

Setting up a trust for Russian tax residents - most common questions

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Helpsheet for a trustee

The last couple of years have seen a period of uncertainty around the use of trusts for Russian tax residents following the introduction of Russian 'controlled foreign corporation' ('CFC') rules in 2015. They lacked the clarity and guidance to provide assurances for clients and trustees resulting in some agonising choices and a reluctance to actively plan.

The new rules continue to shape the way Russians think, plan and comply since their concerns around succession and asset protection may be even more relevant now. Since the reporting deadlines at the start of this year, we are now starting to see some of the practical applications and clarifications from Russia on the rules. There are some positives here to highlight and why a trust may just be the right option for them.

There is still no alternative to trusts in Russia, despite several attempts to change succession rules and introduce more flexible succession tools. The good news is that the new tax rules did finally address tax inefficiencies on capital succession between family members via trusts making them tax neutral. Some families are increasingly concerned about the threat to their asset protection in light of global transparency, becoming a primary focus for them. Trusts may not be a universal solution, but they do help protect and manage assets to the standards required by a particular family.

We set out below some of the most common questions around trust structuring options from a Russian tax and legal perspective.

Are trusts recognized in Russia?

No, but there is no restriction in Russia for residents to enter into legal arrangements under foreign law as long as it does not contradict the public policy in Russia. The new term 'non-corporate structure' introduced in the Russian Tax Code in 2015 defines trusts and similar structures for tax purposes in Russia.

Can trusts be tax efficient?

Trusts are tax neutral in Russia, as the settlors are generally taxed on undistributed trust income at the same income tax rate of 13% as if they would have paid tax on income generated from the assets they owned directly. At the same time, beneficiaries will not be taxed on trust income, which has been taxed in the hands of the settlors or other controlling persons.

Settlors with no powers and rights in the trust may be exempt from CFC tax and reporting exposure.

Where the settlor or other controlling person is resident outside Russia, income tax will be deferred in Russia until such time when Russian resident beneficiaries will receive income distribution.

Who is reportable in case of corporate settlors?

There is no requirement for the ultimate beneficial owners of such entities to submit notification on the set up of a trust, but they are most likely to be subject to reporting in Russia in relation to such entity separately. CFC reporting may arise if they control the trust regardless of the legal set up.

Can 'control' be established via corporate settlors, protectors and appointors?

Yes, the recent official clarifications clearly suggest that a 'look through' approach is most likely to apply in these scenarios. Please bear in mind,

however, that in some cases establishing control is not sufficient for a person to be subject to CFC rules.

When does the trust become 'controlled'?

Recent clarifications stated that the controlling person should be identified at the earlier date of either the decision made on income distribution or at the end of the calendar year following the end of the trust accounting year for each relevant CFC assessment period. This means that termination of control before any such date would also mean that no tax and reporting obligations arise for the relevant period (only applicable to financial years starting in 2015).

Is capital contribution taxable?

No, as long as trust capital contributions are made from funds/assets belonging to the settlor or his close family members. It can therefore get tricky where corporate settlors are used for trust funding, however there is a concession for controlled companies funding trusts which are controlled by a close family member.

Are beneficiaries taxed on capital distributions in Russia?

No, as long as the settlor is a close family member. This is the most important change, which finally made trusts tax neutral in comparison with the position under the old rules. Under old rules, any distributions made out of trusts were taxed as income. As there is no inheritance tax in Russia, succession planning via trusts was never particularly tax efficient. Under new rules, where trusts are used for succession, it can be done without an additional tax burden.

It is important to remember, however, to check whether a capital distribution of a certain kind would be treated as capital ('asset') in Russia for this rule to apply.

If the settlor is not a controlling person, should the settlor report the trust on set up?

Yes, the rules are clearly devised to put requirement on any settlors to make relevant notification.

Benefits in kind

This is another area of positive development in Russia which allows the tax free use of assets held in trusts by beneficiaries – close family members of the settlor, unless there is undistributed income which can be 'matched' with the benefit in kind distributions.

What about loans?

Interest free and low interest loans issued to the settlors and beneficiaries are most likely to be taxed under the general tax rules where material gain released on the amount of saved interest is taxed at higher 35% income tax rate in hands of the recipient.

Is voluntary audit of accounts helpful?

Yes, voluntary audit will allow use of trust accounts (unless the trust is located in treaty country) without reference to the Russian tax code for tax calculations. It would also help minimise liaising with tax officials in Russia.

Losses

Losses for 2012-14 would be allowed subject to a number of conditions and prorated according to the special rules. It is therefore important to extract and keep records of accounts from 2012 for all existing trusts as of 1 January 2015.

What if trust generates no income?

If trust generates no income or has losses in the relevant period, the controlling person is still subject to CFC reporting, but has no obligation to submit self-assessment tax return.

What is 'income'?

Broadly, income will include income (cash and in kind) and capital gains released on disposal of assets.

Trustee's liability

There are more cases in Russia where subsidiary liability is assessed on third parties connected with the taxpayers, therefore we do not exclude that trustees may be involved in tax disputes over outstanding Russian tax liabilities of settlors and beneficiaries of the trusts in the future. Whether any such claims will be successful or assisted with by the foreign courts remains to be seen.

Reporting of trustees

Under current Russian tax rules, foreign trustees will only be required to submit annual reporting and pay property tax in relation to the Russian real estate property held directly by the trust.

Are trusts subject to Russian currency control restrictions on investments?

No, investments held on a trust bank account are not subject to these restrictions and can be traded freely.

Interaction with the common reporting standard ('CRS')

There is nothing more costly than a mistake, when it comes to fixing it with Russian tax officials. Mistakes in reporting leading to discrepancies in relation to CFC and CRS reporting must be avoided. It is essential to cross check and prepare full documentary evidence where discrepancies may arise from differences in legal requirements, which cannot be unified.

Case study 1

Alexander is a UK non-dom who benefits from remittance basis taxation and settles an offshore trust with an investment account, the trust is making regular income distributions to his parents. The beneficiaries of the trust are his parents and adult children from first marriage residing in Russia. In this scenario, Alexander benefits from remittance basis in the UK, Russian income tax is deferred until income is distributed to parents. After death of his parents the capital is distributed to children. No inheritance tax in both jurisdictions and no Russian income tax on distribution of capital to beneficiaries.

Case study 2

Alexander is a Russian resident and sets up a trust with cash funds for the benefit of his family (himself, his wife and minor children). All beneficiaries are Russian residents. Alexander pays Russian income tax on undistributed income of trust, which is accumulated over the course of several years. After Alexander's death the trustees use accumulated income to pay for the children's education in the future, and part of the capital to distribute to his surviving spouse. None of these distributions are subject to tax in Russia. When the children become 25 years old the trustees distribute the remaining capital to them according to Alexander's wishes, and no income or inheritance tax would apply on capital distributions.

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