



**THE DISCLOSURE OF BENEFICIAL OWNERS IN OFFSHORE TRUSTS
AS A METHOD TO PREVENT TAX AVOIDANCE IN THE RUSSIAN FEDERATION
AND THE UNITED KINGDOM**

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Abstract

This thesis analyses the disclosure rules for beneficiary owners in offshore trusts, starting from international standards and then focusing on two jurisdictions: Russia and the UK. After defining the notion of beneficial ownership, it discusses OECD BEPS Actions (primarily Action 3 “Controlled Foreign Companies” and Action 12 “Mandatory Disclosure Rules”) and their implementation in Russia and the UK. It also gives an overview of current tendencies in the development of disclosure rules and provides recommendations for making these rules more effective. In order to conduct this research, the thesis analyzes OECD regulations, legislative and executive acts of Russia and the UK, and case law. The methodology used includes analysis of primary and secondary written sources, case studies, classification, comparative method, systematization and synthesis. The key findings are that Russian and the UK disclosure systems are similar, however, the UK disclosure system is more developed than the Russian one. It is recommended to implement some of the UK policies in Russia, such as public registers of beneficial ownership. It is also recommended to improve certain OECD standards, such as the uniform definition of beneficial ownership. It is noted that the general tendency in the development of disclosure rules is the expansion of their scope, along with the restriction of reporting standards. It is recommended that both Russia and the UK follow these trends in order to improve their disclosure policies.

List of abbreviations

AEOI	Automatic Exchange of Information
BEPS	Base Erosion and Profit Shifting
CFC	Controlled Foreign Companies
EOIR	Exchange of Information on Request
HMRC	Her Majesty's Revenue and Customs
NGO	Non-governmental Organization
OECD	Organization for Economic Cooperation and Development
PSC	Persons with Significant Control
RTC	Requirement to Correct

Introduction

Tax avoidance is a key contemporary issue for state governments, as they seek to ensure tax compliance while businesses and individuals search for ways to minimize their tax expenditures. Among the most popular methods of so-called ‘tax planning’ is the use of offshore tax heavens. According to the NGO Tax Justice Network, over \$21 trillion of “unreported private wealth” was owned by high net worth individuals via offshores in 2010.¹ One popular method by which businesses and individuals avoid reporting income in their home jurisdictions is through the creation of offshore trusts. In addition to low tax rates, in most offshore jurisdictions there are no statutory requirements for the disclosure of beneficiary owners.² Thus, such tax avoidance schemes leave the taxpayers’ home governments without a substantial portion of tax revenue, as it is difficult to identify a prospective taxpayer without knowing the full extent of their taxable assets or income. In order to address this problem, in the past five years many states have tried to restrict their policies regarding the disclosure of beneficial owners of foreign trusts. This thesis analyses such rules and their practical significance, starting from international standards and then focusing on two jurisdictions: Russia and the UK.

One of the leading organizations that works on preventing tax avoidance and promoting ownership transparency is the OECD. It first addressed the tax avoidance problem in 1998, when it published a report on harmful tax competition.³ This was followed by regular publications of “non-cooperative tax havens” black lists, and a number of other measures for increasing tax

¹ James S. Henry, *THE PRICE OF OFFSHORE REVISITED: NEW ESTIMATES FOR “MISSING” GLOBAL PRIVATE WEALTH, INCOME, INEQUALITY, AND LOST TAXES*, TJN (2012), 5.

² See, for example, OECD, Directorate for Financial, Fiscal and Enterprise Affairs: Committee on Fiscal Affairs, Committee on Financial Markets, Joint Sessions on Globalisation and the Tax Treatment of Income and Capital, *A Comparative Analysis of Selected Offshore Financial Centres and Their Influence on Taxation (a discussion draft)*, (1994), Paris.

³ OECD, *Harmful Tax Competition: An Emerging Global Issue* (Report) (1998), Paris.

transparency. One of the most recent measures was the adoption of BEPS (Base Erosion and Profit Shifting) Actions in 2013, which was followed by signing Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS on 7 June 2017.⁴ BEPS Actions provide a variety of recommendations for preventing tax avoidance, and designing effective rules for controlled foreign companies and non-corporate entities is one of them. Over 100 countries are members of the Inclusive framework on BEPS, including both Russia and the UK.⁵

This thesis analyses how the OECD's recommendations have been implemented in Russia and the UK and compares these two jurisdictions. Russia is of particular interest as it has only recently introduced controlled foreign company (hereinafter – “CFC”) and disclosure rules, and, considering that tax avoidance via offshore trust schemes is very common among high net worth individuals, the effectiveness of such rules is as yet unassessed.⁶ The United Kingdom was chosen as it has a longer history of CFC and disclosure rules and at present there is a clear tendency towards restricting control over beneficiary owners. Even though the UK consists of four relatively autonomous jurisdictions, the disclosure rules are adopted at federal level and apply for all four parts of the country.⁷ Moreover, cooperation between Russia and the UK exists in regard to disclosure policies, which is illustrated, in particular, by a series of cases of *Mezhprombank v Pugachev* that are discussed in this thesis.⁸ Following the comparison of regulations and cases in these two jurisdictions, it is possible to make recommendations for the improvement of Russian

⁴ BEPS Actions (Dec. 3, 2017, 2.00 p.m.), <http://www.oecd.org/ctp/beps-actions.htm>, OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (2016).

⁵ OECD: About the Inclusive Framework of BEPS, (Jan. 23, 2.00 p.m.), <http://www.oecd.org/tax/beps/beps-about.htm>.

⁶ *Nalogovii Kodeks RF, chast'1, gl. 3.4 (1998)* [NK] [Tax Code, part 1, section 3.4 (1998)].

⁷ Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017/692 apply at the federal level, meaning that they set uniform requirements for England, Scotland, Wales and Northern Ireland.

⁸ *JSC Mezhdunarodniy Promyshlennyi Bank v. Pugachev*, [2017] EWHC 2426 (Ch).

legislation based on the UK experience, as well as to assess the general effectiveness of disclosure rules in both countries.

This thesis is topical, because BEPS Actions introduced a new approach to promoting tax transparency worldwide, and the effectiveness of this approach still remains to be assessed, as well as practical significance of new disclosure rules in Russia and the UK. This thesis is one of the first comprehensive research works, which not only analyzes new disclosure rules, but also compares them and assesses their practical importance.

The aim of this thesis is to analyze the regulations of the Russian Federation and the United Kingdom for the disclosure of beneficiary owners of foreign trusts after the implementation of BEPS Actions and to propose possible ways of making these regulations more effective. In order to conduct this assessment, the thesis analyzes OECD regulations, legislative and executive acts of Russia and the UK, and case law. The methodology used includes analysis of primary and secondary written sources, case studies, classification, comparative method, systematization and synthesis.

In addition to primary sources, this thesis analyzes a variety of scholarly works. Many authors in both Russia and the UK have researched various aspects of trusts, such as the concept of beneficial ownership and the relationship between the trust participants.⁹ There have been some publications on the disclosure rules as well, but they are not numerous. The thesis relies on recent publications that are familiar with the current regulatory framework.¹⁰ However, in general the

⁹ See, for example, Matthew Russo, *ASSET PROTECTION: AN ANALYSIS OF DOMESTIC AND OFFSHORE TRUST ACCOUNTS*, 23 Mich. St. Int'l L. Rev., 265, (2014); Elena Marty-Nelson, *OFFSHORE ASSET PROTECTION TRUSTS: HAVING YOUR CAKE AND EATING IT TOO*, 47 Rutgers L. Rev., 12, 11 (1994); Vladimir Gidirim, *NALOGOVBLOZHENIE INOSTRANNIH KONTROLIRUEMIIH KOMPANII: MEZHDUNARODNAYA PRAKTIKA*, *Mezhdunarodnoe pravo* 4, 42-60, (2014) [Gidirim, Vladimir, *TAXATION OF CONTROLLED FOREIGN COMPANIES: INTERNATIONAL PRACTICE*, *Int. Law*, 4, 42-60, (2014)].

