

Offshores Restricted From Participation In Privatizations And Acquisitions Of Russian Strategic Companies

July 10, 2017

On July 1, 2017, the President of Russia signed into law the ‘de-offshorization’ amendments (the “Amendments”) to Federal Law No. 178-FZ “On Privatization of State and Municipal Assets” of December 21, 2001 (the “Privatization Law”) and Federal Law No. 57-FZ “On the Order of Accomplishing Foreign Investment in Entities Having Strategic Importance for Procuring State Defence and Security” of April 29, 2008 (the “FSIL”). The Amendments were officially published at www.pravo.gov.ru on the same date and became effective immediately upon publication. In short, the Amendments ban offshore companies established in 40 jurisdictions identified by the Ministry of Finance of Russia (an “offshore company”) from purchases of Russian state (or municipality) owned assets in privatization sales and from acquisition of control over Russian ‘strategic’ companies (or their assets).

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors

MOSCOW

Cleary Gottlieb Steen & Hamilton LLC
Paveletskaya Square 2/3
Moscow, Russia 115054
T: +7 495 660 8500
F: +7 495 660 8505

Scott Senecal

+7 495 660 8520
ssenecal@cgsh.com

Murat Akuyev

+7 495 660 8540
makuyev@cgsh.com

Yulia Solomakhina

+7 495 660 8588
ysolomakhina@cgsh.com



A. Restricted Jurisdictions

To date, the ‘de-offshorisation’ reform has been principally carried out with respect to taxation. The Amendments make use of the list of restricted jurisdictions (the “List”) originally promulgated by the Ministry of Finance of Russia¹ for tax purposes, which identifies 40 states and territories, including the Bahamas, Bahrain, Bermuda, the British Virgin Islands, the Cayman Islands, the Channel Islands, Gibraltar, Panama and the UAE (for the complete List, see Annex A). Certain jurisdictions often used for corporate holdings of Russian businesses – such as Cyprus, Luxemburg and the Netherlands – are not on the List. So far, the List has been used in taxation to determine the jurisdictions with respect to which Russian companies may not apply zero tax on dividends received from foreign entities, which may otherwise apply. Since 2016, the List has also been used to define the jurisdictions the residents of which may not (directly or through its controlled foreign or Russian companies) receive Russian state subsidies and state budget funds.

B. Privatization Law

Pursuant to the Amendments, the following legal entities may not act as purchasers of state (or municipality) owned assets in a privatization transaction: (1) an offshore company; (2) a legal entity controlled by an offshore company; and (3) a legal entity “controlled by a group of persons which includes an offshore company”.

In light of the statutory definition of a “group of persons”, the third category is quite broad, so that a purchaser registered in a ‘clean jurisdiction’ would be prohibited from participation in a privatization transaction if the purchaser has a sister company registered in a restricted jurisdiction, even though such sister company does not have any control over the

purchaser. In this vein, it is unclear if the new restrictions capture a purchaser ultimately controlled by an identified individual with Russian citizenship or a corporate entity incorporated in Russia where the corporate holding structure controlled by such person includes an off-shore company. Arguably, an offshore company could hold a minority, non-controlling stake in an acceptable purchaser.

Although the Amendments may appear severe on their face, their effect on certain future privatizations may be tempered for at least two reasons. First, the largest privatizations have been specifically exempted from the requirements of the Privatization Law. Second, one cannot exclude the use of the back-to-back or similar structures under which state-owned assets are initially purchased by independent intermediaries or companies registered in clean jurisdictions for on-sale to various investors on the secondary market (as would be the case in an underwritten public offering).

