankruptcy legislation

- Violation of bankruptcy legislation;
- Filing the bankruptcy petition while the debtor is able to fully settle creditors' claims;
- No measures taken to appeal against unreasonable creditors' claims in the bankruptcy case;
- No measures taken to appeal against unreasonable creditors' claims, filed before or after the initiation of bankruptcy proceedings, beyond bankruptcy proceedings.
- Violation of bankruptcy legislation;
- Resolution on (approval of) filing the bankruptcy petition while the debtor is able to fully settle creditors' claims.

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

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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