¹⁰ For instance, Jim Edmondson, *THE PROLIFERATION OF NEW REGISTERS: SOME THOUGHTS ON THE DRIVE FOR TRANSPARENCY*, P.C.B., 150 (2017).

literature is yet to catch up with the new regulatory developments. For example, on some of the most recent changes discussed in this thesis, such as OECD Model Disclosure rules 2018, no scholarly works have been published yet.¹¹ In relation to these changes, the thesis discusses a number of OECD working papers, reports and discussion drafts that explain the background, aims and methods of these initiatives.¹² As far as the domestic regulations of Russia and the UK are concerned, in addition to academic sources the thesis relies on the official guidance of HMRC and the information provided by the Russian tax service.¹³

The thesis will proceed in four parts. The first part of this thesis is concerned with defining the classic concept of beneficial ownership in trusts. It discusses in what context beneficial ownership is used for the purpose of disclosure rules in Russia and the UK. It also gives an overview of the role of the beneficial owner in offshore trusts and his relation with other trust participants. The aim of the first chapter is to explain the notion of beneficial ownership, to show the peculiarities of the beneficiary's position in offshore trusts, and to determine the features and criteria of beneficial ownership that are most important for disclosure rules.

The second part is dedicated to an overview of international disclosure standards and the comparative analysis of disclosure rules in Russia and the UK. The purpose of the second chapter is to analyze the existing regulatory framework and to determine the scope of disclosure rules. It discusses BEPS Actions in order to explain the general international framework for disclosure

¹¹ OECD, Model Mandatory Disclosure Rules for CRS Avoidance Arrangements and Opaque Offshore Structures, OECD (2018), Paris.

¹² For example, OECD, *BEPS Project Explanatory Statement: 2015 Final Reports*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, (2016), Paris; Model Mandatory Disclosure Rules for CRS Avoidance Arrangements and Opaque Offshore Structures: *Commentary*, OECD (2018), Paris.

¹³ For example, HMRC Compliance Checks Series: *Higher Penalties for Offshore Matters*, CC/FS17 (2017); FNS: *Podvedeni Resultati Primeneniya Nalogoplatelschikami Pravil KIK v 2017 Gody* [Federal Tax Service: The Results of Using CFC Disclosure by the Taxpayers by 2017] (Mar., 27, 2018, 2.00 p.m.), https://www.nalog.ru/rn77/news/activities_fts/7144772/.

rules.¹⁴ The thesis puts emphasis on Action 3 (Designing effective controlled foreign company rules) and Action 12 (Mandatory disclosure rules), as these Actions are of biggest relevance for the disclosure of beneficial owners.¹⁵ Then, the thesis assesses how these international standards were implemented in Russia and the UK, analyzing domestic legislation of these states. It also gives an overview of OECD Model Disclosure Rules 2018, and reflects on how their implementation will affect the disclosure policies of Russia and the UK.¹⁶

The final part discusses the most recent tendencies in the development of disclosure standards internationally, as well as in Russia and the UK. It focuses on the ultimate tendencies of disclosure expansion and the restriction of reporting standards. The expansion of disclosure in practice is illustrated by a 2017 case of *JSC Mezhdunarodniy Promyshelnniy Bank v. Pugachev*, which, using the “true effect of the trust” test, determined the ultimate settlor and beneficiary of an offshore trust.¹⁷ The chapter proceeds by giving an overview of the most recent disclosure initiatives of the OECD, demonstrating how they are implemented in Russia and the UK. The final part of the chapter provides recommendations for the improvement of disclosure rules based on the overall analysis conducted in the thesis and the comparison between Russia and the UK. The objective of the third chapter is to assess the effectiveness of disclosure rules, to determine the areas where they are less effective, to propose the changes that will improve the current policies, and to predict how these policies will develop in the future.

¹⁴ BEPS Actions (Dec. 3, 2017, 2.00 p.m.), <http://www.oecd.org/ctp/beps-actions.htm>

¹⁵ *Id.*

¹⁶ OECD, Model Mandatory Disclosure Rules for CRS Avoidance Arrangements and Opaque Offshore Structures: Commentary, OECD (2018), Paris

¹⁷ *JSC Mezhdunarodniy Promyshelnniy Bank v. Pugachev*, [2017] EWHC 2426 (Ch).

Chapter 1. Theoretical Aspects of Beneficial Ownership in Trusts

This chapter discusses the general concept of beneficial ownership. First, it gives a definition of beneficial ownership in trusts (discussing the concept and structure of a trust, as well as the relationship between trust participants). Then, it shows how trusts are used in offshore jurisdictions, demonstrating how the traditional roles of trust participants can change for the purposes of shifting income and tax avoidance. Finally, the chapter analyses the concept of beneficial ownership that is adopted by international standards and domestic disclosure rules of Russia and the UK. It should be noted that the notion of beneficial ownership in disclosure rules and the notion of beneficial ownership in trusts are different. The definition of beneficiary in disclosure rules is based on the classic trust law concept; however, the final part of the chapter explains that this definition is broader due to the scope and specific nature of the disclosure rules.

1.1. The Concept of Beneficial Ownership in Trusts

The concept of beneficial ownership describes a situation when an individual (a beneficiary) receives profit from property or assets in the absence of legal ownership of such property or assets. This concept is of crucial importance for preventing tax avoidance since the income of beneficiaries is taxable, therefore, the existence of such income should be disclosed. Before discussing the disclosure rules for foreign trusts, it is necessary to define the concept of beneficial ownership in general and to determine the role of beneficiary in a trust. Thus, this part of the thesis focuses on legal and scholarly definitions of beneficial ownership. It also gives a brief overview of trust concept and structure in order to determine the place and role of beneficiary in a trust.

The notion of beneficial ownership was first developed in common law, as well as the trust legal structure itself. According to Black's law dictionary, a beneficial owner is "one for whose

benefit a trust is created; a cestui que trust. A person having the enjoyment of property of which a trustee, executor, etc. has the legal possession”.¹⁸ This definition essentially means that the beneficiary receives income from property or assets held in trust by someone else. The characteristic feature of beneficial ownership is that it is based on the equitable title, while the legal title remains with the trustee. One of the best comprehensive explanations of this phenomenon, often referred to as “split title”, was given by Lord Diplock in *Ayerst v. C&K Construction Ltd*:

The concept of legal ownership of property which did not carry with it the right of the owner to enjoy the fruits of it or dispose of it for his own benefit, owed its origin to the Court of Chancery. The archetype is the trust. The “legal ownership” of the trust property is in the trustee, but he holds it not for his own benefit but for the benefit of the cestui que trust. Upon the creation of a trust in the strict sense as it was developed by equity the full ownership in the trust property was split into two constituent elements, which became vested in different persons: the “legal ownership” in the trustee, what came to be called the “beneficial ownership” in the cestui que trust.¹⁹

Thus, the nature of trust is quite particular. It is based on a distinction between legal and equitable title. The first one is transferred to the trustee, and the latter one remains with the beneficiary. The legal owner has the right to possess and use the property, however, he does not hold actual interest in it.²⁰

¹⁸ Black’s Law Dictionary, 4th ed. (1968), 199.

¹⁹ *Ayerst (Inspector of Taxes) v C&K (Construction) Ltd* [1976] AC 167.

²⁰ Matthew Russo, *ASSET PROTECTION: AN ANALYSIS OF DOMESTIC AND OFFSHORE TRUST ACCOUNTS*, 23 Mich. St. Int’l L. Rev., 266, (2014).

In order to understand the place of the beneficiary in the trust, it is necessary to define the trust concept as a whole and to determine the roles of other participants of this legal relationship. Black's law dictionary defines trust as "the right, enforceable solely in equity, to the beneficial enjoyment of property to which another person holds the legal title; a property interest held by one person (the trustee) at the request of another (the settlor) for the benefit of a third party (the beneficiary)."²¹ The second part of this definition names three participants of a trust. The settlor puts his assets in trust, therefore, the settlor creates the trust. Every-day management of these assets is conducted by the trustee, without the participation of the settlor. Any profit that is derived from trust is distributed to the beneficiary, who, in some cases, may be the same person as the settlor. One of the most universal and comprehensive descriptions of trust participants, along with other specific characteristics of trust, is given in the Hague Convention on the Law Applicable to Trusts and on Their Recognition.²² Art. 2(2) of the Convention states three features of the trust (essentially looking at them from the trustee's perspective):

(1) the assets constitute a separate fund and are not a part of the trustee's own estate; (2) title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee; (3) the trustee has the power and the duty, in respect of which he is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law.²³

²¹ Black's Law Dictionary, 8th ed. (2004), 4699.

²² Hague Conference on Private International Law, Convention on the Law Applicable to Trusts and on their Recognition, (1985).

²³ *Id.*, art. 2(2).