C. FSIL

Pursuant to the Amendments, (1) an offshore company or (2) an investor controlled by an offshore company is now effectively treated as a sovereign investor under the FSIL (while, unlike the Amendments to the Privatization Law, a legal entity controlled by a group of persons which includes an offshore company is not captured by the Amendments to the FSIL) and as such:

(1) such entity may not acquire “control” over a strategic company or own, hold or use main operational assets of a strategic company if the value of such assets is or above 25 per cent of the strategic company’s total assets; for this purpose, “control” certainly includes owning more than 50 per cent of the voting shares of the strategic company, and may capture a less than 50 per cent shareholder that affords effective control (e.g., a 40 per cent shareholding in a

¹ Order of the Ministry of Finance of Russia No. 108n of 13 November 2007 “On Approval of the List of States and Territories Providing Beneficial Tax Treatment and (or) Not Disclosing and Sharing of Information in Conducting Financial Operations (Offshore Zones)”, as amended.

public company that otherwise has a broad diversified shareholder base with no other major shareholder);

(2) such entity is required to obtain a prior approval of the special governmental commission for monitoring foreign investment into strategic companies chaired by the Russian Prime Minister (the “Commission”) for a transaction resulting in a direct or indirect acquisition by such entity of (i) more than 25 per cent of voting rights in a strategic company (or more than 5 per cent if the Russian target is a strategic mining company), or (ii) the ability to block such company’s corporate decisions.

The above thresholds apply on an aggregated basis, now aggregating the holding of such persons and all sovereign investors. In practice, it may be difficult to ascertain the aggregate holdings of such entities.

Pursuant to the FSIL, the Commission cannot waive the above restrictions. However, under the FSIL its restrictions are not applied in respect of entities ultimately controlled by a Russian individual who is a Russian citizen and tax resident, without dual citizenship, provided proper disclosure of such Russian beneficiary has been made.

The Amendments expressly do not have a retroactive effect. However, any new investment made by an offshore company (or an investor controlled by an offshore company) after July 1, 2017 will be aggregated with pre-July investments in assessing whether such new investment may result in “control” over a strategic company or whether the Commission’s prior approval is required.

If you have any questions, or if you wish to discuss the Amendments further, please feel free to contact your usual contacts at the firm. You may also contact Scott Senecal (ssenecal@cgsh.com), Murat Akuyev (makuyev@cgsh.com) or Yulia Solomakhina (ysolomakhina@cgsh.com) at the Moscow office of the firm at +7 495 660 85 00.

...

CLEARY GOTTLIB

Annex A

List of Restricted Jurisdictions promulgated by the Russian Ministry of Finance

1. Anguilla;
2. the Principality of Andorra;
3. Antigua and Barbuda;
4. Aruba;
5. the Commonwealth of Bahamas;
6. the Kingdom of Bahrain;
7. Belize;
8. Bermuda;
9. Brunei-Darussalam;
10. Republic of Vanuatu;
11. British Virgin Islands;
12. Gibraltar;
13. Grenada;
14. the Commonwealth of Dominica;
15. People's Republic of China:
 Hong Kong Special Administrative Region (XiangGang);
 Macao Special Administrative Region (Aomen);
16. the Union of Comoros:
 Anjouan Island;
17. the Republic of Liberia;
18. the Principality of Liechtenstein;
19. the Republic of Mauritius;
20. Malaysia:
 Labuan Island;
21. the Republic of Maldives;
22. the Republic of the Marshall Islands;
23. the Principality of Monaco;
24. Montserrat;
25. the Republic of Nauru;
26. Curacao and Saint Martin (the Netherlands territory);
27. the Republic of Niue;
28. United Arab Emirates;
29. Cayman Islands;
30. Cook Islands;
31. Turks and Caicos Islands;
32. the Republic of Palau;
33. the Republic of Panama;
34. the Republic of Samoa;
35. the Republic of San Marino;
36. Saint Vincent and the Grenadines;
37. Saint Kitts and Nevis;
38. Saint Lucia;
39. The Administrative Units of the United Kingdom:
 Isle of Man;
 Channel Islands (Guernsey, Jersey, Sark, Alderney Islands);
40. the Republic of the Seychelles.