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# A Gateway to Tax-Free Financing of Projects in Russia

Since Russia introduced the concept of the 'beneficial owner of income' into its tax law and court practice, popular schemes of exporting income from Russia free of withholding tax through classic intermediary jurisdictions such as Cyprus, Netherlands, Austria, Switzerland etc. have almost entirely lost their appeal.

The main problem of such schemes is that the income-receiving company that wishes to rely on the privileged rate of withholding tax under the double taxation avoidance treaty can not conclusively prove that it is the beneficial owner of the interest income received from Russia. In the classic layout of such schemes the money is sourced from a purely offshore treasury and then put through the company in a double tax treaty country in a back-to-back fashion to be then loaned to the Russian borrower. Interest from Russia follows a reverse route and ends up offshore.

Consulting firms in the classic transit jurisdictions have come up with several solutions which technically help to prove that the (de-facto) intermediary company can qualify as the beneficial owner of the income (Eg. through the «group relief» scheme, when one company receives an offshore loan and books a loss through the payment of interest on the loan, the amount of the loan is invested into the capital of the second company which lends it into Russia and claims to be the beneficiary of the income because it got the money as capital). However, the Russian tax authorities now have numerous tools to investigate the trail of transfers in such arrangements and will not accept the arrangement's form over substance if the money still ends up with a zero-tax offshore entity.

It becomes evident that as Russia administers its tax matters more and more diligently, low tax solutions should not be based on fiction and trickery. It is much better if a direct provision of the Russian tax law can be used to receive an advantageous tax treatment of certain income.

Such a provision does exist in relation to taxing interest paid by the Russian borrower abroad (withholding tax on interest). The provision was introduced to support Eurobond issues of Russian companies and to provide tax incentives and certainty to international investors, many of whom are zero-tax offshore funds.

The provision of the Russian Tax Code (Art. 310) reads that if the borrowing is made by issuing debt securities which are listed on one of the exchanges on the Russian Central Bank-approved list, there is no withholding tax on interest at all, irrespective of who is the beneficial owner of the interest. It does not matter whether the securities are issued by the Russian borrower or through a dedicated SPV. The

central point is the exchange listing.

Very recently the Central Bank of Russia has added the Kyrgyz Stock Exchange to its approved exchanges list, driven by the political objective of stimulating cooperation between the Customs Union States.

In order to finance a Russian project with debt without having to worry about the withholding tax on interest one has the following options:

- the Russian borrower may issue bonds and list them (as a primary listing) on the Kyrgyz Stock Exchange, or-
- a Kyrgyz company can be used as the SPV to issue bonds and list them on the Kyrgyz Stock Exchange, or-
- the SPV could be registered in any comfortable country (Eg. Cyprus or the Cayman Islands), the issue of bonds could be approved by the Kyrgyz regulator as foreign securities registered for local distribution, and the bonds could then be listed on the Kyrgyz Stock Exchange.

When planning this arrangement it is vital that proper tax consultants are employed on the Russian side, to deal with many ancillary matters which require planning (such as the thin capitalization rules etc.). On the Kyrgyz side we can support the described financing scheme on a turn-key basis.