

RUSSIA'S CONTROLLED FOREIGN COMPANY RULES – A DISCUSSION OF EFFECTIVENESS IN LIGHT OF THE OECD'S RECOMMENDATIONS

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ABSTRACT

This article assesses the effectiveness of Russia's recently introduced controlled foreign company ('CFC') rules against the recommendations for the Design of Effective Controlled Foreign Company Rules as prescribed by the Organisation for Economic Co-operation and Development ('OECD'). This article, through the lens of comparative analysis, endeavours to respond to the question of whether the Russian CFC rules are effective given their current construction. The article responds affirmatively to the research question and notes that the CFC rules are broadly effective given Russia's political and economic directives although not beyond reproach.

I INTRODUCTION

Extensive tax reform has seen the Russian economic and tax landscape change significantly over the past 18 years.¹ Targeted reform measures have, by and large, endeavoured to improve procedural tax rules, reduce the number of taxes, and minimise the overall tax burden in Russia in an attempt to cultivate a more favourable economic environment for taxpayers and investors.²

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¹ Consider Baker & McKenzie, *Doing Business in Russia* (2018) Baker & McKenzie – CIS Limited, 122.

² For an excellent overview of the development of the Russian taxation system, consider Alexander Pogorletskiy and Nadezhda Bashkistrova, 'The Dynamics of Tax System and Tax Administration Development in the Russian Federation' (2015) 1(1) *Journal of Tax Reform* 4.

Recent legislative enactments have seen substantial modifications to the rules governing the reporting and taxation of participation interests by Russian tax residents in controlled foreign companies ('CFCs') and further refinements to the concepts surrounding tax residency and beneficial ownership.³ These measures codify Russian President Vladimir Putin's commitment to protecting the Russian tax base by combatting the use of offshore jurisdictions to minimise tax liabilities and are indicative of Russia's further commitment to harmonising its domestic tax law with international best practice.⁴

Whilst it may be premature to draw definitive conclusions as to the utility of these measures given their limited existence in the *Tax Code of the Russian Federation* ('TC RF'), this article will nonetheless consider the effectiveness of these measures in the context of their intended purpose and contrast the relative strengths and weaknesses of these provisions against the Organisation for Economic Co-operation and Development ('OECD') recommendations for the Design of Effective Controlled Foreign Company Rules.⁵

The next part will therefore proceed to consider the policy objectives associated with the introduction of CFC rules and broadly discuss their operation as purported by the TC RF. The article will then consider an appropriate theoretical framework to measure the effectiveness of these rules. In this part, the article will primarily concern itself with the notion of effectiveness as purported by the OECD. In applying this framework to the provisions, the article will then resolve the question of whether the rules may be considered effective, before offering some concluding remarks.

³ As a result of extensive consultation and discussion in 2014, the Russian Government passed new tax anti-avoidance legislation introducing rules targeting the taxation of the profits of controlled foreign companies, effective 1 January 2015. See Federal Law N 376-FZ 'On amendments to Parts I and II of the Russian Tax Code' (in respect of taxation of the profits of controlled foreign companies and profits of foreign organizations) dated 24 November 2014.; *Tax Code of the Russian Federation* ('TC RF'), Chapter 3.4.

⁴ See, Vladimir Putin, *The List of Instructions on the Implementation of the Message of the Federal Assembly*, 27 December 2013 (President of Russia), 1.31; Rustem Ahmetshin, 'Taxes in 2014: Attention on Cross-Border Transactions' (2014) *Globe Business Media Group* 1.

⁵ OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 – 2015 Final report* (OECD Publishing, 2015) ('OECD DECFCR')

II CONTROLLED FOREIGN COMPANY RULES

This part considers the high level policy framework for CFC rules. Given CFC rules traverse a jurisdiction's overall system of tax, the design and objectives of CFC rules can differ significantly from one jurisdiction to another as a consequence of policy objectives.⁶ This part therefore assesses the policy considerations that broadly underlie all CFC rules, and where necessary, considers parallels with Russia's political and economic objectives.

