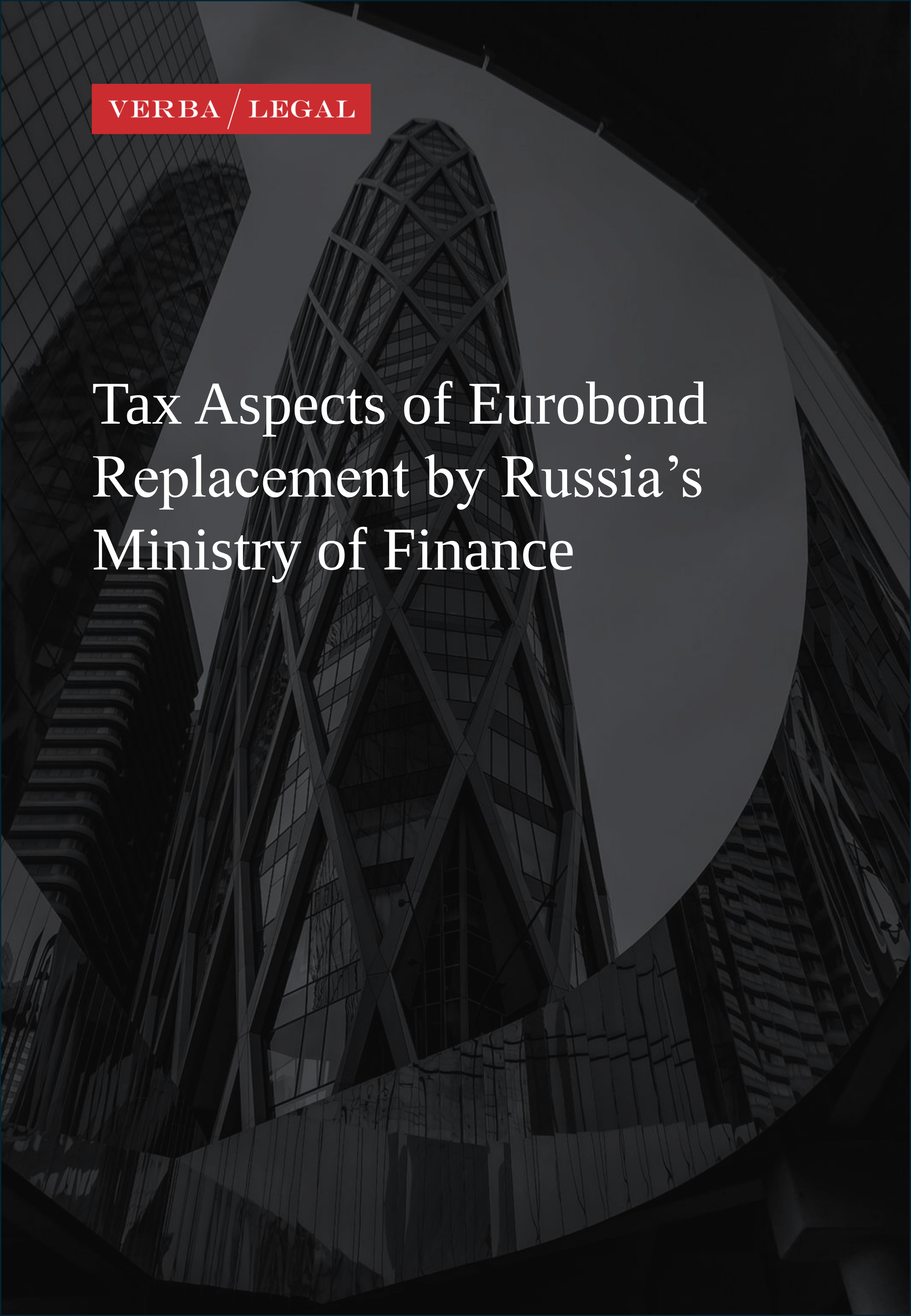
VERBA / LEGAL



Tax Aspects of Eurobond Replacement by Russia's Ministry of Finance

The August 2024 Presidential Decree provided to the investors an opportunity to have the Eurobonds issued by Russia’s Ministry of Finance replaced (Decree of the President of the Russian Federation No. 677 dated 8 August 2024). This step was made because the imposed sanctions did not allow the Eurobond holders to receive coupon payments.

For the purposes of the above-mentioned Presidential Decree, the Ministry of Finance developed the terms for the so-called “replacement” of its Eurobonds (Order of the Ministry of Finance of the Russian Federation No. 388 dated 5 September 2024). The idea of such replacement is very simple: in exchange for the original Eurobond issued by the Ministry of Finance, the investor gets MinFin’s Eurobonds with identical issue details but recorded in accounts of a Russian depository, so that coupon payments might be made without any problems.

From the tax perspective, replacement of Eurobonds (i.e. exchange of one security for another) gives way to double profit-taking (from the civil law point of view, it is assumed that the investor has disposed of the Eurobond being replaced, and has received the replacement Eurobond in exchange). As a general rule, in respect of any individual selling securities, it is required to determine the taxable base (financial result) of the sale for personal income tax (PIT) purposes.

