

CFC RULES: RUSSIAN LEGISLATION, INTERNATIONAL APPROACHES AND OECD RECOMMENDATIONS

RESEARCH QUESTIONS:

- What are the contemporary trends in the tax anti-avoidance regulation and CFCs' taxation as a part of it?
- How are the "contemporary" CFC rules different from the "classic" ones in the objectives and substantive rules?
- What are the peculiarities of the newly adopted Russian CFC rules in comparison with the foreign rules and OECD recommendations as presented in BEPS Action 3? Are they "targeted anti-avoidance" rules?
- Do the Russian CFC rules, if prove to be not targeted anti-avoidance measures, comply with the legal principles of equality, legal certainty and balance of interests and can they be applied in the context of DTT?
- If not, what amendments to the Russian CFC rules can one propose?

KEY CONCLUSIONS:

- The "contemporary" CFC rules are broader in objectives and substantive application than the classic CFC rules: they tend to apply to both corporate and unincorporated entities using legal, factual and economic control for the definition of a "controlling" party and tend to tax all income of the CFC without distinction between active and passive.
- Despite the broad application, the foreign CFC rules generally provide an exception for CFCs engaged in genuine economic activities and remain "targeted anti-avoidance measures".
- The Russian CFC rules in significant part follow the international approach, although do not have "genuine economic activity" exception and are not "targeted anti-avoidance measures"
- The Russian CFC rules can be challenged as violating the key legal principles and DTTs

| Criterion | Foreign CFC Legislation | OECD Recommendations | Russian CFC Law |
|---------------------------------------|--|---|---|
| CFC rules' objectives | Anti-avoidance (as predominant) CEN+CIN / CEN Information gathering | Anti-avoidance/Deterrent effect (as predominant) + Any objective (as part of fiscal sovereignty) | Fiscal (as predominant) CEN + deoffshorization Anti-avoidance Information gathering |
| CFC substantive rules | <ul style="list-style-type: none"> • "classic" CFCs: narrow application • "contemporary" CFCs: broad application to corporate and unincorporated entities using legal, factual, economic control definition; taxing all or predominantly all income | <ul style="list-style-type: none"> • Broad application • To corporate and transparent entities and PEs • Using legal, economic plus de facto control test • The level of control – more than 50% although lower level is possible • The CFC attributable income is income that raises BEPS concerns. | <ul style="list-style-type: none"> • Very broad application • apply to both corporate and unincorporated entities • use legal and de facto control for definition of a "controlling" party • tax all income of a CFC without distinction for active and passive |
| CFC rules and legal principals | <ul style="list-style-type: none"> • generally do not violate the principle of equity (non-discrimination) and legal certainty, exceptions are possible | CFC rules should: <ul style="list-style-type: none"> • effectively prevent avoidance while reducing administrative and compliance burdens • meet the balance between taxing foreign income and maintaining competitiveness | <ul style="list-style-type: none"> • can be considered to violate the equity principle as Russian CFC rules are not "targeted anti-avoidance" measures • can violate legal certainty as the formation of a "black list of jurisdictions" is not fully transparent and is subject to frequent changes • violate the principle of balance of public/private interest |
| CFC rules and DTTs | <ul style="list-style-type: none"> • Direct derogations on CFC - in DTTs (i.e. France's DTTs, Canada's DTTs, etc.) • Direct derogations on CFC application despite DTTs – in the national law (i.e. Germany, Australia) • If no direct derogations, CFC application in the context of DTT can be challenged to violate art. 7 (1), 5(1) | <ul style="list-style-type: none"> • CFC rules do not contradict MC and DTT if the states maintain "equity and neutrality" | <ul style="list-style-type: none"> • Direct derogations permitting CFC rules application in the Russian DTTs with Brazil, Mexico, US(?), France (?), Canada (?) • CFC rules application in the context of other DTTs can be challenged |

THE POSSIBLE PRACTICAL APPLICATION OF THE THESIS CONCLUSIONS:

- **by the Legislator** – to introduce the recommended amendments to the Russian CFC Law
- **by the practitioners** – to apply thesis ideas and conclusions while structuring the client's defence position to challenge the application of the Russian CFC rules
- **by the students** – to deeper understand the topic of the CFC taxation as part of their contemporary tax study