A *Object of CFC Rules*

While the construction of CFC legislation may vary considerably, a common and consistent feature of these rules is that they enable a state to tax its residents on undistributed income attributable to their participation as a foreign tax resident.⁷ The manner in which this result is achieved largely coincides with the broader fiscal policy objectives of the relevant state.⁸

Russia, as the relevant jurisdiction considered in this article, achieves this objective through including the undistributed profits earned by a CFC in the tax base of the Russian tax resident, pro-rata to its participation.⁹ The Russian tax resident is then subject to tax at its applicable entity rate, subject to certain exemptions.¹⁰ Under Russia's domestic legislation and tax treaties, a credit may be granted for income taxes paid abroad.¹¹

These measures clearly advance Russian President Vladimir Putin's broader policy intentions by facilitating the reversion of capital back to Russia through the imposition of reporting requirements and tax liabilities on Russian residents who have established or who control or influence offshore companies, trusts and other holding vehicles.¹² The effectiveness of these measures however, will be examined in detail later in this article.

⁶ OECD DECFRCR, 13.

⁷ Daniele Canè, 'Controlled Foreign Corporations as Fiscally Transparent Entities. The Application of CFC Rules in Tax Treaties' (2017) 9(4) *World Tax Journal* 521.

⁸ An exceptional insight into the various theories that frame the technical mechanisms of CFC rules is provided by Canè, above n 7 at 528 – 530.

⁹ This measure broadly accords with the 'attribution' approach discussed by Canè, above n 7 at 529. See also, TC RF Chapter 3.4. Note, Article 246.2 TC RF addresses the concepts associated with Russian tax residency. An assessment of these concepts is beyond the scope of this article.

¹⁰ Generally, 20% if the entity is a company: TC RF, Article 284; 13% if the entity is an individual: TC RF, Article 224.

¹¹ TC RF Article 311.

¹² Putin, above n 4.

B Policy considerations of CFC Rules

Commensurate with the broad objectives of these measures, all CFC rules share some general policy considerations, which include but are not limited to: (i) their role as a deterrent measure; (ii) their ability to prevent or eliminate double taxation; and (iii) their ability to reduce administrative or compliance burdens.

These considerations are discussed in turn below.

1 Deterrent effect

CFC rules are generally designed to act as a deterrent, which intends to protect tax revenue by ensuring that profits of a CFC remain within the tax base of the shareholder or parent in their resident country.¹³

Rules concerning CFC's tend to transcend the 'separate entity doctrine'¹⁴ by providing that, in defined circumstances, profits directed to an affiliate of a resident taxpayer in a low-tax jurisdiction can be attributed to its parent and taxed by the resident country.¹⁵

In the Russian context, the rules apply to foreign companies (or foreign legal structures) which meet the definition of a CFC.¹⁶ Broadly, the Russian CFC rules will capture entities which are controlled by legal entities and/or individuals that are recognised as Russian tax residents pursuant to the TC RF, but are not Russian tax residents themselves.¹⁷

The notion of control is widely defined in this context. Subject to certain limited exceptions,¹⁸ a Russian tax resident is considered to be a controlling person of a foreign entity if they own, directly or indirectly: (1) more than 25% of the shares;¹⁹ or (2) more than 10% of the shares if the Russian tax resident in total owns more than 50%;²⁰ or (3) exercises, or has the power to exercise, a decisive influence on decisions regarding the distribution of profits of the foreign entity regardless of legal basis for control.²¹

¹³ Accordingly, CFC rules are not primarily designed to raise tax on the income of the CFC, although this is often the practical consequence. See, OECD DECFRCR, 13.

¹⁴ This doctrine recognizes that, at law, a corporation is a distinct person with its own personality separate and independent from the persons who formed it. See, *Salomon v Salomon & Co Ltd* [1897] AC 22.

¹⁵ OECD, *Comments Received on Public Discussion Draft – BEPS Action 3: Strengthening of CFC Rules* (OECD Publishing, 2015), 84.

¹⁶ TC RF Chapter 3.4.

¹⁷ TC RF Article 25.13-1(1)-(2).

¹⁸ TC RF Article 25.13.

¹⁹ TC RF Article 25.13(3)(1).

²⁰ TC RF Article 25.13(3)(2).

²¹ TC RF Article 25.13(8).