If such is the case, the replacement might have resulted in the investor gaining income from the exchange rate differences, as the Eurobonds are denominated in foreign currency, with the price to be recalculated on the basis of the rouble exchange rate as at the Eurobond purchase and sale dates. For example, if a Eurobond cost 100 USD both when acquired and when replaced (i.e. disposed of), then, in case of the rouble fall against the dollar, the replacement should have given the investor a taxable income in the form of the relevant exchange rate difference.

To eliminate such tax consequences, the legislators made targeted changes in the Russian Tax Code, and provided for retrospective application of same as of 1 January 2024 (Federal Law No. 362-FZ dated 29 October 2024). Similar amendments had earlier been made in respect of corporate Eurobonds.

Now, based on paragraph 25 of Clause 13 of Article 214.1 in the Russian Tax Code, no taxable base shall be determined when government Eurobonds are exchanged for (replaced with) substitution government Eurobonds. Therefore, no taxable income from the exchange rate differences will accrue to the investor in case of replacement.

In case of subsequent sale (redemption) of the replacement Eurobonds received by the taxpayer as a result of such exchange (replacement), documented expenses for the acquisition of the replaced Eurobonds (i.e. historic expenses), which the taxpayer had held prior to such exchange (replacement), shall be recognized as the taxpayer's documented expenses, provided that, should the expenses for the acquisition of the replaced Eurobonds have been borne in foreign currency, they shall be converted into roubles at the exchange rate valid on the date of such subsequent disposal of the replacement Eurobonds.

Subclause 3 of Clause 2 of Article 219.1 of the Russian Tax Code was amended to read that for the purposes of applying the investment tax deduction in the amount of a positive financial result of the security sale (the so-called "long-term possession allowance"), the possession period in respect of the replacement Eurobonds shall run from the date when the investor acquired the replaced Eurobonds. The long-term possession allowance shall apply to investors who have been holding securities for at least three years without interruption. Such investor shall be entitled to a tax deduction of up to 3 million roubles for each year.

For example, if Eurobonds were acquired in 2017 and replaced in 2024, the period of the replacement Eurobonds (when sold) having been held by the investor shall, for tax purposes, run from 2017 (i.e. the replacement procedure shall not interrupt the Eurobond possession period).

The period, when the replaced Eurobond remained in the possession of a controlled foreign company (CFC) with the investor as controlling person, shall also be included in the possession period in respect of the replacement Eurobond.

Essentially similar amendments have been made for the corporate tax purposes, stipulating that (1) no income subject to corporate tax will accrue to a company receiving replacement Eurobonds (subclause 33.3 of Clause 1 of Article 251 in the Russian Tax Code), and (2) for the purposes of financial result determination in case of any subsequent sale of the replacement Eurobonds, the cost thereof shall be deemed equal to the company's expenses for acquisition of the replaced Eurobonds (Clause 5.1 of Article 280 of the Russian Tax Code).

It should be noted, however, that the above rules will apply only in respect of the Eurobonds which were held by the investors or their CFC as at 1 March 2022.

We believe that the relevant clause was included in order to prevent claims for more favourable tax treatment from any investors who acquired Eurobonds at a considerable discount from foreigners in the foreign perimeter (as we understand, there were quite a number of such deals, since many brokers promoted such investment option in 2022–2024).

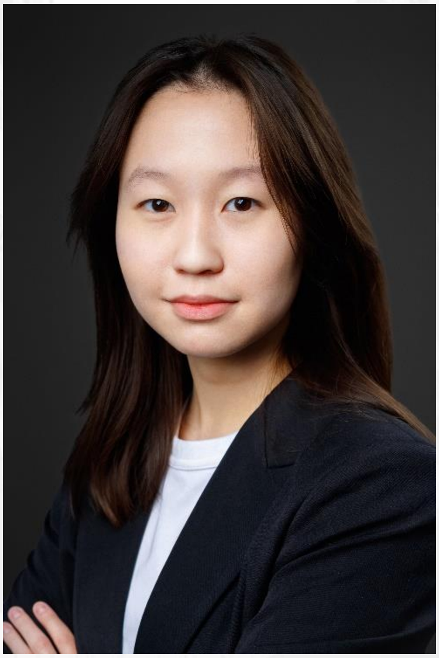
Buying Eurobonds at a discount from foreign holders of Russian bonds became possible, because the imposed sanctions had practically deprived many foreign investors of the possibility to sell such securities on local stock exchanges.

Thus, a replaced Eurobond acquired by the investor after 1 March 2022 will, when replaced, entail (1) such investor's income subject to PIT in the form of an exchange rate difference (if the Eurobond acquisition cost in foreign currency is equal to its cost as at replacement), or of a positive financial result (if the Eurobond was bought at a discount), and (2) the period of the replacement Eurobond having been in the investor's possession shall, for the purposes of the investment tax deduction, start anew from the date of replacement.

Контакты

/ Evgeniia Zainchukovskaia
Counsel
evgeniia.zainchukovskaia@verba.legal

/ Andrey Sheptiy
Senior associate
andrey.sheptiy@verba.legal



/ Altana Lidzhieva
Paralegal
altana.lidzhieva@verba.legal

VERBA / LEGAL

- info@verba.legal
- +7 (495) 374-74-03
- 11 Gogolevsky Boulevard,
  Moscow, 119019

t.me/verbalegal

t.me/ma_nagogolevskom