The final part of art. 2 is of particular interest as it states that “the reservation by the settlor of certain rights and powers, and the fact that the trustee may himself have rights as a beneficiary, are not necessarily inconsistent with the existence of a trust”.²⁴ This part emphasizes that, contrary to the traditional image of trust, the roles of the persons involved may be mingled. For instance, the settlor may still retain some decision power, and he does not disappear completely. In addition, certain interests of the trustee may be the same as those of the beneficiary.²⁵ The convention intentionally draws attention to such possibilities, and they can be very widely interpreted and utilized in the context of offshore trusts, where the beneficiary (often the same person as the settlor) essentially controls all decision-making and management of assets and property.

Although the trust was created in the common law system, as time passed it spread to civil law countries, and even became regulated on the international level by the abovementioned Hague Convention. The ultimate reason for its increased popularity is that it is a very convenient vehicle for property and asset management for a number of purposes, some of which include transfers of wealth within families, real estate management, asset protection, and tax planning (the latter one being the focus of this thesis). Inevitably, trust has undergone modifications in some jurisdictions in order to fit their legal framework and economic realities. In particular, in Russia, one of the jurisdictions this thesis focuses on, there is no distinction between the legal and equitable title to property (since being a civil law country, Russia is unfamiliar with law of equity). Russian Civil Code contains the concept of “trust *management* of property” instead.²⁶ The key difference between trust management and common law trust is that the trustee in trust management does not

²⁴ *Id.*, art. 2(3).

²⁵ Alfred E. Von Overbeck, Explanatory Report on the 1985 Hague Trusts Convention, Proceedings of the Fifteenth Session (1984), volume II, *Trusts – Applicable Law and Recognition*, 380.

²⁶ *Grazhdanskii Kodeks Rossiiskoi Federatsii* (1995) [GK RF], [Civil Code of the Russian Federation (1995)], art. 1012.

acquire ownership of the property, while the structure of the legal relationship, in principle, remains the same: as stated in art. 1012 of the Civil Code, “the transfer of property in trust management does not entail the transfer of ownership to the trustee”.²⁷

Therefore, trust can be characterized as a legal relationship between the settlor, the trustee and the beneficiary. The role of the beneficiary at first sight may be characterized as passive, as the beneficiary only receives profits from assets or property of the settlor, which are managed by the trustee. Thus, the beneficiary contributes neither his assets nor his time and management skills. However, the rights and obligations of the parties may be mingled, as in practice, especially in offshore trusts, beneficiaries (who may be the same individuals as settlors) have some (if not all) decision-making and control power. The next part of this thesis examines the peculiarities of beneficiary’s position in offshore trusts, in particular the relationship between the settlor, the trustee and the beneficiary, which make offshore trusts a popular vehicle for tax planning.

1.2. The Features of Beneficial Ownership in Offshore Trusts

In principle, offshore trusts have the same structure as conventional trusts. However, in practice the functions of trust participants can be quite different. The same applies for the aims of offshore trusts, which, being based on the traditional notion of asset and property management, additionally incline towards asset protection, anonymity and secrecy, and tax avoidance. This part of the chapter discusses the features of participants’ relations in offshore trusts, as well as the aims that justify a shift from their traditional roles.

The two basic reasons for setting up an offshore trust are asset protection and tax avoidance, both of which involve “hiding” of the real beneficiary, who is often the same person as the settlor. According to Elena Marty-Nelson, “offshore asset protection trusts are the trusts created under the

²⁷ *Id.*

laws of certain foreign jurisdictions in order to shield the assets transferred to the trust from future creditors”.²⁸ Thus, the first reason to set up an offshore trust is to put the assets out of reach of creditors. Such shielding of assets occurs because the settlor formally does not own the assets anymore. The second reason to set up an offshore trust is connected to tax benefits of offshore jurisdictions. Generally, in offshore jurisdictions most taxes for companies and individuals are either absent or very low. For instance, the British Virgin Islands (the BVI) does not have capital gains tax, profit tax or inheritance tax, which makes it very attractive for foreign investors.²⁹ Furthermore, since most offshore jurisdictions do not have mandatory beneficiary disclosure requirements, beneficiaries can avoid paying taxes in their domestic jurisdictions as well. For example, in the BVI the information about the trust beneficiary is only available to the settlor and the trustee, or, if the beneficiary holds shares in a BVI company through a trust, to the registered agent of this company. There are no mandatory rules regarding the disclosure of beneficiary owners to state authorities in the BVI.³⁰ This also means that the traditional trust structure may be eroded, since if the beneficiary is undisclosed the authorities will not discover if the beneficiary does not in fact receive income or if the ultimate beneficiary is the settlor.

The reasons above show that in the case of some offshore trusts, the settlor may not really intend to transfer the assets into the trust for the benefit of a third person, but rather for his/her own benefit (even if formally beneficiary is a third party). Therefore, a problem of self-settled, discretionary, illusory and sham trusts in offshore jurisdictions has been raised in a number of court decisions.

²⁸ Elena Marty-Nelson, *OFFSHORE ASSET PROTECTION TRUSTS: HAVING YOUR CAKE AND EATING IT TOO*, 47 Rutgers L. Rev., 12, (1994).

²⁹ British Virgin Islands Tax Guide 2013, PKF International, (Dec. 3, 2017, 2.00 p.m), <http://www.pkf.com>

³⁰ British Virgin Islands Business Companies Act, part V (2006).

A self-settled trust exists when a settlor creates a trust for his/her own benefit.³¹ Such trusts may formally have a beneficiary, however, they contain a spendthrift provision, which restricts the right of the beneficiary to assign his interest in the trust to someone else and puts the trust income out of the reach of the creditors before it is actually transferred to the beneficiary.³² Usually the ultimate beneficiary owner in such trusts is either the settlor or his family members. Elena Marty-Nelson established five criteria for determining whether a trust is self-settled:

- (1) the settlor is a beneficiary;
- (2) the settlor has dominion or control over the trust;
- (3) the settlor reserves a general power of appointment in the trust;
- (4) the settlor creates a trust for his or her own support;
- (5) one person supplies the property of a trust, even though, on paper, the trust is created by a third person.³³

These criteria demonstrate that in self-settled trust the settlor has extensive control over the trust, and in most cases is also the ultimate (final) recipient of the trust income. Therefore, in such trusts the settlor and the beneficiary are almost always the same person. This is contradictory to the purpose of the trust itself, and quite often regarded as a mere scheme for asset protection and tax avoidance.

Another trust category that can be used for offshore asset protection and tax avoidance is discretionary trusts. In this type of trusts there is no specifically defined beneficiary, but rather a class of beneficiaries.³⁴ The trustee has broad discretion in choosing which beneficiary from the

³¹ Kellsie J. Nienhuser, *DEVELOPING TRUST IN THE SELF-SETTLED SPENDTHRIFT TRUST*, 15 Wyo. L. Rev., 556, (2015).

³² *Id.*, 557.

³³ Elena Marty-Nelson, *Supra* note 21, at 31-33.

³⁴ James Lorenzetti, *THE OFFSHORE TRUST: A CONTEMPORARY ASSET PROTECTION SCHEME*, 102 Com. L.J. (1997), 140.

class receives the trust income.³⁵ In such circumstances, the trustee has a higher fiduciary duty by comparison to other trust types, as he must consider the circumstances and needs of every beneficiary from the class before deciding on the income distribution. The trustee must, as stated by Lord Wilbforce in *McPhail v Doulton*:

Examine the field by class and category; might indeed make diligent and careful enquiries, depending on how much money he had to give away and the means at his disposal, as to the composition and the needs of particular categories and of individuals within them; decide upon certain priorities or proportions, and then select individuals according to their needs or qualifications.³⁶

Thus, the powers of the trustee in discretionary trusts are broad and significantly influence the fate of the trust and its beneficiaries. In order to control these powers, many settlors in addition to trustees designate trust protectors, who make sure that the trustee follows the intentions of the settlor. Typically, a protector can appoint or remove the trustees and influence or even veto trustee's decisions.³⁷ In certain cases the settlor may decide to be the protector himself. In such a situation, the role of the trustee becomes very limited, as the settlor controls most of the trust management. Furthermore, if such a settlor is also nominated as one of the beneficiaries in the class, illusory and sham trust claims may arise.³⁸

Illusory and sham trusts are considered as trusts which are not “real”, and exist only for the purposes of shielding the settlor from the creditors or taxes. The distinction between illusory and

³⁵ *Id.*

³⁶ *McPhail v Doulton* [1971] AC 424.