Arguably, this mechanism creates a disincentive for Russian controlled entities to relocate profits offshore and in so doing, deters the use of contrived tax arrangements to facilitate tax benefits and thus protects the Russian tax base.²²

2 Prevention or elimination of double taxation

An additional consideration apparent within the design and subsequent implementation of CFC rules is how to avoid double taxation.²³ As CFC rules subject the income of a foreign entity to taxation in the parent jurisdiction, they can, and often do, lead to double taxation if, for example, the entity is also subject to taxation in the CFC jurisdiction.²⁴

In the Russian context, relief for foreign tax paid may only be available if such relief is provided for in a ratified double tax treaty and the amount of the relief does not exceed the Russian tax corresponding to that income.²⁵

3 Compliance

A final policy consideration seeks to achieve balance between the implementation and administration of CFC rules and their associated compliance burdens.²⁶

Arguably, the benefit of CFC rules is that they can operate relatively mechanically.²⁷ However, CFC rules that are entirely mechanical may not be as effective as rules that allow more flexibility.²⁸ Flexibility, however, may create uncertainty, ultimately affecting the increasing compliance burdens associated with CFC rules.²⁹ Hence, CFC rules must seek to harmonise the reduced complexity inherent in mechanical rules and the enhanced effectiveness of more subjective measures.³⁰

²² OECD above n 15, 84.

²³ OECD DECFRCR, 13.

²⁴ OECD DECFRCR, 13. This is particularly evident in the context where the parent jurisdiction implements a worldwide jurisdictional tax base.

²⁵ Special rules apply to items such as dividends, interest, royalties and rent. Under Russia's domestic legislation and tax treaties, a credit may also be granted for income taxes paid abroad on these items on the proviso that documentary proof of taxes paid abroad is provided. If, however, the treaty provides for a lower withholding rate, no credit will be granted in excess of the treaty rate: see TC RF Article 311.

²⁶ OECD DECFRCR, 13.

²⁷ *Ibid.*

²⁸ *Ibid.*

²⁹ OECD, above n 15. For an excellent evaluation of the trade-offs inherent within tax policy design, see: Nicole Wilson-Rogers and Dale Pinto, 'Tax Reform: A Matter of Principle? An Integrated Framework for the Review of Australian Taxes' (2009) 7(1) *eJournal of Tax Research* 72.

³⁰ Wilson-Rogers and Pinto, above n 29.

This policy consideration is most clearly demonstrated in the context of defining CFC income.³¹ Arguably, a definition which attributes income based entirely on its formal classification may be ineffective and unduly burdensome in its approach, despite reducing administrative and compliance burdens.³² Conversely, a definition which favours a less mechanical, substance analysis to ensure income that is attributed arises from base erosion and profit shifting activities may be more administratively burdensome and less streamlined despite increasing effectiveness.³³

The Russian CFC provisions endeavour to reduce compliance burdens whilst increasing effectiveness through a modified approach in which CFC income is broadly defined and in favour of legal form,³⁴ while simultaneously offering a multitude of exclusions for particular CFC's and their income.³⁵ The effectiveness of this approach will be evaluated later in this article.

III THEORETICAL FRAMEWORK

Against this background, this part considers an appropriate framework on which to evaluate the effectiveness of Russia's CFC rules. This article relies greatly on the 2015 work of the OECD entitled, 'Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report' ('Report')³⁶ which provides contemporaneous guidance and direction for the creation and adaptation of CFC rules.³⁷ The Report considers all constituent elements of CFC rules and classifies them into six (6) categories that are, in the view of the OECD, necessary for the effective design or CFC rules.³⁸ These categories inform subsequent discussion below.

Effectiveness, as expounded by the Report broadly accords with the formative works of Sadler³⁹ and Baker and McLelland⁴⁰ in the field of political and environmental policy assessment, where effectiveness is evaluated by reference to four generic

³¹ OECD DECFRC, 13.

³² Wilson-Rogers and Pinto, above n 29; OECD DECFRC.

³³ Ibid. Concerns about the administrative burden of substance-based rules can, however, be reduced by including suitably targeted CFC exemptions such as an exemption for companies that are not subject to a lower rate of tax.

³⁴ TC RF Article 25.15(3).

³⁵ TC RF Article 25.15(13).

³⁶ OECD DECFRC, above n 5.

³⁷ Ibid, 13.

³⁸ Ibid.

³⁹ See, Barry Sadler, *Environmental Assessment in a Changing World. Evaluating Practice to Improve Performance – Final Report* (Canadian Environmental Assessment Agency, 1996).

