



2020-470 | November 25, 2020

## Russia - New Regime for Paying Personal Income Tax on CFC Profit

The Tax Code of the Russian Federation has been amended<sup>1</sup> to allow individuals who are controlling persons of foreign companies (CFCs) to pay personal income tax (PIT) not on the actual profit of each CFC, but on an imputed “fixed” amount of profit for all CFCs. The amount of PIT on this fixed profit will be approximately RUB 5 million. The new CFC profit tax regime can be applied as early as on the 2020 tax return.

The new tax regime does not apply to controlling persons that are legal entities.

### WHY THIS MATTERS

The new regime may be attractive for some controlling persons, for example, if PIT payment under the new regime and expenses for services necessary for correctly declaring CFC profit by the controlling person are expected to result in tangible savings on an annual basis, or if the controlling person has many CFCs and the risks of fines for late submission of a CFC’s financial statements or audit opinions are high.

### Key Conditions for Applying New Regime

In order to apply the new regime to the 2020 tax return, a controlling person must submit a notice to the tax authorities notifying them of the transition to paying PIT on fixed profits by 1 February 2021. The controlling person must then apply the new regime for at least three years, i.e., when declaring income for 2020, 2021 and 2022.

If the decision to transition to the new regime is taken later, the controlling person must submit a notice of transition to pay PIT on fixed profit by 31 December of the year from which that taxpayer decided to apply the regime. For example, to apply the new regime in the tax return for 2021, the notice of transition must be submitted by 31 December 2021. When a notice of transition is submitted by 31 December 2021, the controlling person must apply it for at least three

years. If a notice of transition to the new regime is submitted in 2022 or in a subsequent year, the minimum period for applying this regime will be five years.

The CFC fixed amount of profit is RUB 38,460,000 for the 2020 tax period and RUB 34,000,000 for 2021 and subsequent tax periods. Given the progressive PIT rate from 1 January 2021, the amount of PIT paid on CFC fixed profit will be approximately RUB 5 million per year.

Other conditions for applying the new regime include:

- Notification of transition to the new regime must be submitted for all CFCs controlled by the individual. It is not possible to apply the regime only to a single CFC of a controlling person.
- The obligation to pay PIT on a CFC's fixed profit ends if the controlling person ceases to be the controlling person of the CFC in the reporting tax period.
- A controlling person who applies the PIT payment regime for the fixed profits of CFCs may discontinue applying this regime when at least one of these two conditions is met:
  1. The amount of tax on the fixed profit increases during the period of its application as a result of changes to the Tax Code (for example, the amount of CFC fixed profit increases, or the threshold for applying the 15-percent rate is reduced), or
  2. the minimum period in which the new regime is applied has expired (three or five years as explained above).

In order to discontinue applying the fixed profit regime, the controlling person must provide the tax authorities with a notice by 31 December of the year: from which the amount of tax on the fixed profit increased (in the case of condition 1), or the minimum period expired (condition 2).

Note that transition to the PIT payment regime for the fixed profit of CFCs does not release the controlling person from the obligation to submit CFC notifications.

## Key Advantages and Disadvantages of Applying Regime

Advantages of the new regime for the controlling person include:

- The expenses for paying PIT on the profit of all CFCs is a fixed amount; thus PIT on a CFC's actual profit is not paid.
- The administrative burden and expenses may reduce for preparing CFC financial statements and audits, as well as for calculating and declaring CFC profit in the tax return of the controlling person.
- Filing CFC financial statements and audit opinions with the tax authorities is not required.
- The risk is eliminated that fines imposed might significantly increase from 9 December 2020, for failing to submit or for late submission of CFC financial statements and audit opinions to the Russian tax authorities.
- CFC losses before transition to the new regime and during its application may be deducted from CFC profit after application of the regime has terminated.

Potential disadvantages of the new regime include:

- Under the tax regime for paying PIT on CFC fixed profits, the amount of PIT on CFC fixed profits may not be reduced by the amount of taxes paid by a CFC, including Russian withholding tax.<sup>2</sup>
- Dividends distributed by a CFC do not reduce the CFC's fixed profit subject to PIT.
- When determining the amount of dividends subject to PIT, the CFC's fixed profit – based on which PIT is paid – is not reduced by the amount of dividends distributed from the CFC profit for periods over which the controlling person has applied the regime to pay PIT on fixed profit.
- Upon the transition of several controlling persons of the same CFC to the new regime, each of them must pay PIT on the full amount of the CFC's fixed profit; a CFC's fixed profit is not allocated to correlate with a controlling person's interest in the CFC.

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## KPMG NOTE

If you have any questions about applying the new regime in your circumstances, you are advised to contact your qualified tax professional; alternatively, you may contact one of the professionals with the KPMG International member firm in Russia noted in the Contact Us section.

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## FOOTNOTES:

1 Federal Law No. 368-FZ On Amendments to Parts One and Two of the Tax Code of the Russian Federation dated 09.11.2020.

2 According to the draft law on amendments to the Tax Code submitted to the Federation Council on 12.11.2020 (which stipulates, inter alia, amendments to the taxation of dividends), in certain cases a controlling person may have the right to offset Russian withholding tax withheld when a Russian entity pays dividends to a CFC.

\* \* \* \*

RUB 1 = USD 0.0132

RUB 1 = GBP 0.0099

RUB 1 = EUR 0.011

## Contact us

For additional information or assistance, please contact your local GMS or People Services professional or one of the following professionals with the KPMG International member firm in Russia.



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**The information contained in this newsletter was submitted by the KPMG International member firm in Russia.**

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