³⁷ Matthew Russo, *ASSET PROTECTION: AN ANALYSIS OF DOMESTIC AND OFFSHORE TRUST ACCOUNTS*, 23 Mich. St. Int'l L. Rev., (2014), 284.

³⁸ As in *JSC Mezhdunarodniy Promyshel'niy Bank v. Pugachev*, [2017] EWHC 2426 (Ch), which will be discussed in detail in Chapter 3.

sham trusts was drawn in *Clayton v. Clayton*, where the Supreme Court of New Zealand found a trust illusory when “the document as executed does represent the terms to which the parties intended to agree but, despite their subjective intention to create a trust, they failed in their attempt to do so”.³⁹ Therefore, in distinguishing illusory and sham trusts, subjective intent is a decisive factor. If there was no intent to create a trust that was not real, it is illusory, however, if there was such intent, it becomes a sham. In *Equus Corp Pty Ltd v Glengallan Investments Pty Ltd*, the High Court decided that sham is a “legally effective transaction but which the parties intend should not have the apparent, or any, legal consequences”.⁴⁰ In *Snook v London and West Riding Investments Ltd* Lord Diplock said:

[Sham] means acts done or documents executed by the parties [...] which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.⁴¹

Thus, in an illusory trust the parties intended to create a trust, but for some reason failed to do so. As stated in *Clayton v. Clayton*, even though Mr. Clayton has excessive trustee powers, a valid trust may come into existence if he is replaced by a new trustee who is not a family member.⁴² In contrast, a sham trust may not become a valid trust at any time, as there was never an intention to make it such. The essential effect of both forms is that the settlor stays in control of the trust, and is a de facto beneficiary. The settlor in both forms may “mislead other people, by creating the appearance that the property did not belong to him”.⁴³

³⁹ *Clayton v Clayton* [2016] NZSC 29.

⁴⁰ *Equuscorp Pty Ltd v Glengallan Investments Pty Ltd* [2004] HCA 55.

⁴¹ *Snook v London & West Riding Investments Ltd* [1967] 2 QB 786.

⁴² *Clayton v Clayton*, [2016] NZSC 29.

⁴³ *JSC Mezhdunarodniy Promyshlenniy Bank v. Pugachev*, [2017] EWHC 2426 (Ch).

To sum up, the most common offshore trust scheme exists where an individual is a settlor and a beneficiary at the same time. The purpose of such trusts is to avoid paying taxes on the assets and income from them, as well as to put the assets out of the reach of creditors. In such a case, to disclose the ultimate beneficiary means essentially to reveal the entire scheme, which will most likely be considered fraudulent and invalid by the court. Clearly, the courts in Russia and the UK seek to reveal such schemes, and therefore disclosure rules are developed. However, before moving onto the analysis of disclosure requirements, it is essential to determine what is considered as beneficial ownership for the purposes of disclosure in both countries.

1.3. The Approaches to Beneficial Ownership in the Context of Tax Avoidance in the Russian Federation and the United Kingdom

After determining the general meaning of beneficial ownership and establishing its features in offshore trusts, it is crucial to analyse the approaches to beneficial ownership in the context of anti-tax avoidance and anti-money laundering regulations of Russia and the UK. While they are based on the beneficial ownership notion developed in common law trusts, they differ from it due to the specific nature and purpose of anti-avoidance and anti-money laundering rules. As it will be explained in this part, the definitions in these rules are broader, because the rules intend to encompass a wide range of scenarios where tax avoidance can occur: the more categories fall under the definitions, the more effective the prevention of tax avoidance is. Therefore, this part of the chapter gives an overview of approaches to beneficial ownership in Russia and the UK, taking into account the international standards for preventing money laundering and tax avoidance.

Both Russia and the UK follow the model rules and definitions set by the OECD. A number of OECD documents deal with beneficial ownership, and one of the most significant is Model Tax

Convention on Income and on Capital.⁴⁴ Although this Convention does not give a definition of beneficial ownership, it has provisions related to beneficial owners in art. 10-12 (which are concerned with dividends, interest and royalties).⁴⁵ They were introduced in order to clarify who can benefit from double taxation agreements, providing that it is not sufficient if the immediate recipient of income is a resident of a contracting state, but instead, such recipient must also be the ultimate beneficial owner of this income.

The absence of a formal definition in the Model Convention led to certain difficulties in determining beneficial ownership, leaving much discretion to court decisions. One of the most important precedents that influenced the rules of interpretation of the Convention is an English case *Indofood International Finance Ltd. v. JPMorgan Chase bank N.A.*, where the court stated that the term “beneficial owner” should not be interpreted according to a “narrow technical domestic law meaning”, but rather to the “international fiscal meaning”.⁴⁶ It essentially means that the court acknowledged that beneficial ownership for the fiscal purposes should not be determined the same way as in classic common law trusts. The court described the beneficial owner of income as a person “that has the full privilege to directly benefit from the income”. This case led to the amendments in the OECD Commentary to the Model Convention in 2014, and the introduction of “use and enjoyment” test.⁴⁷ This test is used to determine the ultimate beneficiary, who has the right to use and enjoy the benefits of the income and who is not limited by an obligation to transfer such income to a third person. If such obligation exists, a person is an intermediary acting in the interest of the ultimate beneficiary owner. An individual is acting as an intermediary if he has very

⁴⁴ OECD Model Tax Convention on Income and on Capital, full version (2014).

⁴⁵ *Id.*, art. 10-12.

⁴⁶ *Indofood International Finance Ltd v JP Morgan Chase Bank NA London Branch* [2006] STC 1195.

⁴⁷ OECD, Commentaries on the Articles of the Model Tax Convention (2014).

narrow powers in relation to the use and transfer of income, and in fact acts as a trustee.⁴⁸ In relation to that, it is crucial to mention the two approaches to beneficial ownership undertaken by scholars, which are the legal and the economic understanding of the concept. While an individual can formally qualify as a beneficiary (for instance, it is so stated in the trust or corporate documentation), in fact he may not be a beneficiary in the economic sense if he does not receive and use the income (for example, if he is a nominee).⁴⁹ For the purpose of tax treaties, there is a requirement to prove that an individual is a de facto beneficiary.

Even with clarifications provided by the OECD Commentary, the absence of clear definition still poses difficulties for determining beneficial ownership in different jurisdictions. According to art. 3(2) of the Model Convention, in the absence of definition in the Convention, every term has a meaning currently accorded to it by the tax legislation of the state party to a tax treaty, and the definitions in tax regulations prevail over the ones in all other regulations of that state.⁵⁰ However, in some countries there is no definition of beneficial ownership in domestic legislation. These are civil law jurisdictions, that are not familiar with the common law trust concept in its classical meaning and that do not have a distinction between law and equity. Russia used to be one of these jurisdictions, however, the necessity to address tax avoidance and money laundering issues led to the recent introduction of beneficial ownership definitions.

The term was first introduced in Russian anti-money laundering law.⁵¹ Four aspects the Russian beneficiary definition are of utmost importance. First, the definition refers to the “ultimate

⁴⁸ *Id.*, 194.

⁴⁹ Inna A. Khavanova, *KONTSEPTSIYA BENEFITSIARNOGO VLADEL'TSA (SOBSTVENNIKA) V NALOGOVOM PRAVE*, Zhurnal Rossiiskogo Prava #12, (2014), 57 [*CONCEPT OF BENEFICIARY OWNER (PROPRIETOR) IN TAX LAW*, Russian Law Journal, 12 (2014), 57].

⁵⁰ OECD Model Tax Convention on Income and on Capital, full version (2014), art. 3(2).

⁵¹ FZ “*O Protivodeistvii legalizatsii (otmivaniu) dokhodov, poluchennih prestupnim putem, i finansirovaniu terrorizma*” (2001), #115-FZ [Federal Law on Prevention of Legalization of Proceeds obtained from Criminal Action and on Prevention of Terrorism Financing].

beneficial owner”, thus meaning that only the final recipient of income qualifies as beneficiary. Second, it mentions that the beneficiary has an interest in at least 25% of the capital, thus setting a threshold for substantive interest in the income from the capital. Third, it states that the beneficiary has ultimate control over the company or non-corporate entity. Finally, it refers only to natural persons as beneficiaries, although in other (for instance, tax) legislation it is undisputed that a legal entity can also be a beneficiary.⁵² Thus, this definition follows the OECD standard in stating that it is the ultimate control and right to benefit from the income which matters in determining beneficial ownership. Only individuals qualify as beneficiaries under anti-money laundering regulations because mostly anti-money laundering regulations are directed at individuals and not legal entities.