⁴⁰ Douglas Baker and James McLelland, 'Evaluating the Effectiveness of British Columbia's Environmental Assessment Process for First Nations' Participation in Mining Development' (2003) 23(5) *Environmental Impact Assessment Review* 581.

criteria: (1) procedural effectiveness – where policy is considered broadly effective if it meets accepted principles and provisions;⁴¹ (2) substantive effectiveness – where policy is considered broadly effective if it meets its established purposes and objectives;⁴² (3) transactive effectiveness – where policy is considered broadly effective if the time and cost associated with achieving its purported outcomes is relatively low;⁴³ and (4) normative effectiveness – where policy is broadly effective if it is resilient towards societal, economic and political change.⁴⁴ Overall, policy effectiveness is thus reflected by the extent to which a policy adheres to all four aspects of the effectiveness paradigm.⁴⁶

Noting the prevalence of the OECD's work in the field of international tax policy and administration and recognising the rigor with which the categories in the Report have been assessed and adopted, it is both practical and appropriate to measure Russia's recently enacted CFC rules against the OECD's benchmarks.

A Methodology

This article endeavours to respond to the question⁴⁷ of whether the Russian CFC rules are effective given their current construction. Comparative analysis is undertaken to respond to the research question. This analysis is two-fold in its approach. Initially, the article will review each component of the Russian CFC rules against the six categories ascribed by the OECD. Arguably, where the particular constituents of the Russian CFC rules are fundamentally similar in construction to those ascribed by the OECD, they may be considered effective. Where however, the Russian CFC rules diverge from the OECD recommendations, the effectiveness of the component is subject to scrutiny. Secondly, the article will seek to review the effectiveness of the Russian CFC rules in the context of their construction as a whole, in an attempt to address any ambiguity in the initial analysis, prior to resolving the research question.

⁴¹ Sadler, above n 39.

⁴² Ibid.

⁴³ Ibid.

⁴⁴ Baker and McLelland, above n 40.

⁴⁵ See Neera Shrestha Pradhan, Yufang Su, Yao Fu, Liyun Zhang and Yongping Yang, 'Analyzing the Effectiveness of Policy Implementation at the Local Level: A Case Study of Management of the 2009–2010 Drought in Yunnan Province, China' (2017) 8(1) *International Journal of Disaster Risk Science* 64.

⁴⁶ See Sadler, above n 39; Baker and McLelland, above n 40; Pradham et al, above n 45.

⁴⁷ Consider Frank Esser and Rens Vliegthart, 'Comparative Research Methods' in Jörg Matthes, Christine S. Davis and Robert F. Potter (eds), *The International Encyclopedia of Communication Research Methods* (John Wiley & Sons, Inc., 2017).

B *Criteria for evaluation*

The following criteria have been extracted from the Report and will inform subsequent analysis:

1. *Definition of a CFC.* The Report recognises two salient features which need to be addressed when defining a CFC:⁴⁸ (1) what entities should be considered CFCs; and (2) whether the parent entity had sufficient influence or control over the foreign entity for the foreign entity to be considered a CFC. In response to (1), the Report recommends that the term CFC be broadly defined to include both corporate and non-corporate foreign entities that are controlled by shareholders in the parent jurisdiction.⁴⁹ In response to (2), the Report endorses the use of both legal and economic tests to determine when shareholders have the requisite influence or control over a foreign entity for the purposes of recognising a CFC, and encourages an evaluation of control based on indirect and direct participation in an entity.⁵⁰
2. *CFC exemptions and threshold requirements.* The Report encourages the use of exemption and threshold requirements to exclude certain entities from CFC rules, where those entities pose little risk to base erosion and profit shifting activities, or where, in the interest of remaining economically competitive, it would be appropriate to do so.⁵¹ The Report recommends that CFC rules only apply to CFC's that are subject to effective tax rates that are significantly lower than those applied in the parent jurisdiction.⁵²
3. *Definition of CFC income.* The Report recommends that CFC rules include a definition of CFC income that ensures income that raises tax base erosion concerns is attributed to controlling shareholders in the parent jurisdiction.⁵³
4. *Computation of CFC income.* The Report recommends that CFC rules use the rules of the parent jurisdiction to compute the CFC income to be attributed to shareholders.⁵⁴ It also recommends that, to the extent legally permitted, jurisdictions should adopt specific rules limiting the offset of CFC losses, so that they can only be applied against the profits of the same CFC or against the profits of other CFCs in the same jurisdiction.⁵⁵
5. *Attribution of CFC income.* The Report recommends that, when possible, the attribution threshold should coincide with the control threshold and that the amount of income to be attributed should be calculated pro-rata to the proportionate ownership or influence of the controlling entity.⁵⁶

⁴⁸ OECD DECFRCR, 21.

