

“TRUST” – A NEW CONCEPT IN RUSSIA

Authors

Stanley C. Ruchelman
Rusudan Shervashidze

Tags

Deoffshorization
Doveritelnoe Upravlenie
Trust
Russia

In recent years, Russia has introduced several economic and political reforms, including a deoffshorization policy that some would say appears to be sound economic policy but others would say is more politically motivated by the centralization of power in the office of the President. In principle, the idea is to make Russian legislation friendly for Western investors, although the context suggests otherwise. Nonetheless, Russia is attempting to westernize its domestic laws and introduce economic concepts that are familiar to Western businessmen.

BACKGROUND

In 2014, the Russian government came out with a plan that would attack capital flight by residents. This was the so-called “deoffshorization” of investments. Among other things, this legislation increases the tax burden of many offshore holding companies by requiring payment of Russian taxes in the absence of any repatriation of profits. It also requires the disclosure of beneficial owners in the accounting statements of these holding companies. Again, these are concepts that are popular among policy makers in Western Europe, albeit in a different context.

Now, the Russian government is contemplating introduction of the “trust” into the Russian legal system. New laws are anticipated that are intended to formalize Russian arrangements where the nominal owner and the beneficial owner are separate individuals.

TRUST

The concept of the trust has been alien in Russian law, if not Russian practice. In external matters, many Russians have set up trusts in low tax jurisdictions, such as the Bahamas, the Cayman Islands, the Channel Islands, the Isle of Man, Cyprus, and Bermuda. In the West, these arrangements are often used as the first step of an investment in the U.S., Western Europe, or Canada. However, Russian settlers of these trusts often place Russian assets into the trusts, and Russian residents often are unknowing beneficiaries.

Although trusts are often used by businessmen for “tax planning” reasons, the Russian government believes that introduction of the trust concept in which legal ownership is separated from beneficial ownership will not conflict with the previously-announced deoffshorization initiative.

The idea of “*Doveritelnoe Sobstvenost*,” or trust ownership, was introduced in 1993 by executive order. In 1996, the second part of the Russian Civil Code was enacted. It dedicated an entire chapter to the idea “*Doveritelnoe Upravlenie*,” which broadly equates to trust management, and both clarified and altered the way the executive

order was interpreted.

For many, *Doveritelnoe Upravlenie* appears similar to the concept of a trust. However, many important planning tools of the trust are not available under the Russian legal system. Among other things, the concept of *Doveritelnoe Upravlenie* does not recognize a distinction between legal and beneficial ownership, and the duration of the transfer is usually for a short period, much like an escrow prior to a sale or a period of administration during incompetency. These and other differences suggest that a *Doveritelnoe Upravlenie* is not really a viable alternative to a trust.

“Russia has introduced several economic and political reforms, including a deoffshorization policy that some would say appears to be sound economic policy but others would say is more politically motivated.”

ISSUES TO BE RESOLVED

The lack of clear guidance creates uncertainty for Russians who wish to plan for the future and manage their assets. One of the problems that arise when creating a trust is its place of residence. Because the concept of trust is not recognized in Russia, other than the *Doveritelnoe Upravlenie*, there are no rules to determine the tax residence of a trust. Many Russians are advised to place a corporation or holding company under the trust to hold all the assets. This creates additional protection in the event that the trust is not recognized by the Russian tax authorities. The country where the entity is incorporated or managed may provide additional factors to determine the residence of the trust.

Under Russian law, foreign trusts are taxed according to the applicable foreign legislation. Russian-source income that is distributed to a foreign trust is subject to Russian withholding tax imposed at the rate of 15% on dividends. When a legal entity owns the assets, a treaty benefit may further reduce Russian withholding tax. Distributions from a foreign trust to a Russian tax resident are subject to individual income tax at a rate of 13%.

There is also talk of legislation to introduce the concept of an irrevocable trust, which would allow a Russian individual to transfer property to a trust and cease to be the owner of that property. Once the text of proposed legislation is issued, there will be a better idea of how the law will operate on a prospective basis. In meantime, the Russian Tax Code is developing rapidly.