Furthermore, Russian tax code uses the term “beneficial owner” (without defining it) in relation to foreign non-corporate entities (including trusts and other forms, such as funds and partnerships).⁵³ It states the obligation of such non-corporate entities to report the data about their beneficiaries, if these entities have income sources in Russia. However, to determine tax liabilities of Russian citizens with respect to foreign income, the tax code uses a different term, “controlling individual or legal entity” (for a foreign trust, the controlling individual for the purposes of the Tax Code is usually the settlor of this trust).⁵⁴ In principle, the nature of this term is similar to the nature of the beneficial owner, since the controlling individuals or entities are almost always the ultimate income recipients. Such wording shows that in the tax code control (the power to appoint or remove trustees/beneficiaries, deal with trust assets, terminate the trust, exercise consent or veto powers), is the most important criterion in determining beneficiary ownership of foreign entities⁵⁵.

⁵² *Id.*, art. 3.

⁵³ *Nalogovii Kodeks RF, chast'1, st.11 (1998)* [NK] [Tax Code, part 1, art. 11 (1998)].

⁵⁴ *Id.*, section 3.4.

⁵⁵ *Id.*, section 3.4, art. 25.13.

In the UK, on the other hand, the beneficial ownership concept is deeply rooted in the legal system, and therefore understanding it from the perspective of anti-money laundering and tax regulations is not as confusing as in Russia. In addition to OECD standards, the UK is also relying on 4th Anti-Money Laundering Directive of the European Union.⁵⁶ The Directive was published on June 25, 2015 and came into force on June 26, 2017. Even though the UK is in the process of leaving the EU, the implementation of this directive continues. The Directive defines a beneficial owner as a natural person who “ultimately owns or controls” the trust, and that in principle includes all trust participants.⁵⁷ Following this definition, the UK anti-money laundering regulations (Regulation 6, art. 3) define a “beneficial owner” as any of these trust participants, as well as a class of possible beneficiaries or anyone else who exercises control.⁵⁸ This approach is similar to the approach of the Russian Tax Code, where by default the settlor is the controlling individual, but it is potentially possible for all other trust participants to fall under this category, provided that they exercise control or receive income from the trust.⁵⁹

In regard to taxation matters, a number of acts, such as Income Tax (Trading and Other Income) Act (Chapter 5), the Taxation of Chargeable Gains Act (Chapter 2), and Inheritance Tax Act⁶⁰ deal with income derived from foreign trusts by the UK beneficiaries. In principle, there is

⁵⁶ Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the Prevention of the Use of the Financial System for the Purposes of Money Laundering or Terrorist Financing.

⁵⁷ *Id.*, art. 3.

⁵⁸ Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017/692 (UK), Regulation 6, art.1. It should also be noted that in the older version of UK Money Laundering Regulations (2007), a different definition was used. A beneficiary of a foreign trust was defined as: (a) any individual who is entitled to a specified interest in at least 25% of the capital of the trust property; (b) as respects any trust other than one which is set up or operates entirely for the benefit of individuals falling within sub-paragraph (a), the class of persons in whose main interest the trust is set up or operates; (c) any individual who has control over the trust. Therefore, this definition is almost the same as the one given by Russian money laundering regulations, which is most likely due to the fact that they are both based on international standards and OECD Commentary.

⁵⁹ *Nalogovii Kodeks RF, chast'1, gl. 3.4, st. 25.13 (1998)* [NK] [Tax Code, part 1, section 3.4, art. 25.13 (1998)].

⁶⁰ See The Income Tax (Trading and Other Income) Act (2007), The Taxation of Chargeable Gains Act (1992), The Inheritance Tax Act (1984).

an obligation for beneficiaries to disclose basic trust-relevant information, including their income from it, on a tax return, which is supplied to HMRC.⁶¹ There are differences in defining non-resident trusts and their beneficiaries for the purposes of each tax. In principle, a non-resident trust is a trust where “none of the trustees are resident in the UK for tax purposes or only some of the trustees are resident in the UK and the settlor of the trust was not resident”⁶², and a beneficiary is the person who benefits from the trust⁶³. Therefore, the UK has a much broader and more developed regulation of beneficial ownership in the context of taxation than Russia, and a number of specific rules for beneficiaries of foreign trusts. This is due to the fact that, first, it is the jurisdiction where trusts originate from, and second, it has a longer and more diverse experience of dealing with tax avoidance via foreign trusts than Russia, where this problem became topical only in the last ten years.

To sum up, defining beneficial ownership still poses difficulties due to the absence of definition of OECD and vagueness of OECD Commentary. However, the “use and enjoyment” test is widely used and is present in the both Russian and the UK definitions, which rely on the criteria of control and “main interest”. While anti-money laundering regulations in both countries provide similar definitions, the UK tax regulations are much more detailed than Russian tax code as far as defining beneficial ownership is concerned. This is due to the difference between the legal systems, as well as to the experience of both countries in dealing with tax avoidance issues.

Chapter 1 Conclusion

The first chapter defined the notion of beneficial ownership in trust and its features in offshore jurisdictions. Firstly, a beneficial owner is the one who receives income from the trust,

⁶¹ HMRC: Non-resident trusts: Guidance (Dec. 3, 2017, 2.00 p.m.), <https://www.gov.uk/guidance/non-resident-trusts>.

⁶² *Id.*

⁶³ *Id.*

but has only equitable title to trust assets or property. The legal title belongs to the trustee, who manages the trust. The phenomenon of “split title” is one of the most characteristic trust features. Due to the absence of distinction between law and equity in some civil law jurisdictions the trust concept is absent or substantially modified (like in Russia, where trust management of property exists instead, which does not involve the transfer of legal title to the trustee). Secondly, in practice in offshore trusts the settlor and the beneficiary are often the same person, because the sole purpose of offshore trusts is to “hide” the settlor’s assets from taxes or creditors. Such self-settled trusts are considered illusory or sham. Finally, the meaning of beneficial ownership for the purposes of anti-tax avoidance and money laundering regulations is different from the ordinary meaning. The core aspects of beneficial ownership in this sense are control and the finality of receiving income (without transferring it to someone else). These regulations set forth the criteria for determining the beneficial owner and the times when his information has to be disclosed to the authorities. The second chapter will focus on these criteria and disclosure policies.

Chapter 2. Disclosure Rules for Offshore Trust Beneficiaries

After the concept of beneficial ownership has been defined in Chapter 1, Chapter 2 focuses on the disclosure rules for offshore trust beneficiaries. First, it discusses the OECD international standards for disclosure and transparency (BEPS Actions). It analyzes the OECD recommendations (in particular, BEPS Actions 3 and 12) for designing domestic disclosure rules. The Chapter proceeds by analyzing and comparing the disclosure rules of Russia and the UK.

2.1. International Standards for the Disclosure of Beneficiaries in Trusts

International tax planning has increased significantly with the globalization of world economy. Although tax planning is not illegal per se, it often exceeds its legitimate goals (to reduce the unduly heavy tax burdens and to avoid double taxation) and leads to tax avoidance.⁶⁴ In the context of financial and fiscal crisis of 2008 it has become obvious that there are weaknesses in the current international tax system, and a higher level of cooperation between national governments is needed.⁶⁵ The OECD, which is at the forefront of the international tax agenda, addressed the problem of tax avoidance by adopting BEPS Actions in 2013, which was followed by signing the Multilateral Convention to Implement Tax Treaty Related Measures to prevent BEPS to address the issue of tax avoidance in 2017.⁶⁶ The Convention is signed by 72 states, and 111 countries overall are the members of the Inclusive Framework on BEPS, which proves the significance and practical importance of the BEPS project.⁶⁷ Not only OECD Countries are

⁶⁴ OECD Council, *Bringing the International Tax Rules into the 21st Century: Update on Base Erosion and Profit Shifting (BEPS), Exchange of Information, and the Tax and Development Programme* (note by the Secretary General), (2014) Paris.

⁶⁵ *Id.*

⁶⁶ BEPS Actions (Dec. 3, 2017, 2.00 p.m.), <http://www.oecd.org/ctp/beps-actions.htm>, OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, 2016.