⁴⁹ OECD DECFRCR, 21.

⁵⁰ Ibid.

⁵¹ Ibid, 33.

⁵² Ibid.

⁵³ Ibid, 43.

⁵⁴ Ibid, 57.

⁵⁵ Ibid.

⁵⁶ Ibid, 61.

6. *Prevention and elimination of double taxation.* The Report emphasises the importance of both preventing and eliminating double taxation, and recommends jurisdictions with CFC rules allow a credit for foreign taxes actually paid, including any tax assessed on intermediate parent companies under a CFC regime.⁵⁷

These criteria, in conjunction with the findings of this article, have been tabularised and included for reference purposes at Appendix A.

C *Limitations*

As the scope of this article is confined to assessing the effectiveness of these measures, there are a number of limitations which need to be addressed and which ultimately impact upon the validity of this approach and the framework. These include but are not limited to: (1) the lack of publicly available empirical data; (2) the lack of reliably translated Russian academic and political literature; and (3) the general limitations and restrictions associated with comparative analysis.⁵⁸ This work nonetheless, advances the academic literature in this field through the creation of scholarly arguments and perspectives despite these inherent impediments.

IV DISCUSSION

This part analyses the key design features of the Russian CFC regime against the adopted theoretical framework.

1 *Definition of CFC*

The initial design feature which requires assessment considers the entities which may constitute a CFC.

(a) *Entities subject to the CFC rules*

With regard to the Russian CFC rules we note that the regime applies broadly to both foreign corporations and entities without legal personality.⁵⁹ A foreign entity without legal personality is defined as an entity established under the law of a foreign country that does not have a legal personality (eg funds and partnerships) but which can engage in commercial activity aimed at generating income for the benefit of its participants (eg beneficiaries, stakeholders, principals and other persons).⁶⁰

⁵⁷ Ibid, 65.

⁵⁸ See Esser and Vliegenthart, above n 47.

⁵⁹ TC RF Article 11.2(7).

⁶⁰ TC RF Article 11.2(7).

These provisions have arguably been drafted broadly to avoid scoping issues apparent in comparative regimes,⁶¹ and, in so doing, endeavour to deal with all offshore base erosion and profit shifting activities engendered by any entity.⁶²

A fundamental issue with this approach ironically concerns the breadth with which the CFC definition is drafted. Such a wide definition creates uncertainty in respect of the application of the CFC rules to offshore entities, and debatably avails an opportunity for manipulation or exploitation.⁶³ Conversely, these features also support the effectiveness of the regime as through the wide and uncertain manner in which these provisions are drafted they become a powerful tool in the Russian tax authority's avoidance armoury.⁶⁴

Hence, whilst favourable, and arguably effective in the context of the Report to employ a broad CFC definition, which the Russian CFC rules achieve, the practical implication of this approach remain to be seen.

(b) Control and influence

As a corollary to the CFC definition, the next critical design feature regards the level of control a Russian tax resident needs to exert in order for the CFC regime to apply. As noted, the notion of control is widely defined in the Russian CFC rules and deems a Russian tax resident a controlling person of a foreign entity if they own, directly or indirectly: (1) more than 25% of the participation shares;⁶⁵ or (2) more than 10% of the shares if the Russian tax resident in total owns more than 50%;⁶⁶ or (3) exercises, or has the power to exercise, a decisive influence on decisions regarding the distribution of profits of the foreign entity regardless of legal basis for control.⁶⁷

Conceptually the tests mirror the rudimentary design features purported by the Report. However, the nature of control conceived by the first two tests extends far

⁶¹ Consider Australia's CFC regime, which applies exclusively to entities considered companies pursuant to Australian taxation law. This in turn has led to conceptual and legal challenges to the application of these rules, where for example, a foreign entity fails to meet the requisite definition for the rules to apply. See, *Income Tax Assessment Act 1936* (Cth) ('ITAA36') Part X.

⁶² See, Nolan Sharkey and Evgeny Guglyuvatyy, 'The New Russian Controlled Foreign Company Regime: Review and Comparison with the Australian Regime' (2016) 70(11) *Bulletin for International Taxation* 661.

⁶³ Sharkey and Guglyuvatyy, above n 62.

⁶⁴ Ibid.