⁶⁷ OECD: About the Inclusive Framework of BEPS, (Jan. 23, 2.00 p.m.), <http://www.oecd.org/tax/beps/beps-about.htm>.

committed to implementing BEPS, but also all of G20 countries, and a number of other states.⁶⁸ The non-OECD countries are so-called “BEPS Associate Countries”.⁶⁹ Russia is one of the associate countries, meaning that it has taken the same commitments to the implementation of BEPS Actions as OECD members (the UK being one of them).⁷⁰

The aim of the BEPS Actions is to promote transparency and exchange of information between national governments and to fix the current deficiencies of the international tax system.⁷¹ In 2013, G20 Leaders declared that they are “committed to take steps to change our rules to tackle tax avoidance, harmful practices and aggressive tax planning”.⁷² BEPS Action plan includes 15 actions that address the declared goals.⁷³ Two Actions (Actions 3 and 12) in particular deal with the disclosure of beneficial ownership in companies and non-corporate entities (such as trusts).⁷⁴ These Actions out of all are of the biggest relevance to this thesis, since they set the standards for disclosure rules of Russia and the UK. An overview of these Actions is given below.

In order to address the problem of undisclosed beneficiaries in foreign companies and non-corporate entities, the OECD has introduced BEPS Action 3: Designing Effective Controlled Foreign Company (CFC) Rules.⁷⁵ These rules address the risk that taxpayers with a controlling interest in a foreign company or non-corporate entity will avoid paying taxes (such as income tax)

⁶⁸ Such as Argentina, Pakistan, Kazakhstan and other non-OECD members. It should be noted that there are a lot of developing countries among the participants. From: Members of the Inclusive Framework on BEPS (Mar. 20, 2018, 2.00 p.m.), <http://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf>.

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ OECD, *BEPS Project Explanatory Statement: 2015 Final Reports*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing (2016), Paris.

⁷² G20 Leaders’ Declaration, Saint Petersburg Summit, 5-6 September 2013.

⁷³ BEPS Actions (Dec. 3, 2017, 2.00 p.m.), <http://www.oecd.org/ctp/beps-actions.htm>.

⁷⁴ *Id.* It should be noted that transparency and disclosure are the underlying objectives of all 15 Actions; however, only a few of them are of biggest relevance to disclosure of trust beneficiaries, and, thus, only they are discussed in this thesis.

⁷⁵ OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing (2015), Paris.

in their home jurisdiction by shifting their income to a CFC.⁷⁶ Action 3 provides recommendations for defining a CFC, in particular, regarding the types of entities that fall under the definition, as well as minimum threshold requirements for control.⁷⁷ Action 3 sets the framework for domestic CFC and disclosure rules, which have been introduced in both Russia and the UK.⁷⁸

In defining a CFC, two aspects are of crucial importance: the type of entity that should fall under the rule, and the type and extent of control that makes a foreign entity a CFC. In relation to the first aspect, Action 3 recommends to define a CFC broadly, “so that, in addition to including corporate entities, CFC rules could also apply to certain transparent entities and permanent establishments”.⁷⁹ In practice, many countries (Russia and the UK among them) include trusts in the CFC definition, so that companies or individuals in the home jurisdiction do not avoid CFC rules simply by changing the form of a foreign entity.⁸⁰ Any income from a foreign entity that raises BEPS concerns can lead to this entity becoming a CFC. In an EU case *Cadbury Schweppes* it was stated that CFC rules should “specifically target wholly artificial arrangements which do not reflect economic reality and whose only purpose would be to obtain a tax advantage”.⁸¹ Thus, normally a CFC is an artificial structure without substantial activity, existing solely for the purposes of shifting income and tax avoidance.

As far as the second aspect of CFC definition (control) is concerned, Action 3 recommends to take both legal and economic control into account. Legal control is a relatively mechanical test

⁷⁶ OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing (2015), Paris.

⁷⁷ *Id.*

⁷⁸ See Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017/692, and *Nalogovii Kodeks RF, chast'1, gl. 3.4, st. 25.13 (1998)* [NK] [Tax Code, part 1, section 3.4, art. 25.13 (1998)].

⁷⁹ OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, *Supra* note 58, at 21.

⁸⁰ *Id.*

⁸¹ *Cadbury Schweppes PLC and Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, C-196/04.

(measuring the percentage of ownership or voting rights) and applies mostly to companies.⁸² It is considered too narrow, therefore, most countries use the concepts of economic and de facto control as well. Economic control focuses on rights to the profits and entitlement to a certain part of capital or assets (without formally holding shares).⁸³ De facto control test determines who takes the most important decisions regarding the foreign entity, or a similar type of “dominant influence”.⁸⁴ Clearly, in relation to foreign trusts, the tests of economic and de facto control should be applied, as most beneficial owners have entitlements to profits and influence the decision-making process (especially if they are the same person as settlor, as discussed in Chapter 1), but legally they do not own assets of a trust or a particular share of its capital. As far as the minimum threshold for control is concerned, wide discretion is left to the BEPS countries. Action 3 recommends a threshold of 50% “economic interest” in an entity for most cases, however, countries can make it lower or higher, and in Russia and the UK this threshold is at 25%.⁸⁵

Once it has been determined that a trust falls under the scope of CFC rules, the next question is what kind of information should be disclosed. Action 12: Mandatory Disclosure Rules describes the information that must be disclosed, and also gives a more concrete definition of an offshore vehicle.⁸⁶ The aim of Action 12 is to “increase transparency by providing the tax administration with early information regarding potentially aggressive or abusive tax planning

⁸² OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*, *Supra* note 58, at 24.

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ *Id.*, for Russia and the UK also see Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017/692, and *Nalogovii Kodeks RF, chast'1, gl. 3.4, st. 25.13 (1998)* [NK] [Tax Code, part 1, section 3.4, art. 25.13 (1998)].

⁸⁶ OECD, *Mandatory Disclosure Rules, Action 12 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing (2015), Paris. It should be noted that although most foreign entities described in Action 3 are typically offshores, Action 3 does not mention it, talking about a CFC as a general concept. A definition of an offshore entity is given in Action 12 instead.

schemes”.⁸⁷ The principles for mandatory disclosure rules state that these rules should be “clear and easy to understand, effective in achieving their objectives, accurately identifying the schemes to be disclosed, flexible and dynamic to adjust the system to be able to respond to new risks”.⁸⁸ In order to fulfill the objectives of Action 12, the OECD has adopted Model Mandatory Disclosure Rules on March 9, 2018. These rules are of utmost importance, as they give a detailed definition of offshore structures and introduce the requirement to report information about such structures not only for beneficiaries, but also for intermediaries.⁸⁹ The mandatory disclosure rules apply to attempts to avoid disclosure in the context of automatic exchange of information between the tax authorities under the common reporting standard (CRS). The CRS is a “standardized model for automatic exchange of financial account information, including information on assets and accounts held by banks, insurers and investment entities (such as funds and certain trusts) held by non-residents”.⁹⁰ The beneficial owners and settlors attempt to avoid reporting of the trust income under the CRS using offshore schemes, and the Model rules introduce a concept of an “opaque offshore structure” to specifically target such schemes.⁹¹

Opaque offshore structures are passive offshore vehicles that do not carry substantial activity in the jurisdiction of incorporation and tax residency.⁹² An opaque structure is a structure for which it is reasonable to conclude that “it is designed to have the effect of allowing a natural person to be a beneficial owner of a passive offshore vehicle while not allowing the accurate determination of such person’s beneficial ownership or creating the appearance that such person

⁸⁷*Id.* at 9.

⁸⁸ *Id.*

⁸⁹ OECD, Model Mandatory Disclosure Rules for CRS Avoidance Arrangements and Opaque Offshore Structures, OECD (2018), Paris.

⁹⁰ OECD, Global Forum on Transparency and Exchange of Information for Tax Purposes, *Tax Transparency 2017: Report on Progress* (2017), Paris.

⁹¹ OECD, Model Mandatory Disclosure Rules, *Supra* note 82.

⁹² *Id.*, Rule 1.2. It should be noted that this is very similar to a CFC definition under *Cadbury Schweppes*.

is not a beneficial owner”.⁹³ In principle, any offshore entity which raises doubts in regard to the ultimate beneficial ownership (where there are suspicions about using nominees, or the entire ownership structure is unclear) can be considered an opaque offshore structure.

The Mandatory rules determine which information regarding such structures should be reported, and who and when must report. The rules also advise countries on the consequences of non-compliance with disclosure requirements. The information about an offshore structure should be disclosed not only by beneficiaries (and, in case of a trust – settlors or trustees), but also by any intermediaries (such as registered agents that arrange the establishment of an offshore structure).⁹⁴ The information should be reported, in principle, as early as possible, in case of intermediaries, for example – within 30 days after the establishment of an offshore structure.⁹⁵ The data for disclosure includes names, addresses, jurisdictions and tax numbers of persons who make the disclosure, beneficiaries of the offshore vehicle and any other involved persons. It also includes the information about the offshore structure itself (name, registered address, ownership structure, etc.), with emphasis on the features that impede the accurate determination of beneficial ownership.⁹⁶ The rules are silent on remedies in case of failure to disclose the information, leaving it to the discretion of BEPS participating countries. However, the commentary to the rules advises the countries to use monetary (fines) and reputational (publication of names) penalties, both for the intermediary and the beneficiary.⁹⁷

Therefore, BEPS Actions 3 and 12 target quite successfully any offshore arrangements, including trusts that aim to shift the income from the taxpayer’s jurisdiction in order to avoid

⁹³ *Id.*

⁹⁴ *Id.*, Rule 2.1.

⁹⁵ *Id.*, Rule 2.2.

⁹⁶ *Id.*, Rule 2.3.

⁹⁷ OECD, Model Mandatory Disclosure Rules for CRS Avoidance Arrangements and Opaque Offshore Structures: Commentary, OECD (2018), Paris, 43.

paying taxes. While determining the controlling persons of a foreign entity, the Actions consider legal, economic and de facto control, thus, taking the same approach as the Model Tax Convention and the cases on the general concept of beneficial ownership discussed in chapter 1. This approach is broad and encompasses a variety of offshore vehicles, including trusts. The Actions and the Model Disclosure Rules also give a definition of an opaque offshore structure and provide detailed guidelines for the information that needs to be disclosed about such structure, thus, determining quite precisely what the OECD expects to find in the implementing legislation of BEPS countries. The next part of this Chapter discusses the current state of implementation of BEPS standards in Russia and the UK.

2.2. Disclosure Rules for Offshore Trust Beneficiaries in the Russian Federation and the United Kingdom

The disclosure rules in Russia and the UK are similar, but not the same. While the UK has a wider regulatory framework, in Russia the disclosure provisions are only contained in Chapter 3.4 of the tax code, which deals with disclosure rules for both foreign companies and non-corporate entities (trusts fall under this category), and briefly in art. 6.1 of the anti-money laundering regulations.⁹⁸ The UK rules have been brought in accordance with BEPS Actions (the disclosure rules existed before to a certain extent)⁹⁹, while Russia introduced CFC rules only in 2014, thus, it was a specific measure to implement BEPS Action 3.¹⁰⁰ It should also be noted that BEPS Actions are currently developing and improving, thus, they are ahead of the measures that have already

⁹⁸ See FZ “*O Protivodeistvii legalizatsii (otmivaniu) dokhodov, poluchennih prestupnim putem, i finansirovaniu terrorizma*” (2001), #115-FZ [Federal Law on Prevention of Legalization of Proceeds obtained from Criminal Action and on Prevention of Terrorism Financing], *Nalogovii Kodeks RF, chast’1, gl. 3.4 (1998)* [NK] [Tax Code, part 1, section 3.4 (1998)].

⁹⁹ See The Money Laundering Regulations 2007 (UK).

¹⁰⁰ *Nalogovii Kodeks RF, chast’1, gl. 3.4, st. 25.13 (1998)* [NK] [Tax Code, part 1, section 3.4, art. 25.13 (1998)].

been introduced in Russia and the UK (in particular, Action 12 and CRS, which is only starting to be applied in BEPS states).¹⁰¹

The UK has very strict beneficiary disclosure rules in relation to trusts, resulting from the implementation of both BEPS Actions and the 4th EU Anti-Money Laundering Directive. From June 26, 2017, all UK trusts, as well as non-UK trusts having tax liabilities in the UK (i.e. offshore trusts) have to maintain the registers of their beneficial owners and provide them annually to HMRC.¹⁰² Consequently, HMRC keeps a register of all trusts that are required to pay taxes (including income tax, capital gains tax and others) in the UK. The trustees need to provide such information as the date when the trust was established, the place where it is administered, the name of the beneficiary, his UK reference (i.e. tax) number, and his residential address.¹⁰³ Moreover, in the context of the 4th EU Anti-Money laundering Directive, the term “beneficial owner” may also refer to the settlor or the trustee, or anyone who has control over the trust and the UK Money laundering regulations have the same approach, thus, the data on the trustee and the settlor is also filed.¹⁰⁴ It may also be required to provide details of a “potential beneficiary”, for instance, the one who may be mentioned in a letter of wishes.¹⁰⁵ The trust registers are to be filed online, and the information is accessible only to the UK authorities, however, there are proposals to make it accessible to anyone who has a “legitimate interest”.¹⁰⁶ Even though the requirement to annually file beneficiary information is new, before there was an obligation to notify the authorities about the trust creation by filing a paper-based form to the HMRC.¹⁰⁷ Today the online filing system is

¹⁰¹ See Chapter 3.2 for more information.

¹⁰² Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017/692, Regulation 44.

¹⁰³ *Id.*

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ Jim Edmondson, *THE PROLIFERATION OF NEW REGISTERS: SOME THOUGHTS ON THE DRIVE FOR TRANSPARENCY*, P.C.B. (2017), 150.

¹⁰⁷ *Id.*

less complicated, but at the same time, more information needs to be provided, therefore, a tendency towards restricting government control can be observed. The disclosure rules raise confidentiality (as part of the trustee's fiduciary duty) and data protection concerns, however, the scope of this thesis does not allow for them to be discussed in greater detail.

The disclosure of trust beneficial owners can also occur as a part of a bigger disclosure initiative, the People with Significant Control (PSC) Regulations of 2016.¹⁰⁸ The PSC Regulations are in principle aimed at disclosing beneficial ownership in UK companies. By contrast to the trust beneficiary disclosure rules, the information about people with significant control in UK companies is accessible to the general public on the Companies House website of the HMRC. The Regulations provide four basic conditions to determine beneficial ownership of companies for individuals:

- (1) holding more than 25% of the shares in a company;
- (2) holding more than 25% of the voting rights;
- (3) the power to appoint or remove the majority of the board of directors;
- (4) any other right to exercise significant influence or control over the company (for instance, a company founder who is retired falls under this category).¹⁰⁹

The fifth criterion states that where a trust or firm would satisfy any of the first four conditions if it were an individual, a person who has the right to exercise or actually exercises significant influence or control over this trust or firm is considered a PSC of the company as well.¹¹⁰ For instance, a Russian individual is a beneficiary of an offshore trust, which owns more

¹⁰⁸ Companies Act (2006) (UK), (c.46, part 21A).

¹⁰⁹ HMRC: PSC Register Summary Guidance (Feb. 8, 2018, 2.00 p.m.), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/621568/170622_NON-STAT_Summary_Guidance_4MLD_Final.pdf

¹¹⁰ *Id.*

than 25% of shares in a UK company. For the purposes of PSC Regulations, this individual will be considered a PSC of the UK company, and therefore, his information (name, date of birth, address) will be filed to HMRC and become publicly available.

Thus, the disclosure rules for beneficial ownership are strict and they are quite successfully preventing various avoidance schemes. There is a tendency towards further restriction, as mentioned above, in relation to making all registers public. In addition, there have been proposals about a register of “beneficial owners of overseas entities”, which will exist for those entities that own or want to buy property in the UK.¹¹¹ The intention of this register is that an overseas entity will not be able to “buy, sell, charge or grant a long (over 21 years) lease over UK real estate unless its details are on the new register”.¹¹² It is important that an overseas entity will have to provide the information to the HMRC prior to any transaction. The entities which already own UK property will have one year to register.¹¹³

Russian disclosure rules are set by art. 6.1 of the anti-money laundering regulations and Chapter 3.4 (art. 23.13 – 23.15) of the tax code. They are more generalized than the UK rules and do not cover such a wide scope of avoidance scenarios. However, the general functioning pattern is very similar. The anti-money laundering regulations define the beneficial owner as an individual who either owns more than 25% of the capital of a corporate or non-corporate entity, or exercises control in any other way.¹¹⁴ The tax code has the same rule, referring to beneficiaries as “controlling persons”, much like the PSC in the UK. It additionally states that the beneficial owner

¹¹¹ Jim Edmondson, *Supra* note 99, at 154.