⁶⁵ TC RF Article 25.13(3)(1).

⁶⁶ TC RF Article 25.13(3)(2). This requirement looks to the participation interests of all associates including spouses or minors in the case of individuals.

⁶⁷ TC RF Article 25.13(8).

beyond the Report and comparative regimes.⁶⁸ The Report,⁶⁹ Norway,⁷⁰ Iceland⁷¹ and Finland⁷² as examples, emphasise that the resident taxpayers own at least 50% of the capital or hold at least 50% of the voting rights in the foreign entity as the fundamental legal and economic benchmarks.⁷³ Notably however, the Report endorses the use of lower control thresholds where a country seeks to achieve broader policy goals or wishes to prevent the circumvention of the CFC rules.⁷⁴ Hence, the Russian approach may be best understood as a reaction to the diverse strategies adopted by those who seek to avoid Russian tax and arguably serve as an effective deterrent.⁷⁵

The third test which emulates the Reports *de facto* control recommendation is broadly consistent with comparative regimes.⁷⁶ However, the lack of clarity surrounding concepts of influence and power may raise uncertainty, ultimately impeding compliance, giving rise to costs and inefficiencies.⁷⁷ Additionally, adopting such a broad and uncertain approach compounds the possibility of double taxation, in the absence of appropriate exclusions, as different jurisdictions may also seek to tax the same foreign entity.⁷⁸

2 Exemptions and threshold requirements

Commensurate with the recommendations of the Report, the Russian CFC regime offers a number of concessional exclusions which may absolve a CFC and their income from taxation.⁷⁹ Generally, these exclusions will apply in circumstances where the actions of the CFC pose little risk to the Russian tax base,⁸⁰ or where Russian authorities have deemed certain activities appropriate to exclude in order

⁶⁸ Sharkey and Guglyuvatyy, above n 62.

⁶⁹ OECD DECFRCR, 21.

⁷⁰ Skatteloven (SKTL) (*Norwegian Tax Act*) ss 10 – 68.

⁷¹ Lög um tekjuskatt (TSKL) (*Icelandic Income Tax Act*) Art. 57a

⁷² Laki ulkomaisten väliyhteisöjen osakkaiden verotuksesta (VYL) (*Finnish Act on Taxation of Shareholders in Controlled Foreign Companies*).

⁷³ The Finnish rules also apply if Finnish taxpayers are entitled to at least 50% of the yield. See, SKTL ss 10-62, TSKL Art. 57a(3) and VYL s 3. Little emphasis in this respect is placed on the influence of associates in contrast to the Russian position.

⁷⁴ OECD DECFRCR, 21.

⁷⁵ Sharkey and Guglyuvatyy, above n 62, 664; Putin, above n 4.

⁷⁶ Consider, SKTL ss 10-62, TSKL Art. 57a(3) and VYL s 3.

⁷⁷ Peter Koerver Schmidt, 'Taxation of Controlled Foreign Companies in Context of the OECD/G20 Project on Base Erosion and Profit Shifting as well as the EU Proposal for the Anti-Tax Avoidance Directive – An Interim Nordic Assessment' (2016) 2 *Nordic Tax Journal* 87.

⁷⁸ Sharkey and Guglyuvatyy, above n 62, 664.

⁷⁹ TC RF Article 25(13). A comprehensive list of the criteria for exclusion may be found in Sharkey and Guglyuvatyy, above n 62, 667. OECD DECFRCR, 33.

⁸⁰ As can be seen in the context of non-profit organisations, active foreign companies and jurisdictions with a sufficiently high tax rate. See, TC RF Article 25(13).

to preserve capital exportation and economic competitiveness.⁸¹ A *de minimis* threshold of 10 million rubles is employed as a further measure to ensure that CFC income is not included in the taxable income of the parent company if it falls under that threshold.⁸² In this way, the Russian CFC rules harmonise further with the Report,⁸³ and lower administrative compliances, arguably increasing their effectiveness.

A final measure in pursuit of protecting the Russian tax base is through the use of an objective list which determines when CFC exemptions would automatically not apply.⁸⁴ This approach achieves broadly the same purpose of the recommendation in the Report, notwithstanding that the Report endorses the use of a list which would recognise when CFC exceptions apply.⁸⁵

Against this background, and in strict application of the framework, Russia's CFC rules may be considered effective. Notably however, given the volume of exclusions available to Russian taxpayers,⁸⁶ and the associated complexity of the provisions, there exists a genuine possibility for continued exploitation of low-tax jurisdictions, notwithstanding the Russian authority's intention to deter this behaviour.⁸⁷ The exclusions are also likely to create challenges for administration and could result in significant compliance costs which further affects foreign investment or exportation, thereby limiting their effectiveness.⁸⁸

⁸¹ As is apparent from the exclusion of organisations involved in projects relating the extractions of minerals or in the field of banking and insurance. See, TC RF Article 25(13). See also, Olga Boltenko and Ayshat Gaydarovay, 'Russia's 'de-offshorization' rules and the new taxation of controlled foreign companies' (2015) 21(6) *Trusts & Trustees* 605.

⁸² TC RF Article 25(13).

⁸³ OECD DECFRC, 33.

⁸⁴ The current list includes 109 countries and 19 territories. See, Russian Federal Tax Service, S Order No.-7-17/527 of 30 September 2016.

⁸⁵ OECD DECFRC, 33.

⁸⁶ Exclusions which far exceed a number of comparative regimes. See as example, SKTL ss 10-62, TSKL Art. 57a(3) and VYL s 3, ITAA36 Part X.

⁸⁷ Olga Boltenko and Ayshat Gaydarovay, above n 81; Sharkey and Guglyuvatyy, above n 62, 667.

⁸⁸ *Ibid.*

3 *CFC income*

This part jointly considers criteria 3 through 5 of the Report. As noted by the Report, CFC regimes must be able to identify what income of the foreign entity is attributable to the controlling person as well as addressing issues regarding how to calculate the income of a foreign entity.⁸⁹

In this context, the Russian CFC rules widely define CFC income to include both active and passive income derived by the foreign entity.⁹⁰ CFC income is attributed to the controlling person, proportionally to their interest in the entity and included in their Russian tax base.⁹¹ Where the income of a CFC is derived in a state that has concluded an effective double tax treaty with Russia, CFC income will be computed on the basis of its financial statements.⁹² In the alternative, where the income of a CFC is derived in a state which has not concluded a double tax treaty with Russia, the CFC provisions may not apply and consequentially the income is calculated by way of reference to the Russian tax rules.⁹³

Insofar as measures identified in the Report are concerned, it may again be argued that in strict application of the framework, the Russian rules are an effective legislative device. Again, however, the application of the Russian CFC regime remains uncertain. There is immediate concern in respect of the fact that Russian CFC rules attribute all CFC income and not just passive and tainted income, as is the case in many comparable regimes.⁹⁴ In this context, contrasted with the broad exclusions engendered by the provisions, there is a significant likelihood of the rules solely encompassing non-treaty partner countries and not others.⁹⁵ Consequentially, this may give rise to increased administration costs and inadvertently provide for unwarranted tax planning activities.

⁸⁹ OECD DECFR, 44.

⁹⁰ TC RF Article 25.15.

⁹¹ *Ibid.*

⁹² TC RF Article 309.1. According to Russian tax law, the income of a CFC is reduced by the amount of dividends paid by that entity. In addition, the dividends paid from Russian companies to the CFC are not included to the income of the entity, subject to the provisions of article 312 of the TC RF. Similarly, the income of a foreign structure that is not a legal entity is also reduced by the amount of the distributed income. See, TC RF Article 25.15. CFC losses may also be quarantined and offset against future CFC income.

⁹³ TC RF Article 312.

⁹⁴ Consider, SKTL ss 10-62, TSKL Art. 57a(3) and VYL s 3, ITAA36 Part X.

⁹⁵ Olga Boltenko and Ayshat Gaydarovay, above n 81; Sharkey and Guglyuvatyy, above n 62, 668.

4 *Prevention and elimination of double taxation*

As noted, in the Russian context, relief for foreign tax paid may only be available if such relief is provided for in a ratified double tax treaty and the amount of the relief does not exceed the Russian tax corresponding to that income, and on the proviso that documentary proof of taxes paid abroad is provided.⁹⁶

Notably, there are no identifiable provisions within the Russian CFC rules which specifically provide for double tax relief through either a credit or exemption mechanism. To this end, the rules themselves do not accord with the criteria within the Report nor comparative regimes,⁹⁷ notwithstanding the relief mechanism identified above. Accordingly, the application of the Russian CFC rules creates a real and likely possibility of double taxation, particularly in the context of CFC income derived by CFCs in non-treaty states. It follows therefore that there exists a greater prospect for increased avoidance activities which limits the effectiveness of the provisions. Hence, review of these provisions in future iterations of the Russian CFC rules with this criteria in mind would be recommended.

V CONCLUSION

It follows from the preceding analysis that, in strict application of the framework, and acknowledging the political and economic directives of the Russian administration, the Russian CFC rules may be considered an effective legislative measure. As demonstrated, the Russian CFC rules are broadly similar in principle and operation to a number of comparative regimes and exhibit the hallmarks of each criteria addressed in the Report notwithstanding their subtle departures.

The Russian CFC rules are however, not beyond reproach. The wide ambit and inherent uncertainty associated with both the operation and application of these rules raises significant concerns for capital exportation and foreign investment and avails further tax planning opportunities for resourceful parties.

Given the infancy of these rules, and Russia's vested commitment to the protection of its tax base,⁹⁸ it is expected that that these rules will be refined over time, with each iteration primed to avert ambiguity and further develop their effectiveness.⁹⁹

⁹⁶ TC RF Article 311.

⁹⁷ OECD DECFR, 65. Consider, SKTL ss 10-62, TSKL Art. 57a(3) and VYL s 3, ITAA36 Part X.

⁹⁸ Putin, above n 4.

⁹⁹ As was the case with the formative amendments in June 2015. See, Federal Law 150-FZ 'On Amendments to Parts One and Two of the Tax Code of the Russian Federation and Article 3 of the Federal Law'.

VI APPENDIX A

OECD Criteria	Russian CFC Rules	Effectiveness assessment
<p>1. Definition of CFC</p> <ul style="list-style-type: none"> - Broadly defined. - Control test incorporating both economic and legal concepts. 	<p>1. CFC broadly defined to include both foreign corporations and entities without legal personality.</p> <p>2. Control assessed in respect of legal and economic concepts.</p>	<p>1. On strict application of the criteria: effective. However, given the broader geopolitical and economic climate, may be considered ineffective as shrouded in uncertainty.</p> <p>2. Broadly mirrors approach of the Report: effective at achieving domestic policy. May however give rise to inefficiencies thereby increasing compliance costs and the prospect of double taxation.</p>
<p>2. Exemption and threshold requirements:</p> <ul style="list-style-type: none"> - Exemption based on effective tax rate. - Optional use of lists ie 'whitelists'. 	<p>1. Broad exemptions over a number of categories.</p> <p>2. Additional use of blacklist to limit or remove exemptions.</p>	<p>1. On strict application of the criteria: effective. However, given the broader geopolitical and economic climate, may give rise to unintended consequences given breadth and uncertainty.</p>
<p>3. Definition of CFC income:</p> <ul style="list-style-type: none"> - Targeted definition of income should be included. 	<p>1. CFC income is broadly defined to include both active and passive income of foreign entity. Subject to any applicable exemptions.</p>	<p>1. On strict application of the criteria: effective. However, uncertainty and breadth may give rise to unintended consequences.</p>
<p>4. Computation rules</p> <ul style="list-style-type: none"> - Tax rules of parent jurisdiction apply. - Losses only deductible against profits of the same CFC or other CFCs in the same jurisdiction. 	<p>1. Applicable Russian tax rates apply to CFC income.</p> <p>2. CFC losses quarantined and may be offset against future CFC income.</p>	<p>1. On strict application of the criteria: effective. However, uncertainty and breadth may give rise to unintended consequences.</p>
<p>5. Attribution rules</p> <ul style="list-style-type: none"> - Attribution threshold tied to the control threshold. - Attribution based on the proportion of ownership. - Apply tax rate of the parent jurisdiction. 	<p>1. CFC income is attributed to the controlling person proportionate to their ownership interest.</p> <p>2. The CFC income is included in the controlling person's Russian tax base and tax at the applicable corporate or individual rate.</p>	<p>1. On strict application of the criteria: effective. However, uncertainty and breadth may give rise to unintended consequences.</p>
<p>6. Prevention and elimination of double taxation</p> <ul style="list-style-type: none"> - Ordinary indirect credit relief. - Exemptions for dividends/gains on shareholdings in CFC. 	<p>1. Credit available only where effective double tax treaty has been concluded.</p>	<p>1. On strict application of the criteria: ineffective. Scope for review.</p>