¹¹² *Id.*

¹¹³ *Id.*, 155.

¹¹⁴ FZ “*O Protivodeistvii legalizatsii (otmivaniu) dokhodov, poluchennih prestupnim putem, i finansirovaniu terrorisma*” (2001), #115-FZ [Federal Law on Prevention of Legalization of Proceeds obtained from Criminal Action and on Prevention of Terrorism Financing].

is also a person who has 10% of the capital ownership together with spouse and minor children (if Russian tax residents own more than 50% of the capital overall).¹¹⁵ Such a rule exists to prevent avoidance using family trust schemes, which are very common in Russia. Moreover, even if there is no direct participation in the capital, exercising control in the interest of spouse and children also falls under the beneficial ownership criteria.

The capital-related rules of the tax code refer to both foreign companies and non-corporate entities. However, there are also specific provisions on trusts. The Russian tax code states that the controlling person of foreign trust is the settlor of this trust, with some exceptions.¹¹⁶ These exceptions include absence of the following rights: to receive and use income from the trust, to own the trust property, to receive assets remaining after the termination of a trust, to exercise control in any other form (which is, according to the Code, ability to influence the income distribution decisions). Consequently, any other individual who does have the abovementioned rights is considered a beneficiary.¹¹⁷ Thus, here the “use and enjoyment” test is used, as well as the ownership and control criterion.

Russia, like the UK, has a filing requirement for all beneficial owners (whether they are the same persons as settlors or not). A notice of participation and/or control of any foreign entity must be filed each year, and no later than three months after becoming a beneficiary.¹¹⁸ A notice of termination of beneficial ownership is also required. Nowadays filing takes place online, like in the UK, however, it is possible to provide notice in paper form, by visiting the territorial branch of the Russian tax authority where the beneficiary has permanent residence. The basic information

¹¹⁵ *Nalogovii Kodeks RF, chast'1, gl. 3.4, st. 25.13 (1998)* [NK] [Tax Code, part 1, section 3.4, art. 25.13 (1998)].

¹¹⁶ *Id.*

¹¹⁷ *Nalogovii Kodeks RF, chast'1, gl. 3.4, st. 25.13 (1998)* [NK] [Tax Code, part 1, section 3.4, art. 25.13 (1998)].

¹¹⁸ *Id.*, art. 25.15.

in the notice includes the name and tax number of the beneficiary, the form of the foreign entity (e.g. a trust), the type of control exercised, the disclosure of ownership structure if a beneficiary is not exercising the rights directly (e.g. if there are nominees involved)¹¹⁹. There is also a mechanism which targets those beneficiaries who failed to file a notice. If the tax authorities have information (provided by the foreign authorities or obtained in another way) that an individual is a beneficiary of a foreign entity with no notices filed by this individual, he/she is required to provide explanation/file a notice within 30 days after the tax authorities' inquiry.¹²⁰

Therefore, the disclosure rules are quite similar in Russia and the UK, and they successfully implement the key aspects of BEPS Action 3 and Action 12, regarding both the criteria for determining beneficial ownership and the information that needs to be disclosed. The UK rules are broad and cover a wide scope of avoidance scenarios, requiring the trustee to disclose the information about the beneficiary, as well as about the settlor and the trustee. In Russia a settlor is in principle considered a beneficiary, with a few exceptions. The information about the settlor and any other relevant "controlling persons" has to be filed with the tax authorities annually, the same term as in the UK. In the UK generally information about all trust participants has to be provided. Both countries in principle use an online filing system, and the information to be disclosed is fairly similar. While the UK has a separate set of rules for beneficiaries of foreign trusts and briefly mentions trusts in the PSC regulations for companies, in Russia the rules for controlling individuals of foreign trusts and companies are contained in the same articles of the tax code.

Chapter 2 Conclusion

The second chapter determined the most important pillars of modern disclosure rules. The disclosure framework is set by 15 BEPS Actions, two of which (Action 3 and Action 12) deal with

¹¹⁹ *Id.*

¹²⁰ *Id.*

the disclosure rules for beneficiaries discussed in this thesis. One of the most important recent improvements in disclosure rules was the introduction of OECD Model Disclosure Rules that deal with the definition of offshore vehicles and specific scenarios when the information about such vehicles must be disclosed. The implementation of Model Disclosure Rules will lead to further expansion of disclosure policies in Russia and the UK. Since both countries already base their disclosure laws and regulations on BEPS Actions, the disclosure requirements and processes in them are similar, although the disclosure framework in the UK is more developed than in Russia. Today, in principle all trust participants are required to disclose the information about the trust in both countries, and with the implementation of OECD Model Disclosure Rules the requirement will also extend to intermediaries, such as registered agents and tax representatives.

After discussing the regulatory framework for beneficiary disclosure, the next part of the thesis will focus on practical application of the disclosure rules. It will discuss the most recent landmark cases involving a Russian high net worth individual Sergei Pugachev (often referred to in press as “Kremlin banker”).¹²¹ There were litigations on a number of issues, including ownership of the offshore assets held in New Zealand trusts, both in Russia and the UK, which makes this case interesting for the purpose of this thesis.

¹²¹ Financial Times: Russian Oligarch Had “Sham” Offshore Trusts, UK High Court Rules (Feb. 8, 2018, 3.00 p.m.) <https://www.ft.com/content/c03b2448-ae82-11e7-aab9-abaa44b1e130>

Chapter 3. Practical Application and the Development of Disclosure Rules in the Russian Federation and the United Kingdom

While the previous chapter discussed the current disclosure rules of the OECD, Russia and the UK, this chapter provides the recommendations for their improvement. However, in order to give useful recommendations regarding the development of the disclosure rules, it is also essential to consider the most recent disclosure tendencies, both from a theoretical and a practical standpoint. Therefore, this chapter starts with a 2017 UK case on the disclosure of beneficial ownership in offshore trusts. This case introduces a new approach to determining beneficial ownership in discretionary trusts, and this approach is likely to be followed by similar decisions in the future. It illustrates the direction that the courts are inclined to take in the light of contemporary disclosure policies, as well as the cooperation between the UK and Russia in gaining access to the assets of an undisclosed beneficial owner. The chapter proceeds by giving an overview the most recent disclosure initiatives of the OECD, demonstrating how (and whether) they are being implemented in Russia and the UK. Although this part is more theoretical than the first subchapter, it is equally important, since these tendencies will shape the disclosure framework for the following years. Then, taking into account the current disclosure rules, the main axes of their future development and the most recent landmark disclosure case, the final part of the chapter provides recommendations for the improvement of disclosure rules. It first advises on the general development of the international framework, and then provides recommendations for Russia based on the positive UK experiences, since the disclosure rules of the UK are more comprehensive than the Russian ones.

3.1. *JSC Mezhdunarodniy Promyshelnniy Bank v. Pugachev* as a Leading Precedent on the Disclosure of Beneficial Ownership in Offshore Trusts

JSC Mezhdunarodniy Promyshelnniy Bank v. Pugachev is the most recent and one of the most discussed cases in relation to offshore illusory and sham trusts. It created a precedent where Mr. Pugachev, an undisclosed beneficiary of five discretionary trusts, was recognized by the UK High court as the actual owner and the ultimate beneficiary of the trust assets.¹²² It was stated that a settlor cannot benefit from a trust, when, at the same time, he in reality controls the assets through “extensive non-fiduciary personal powers”.¹²³ The case arose on occasion of shielding the assets from the creditors; however, it is undisputed that extensive tax avoidance by Mr. Pugachev was also the outcome of these trusts.¹²⁴ This case is relevant for the present thesis as it demonstrates the contemporary tendency of expanding the scope disclosure policies, introducing a simpler test for determining the ultimate beneficial ownership. This is one of the few cases where the court was able to disclose the ultimate owner and beneficiary of offshore discretionary trusts. The case also shows the cooperation between Russia and the UK in obtaining access to the assets of a Russian taxpayer (as well as a debtor who owns money to the creditors) hidden in offshore trusts.

Mr. Pugachev is a Russian businessman, ex-senator, and a former political ally of President Vladimir Putin. He was the owner and beneficiary of Mezhprom Bank that went bankrupt in 2010, owing its creditors about 70 billion Russian roubles (2.2 billion US dollars at that time).¹²⁵ The

¹²² *Id.*

¹²³ Mayer Brown LLP: *When is a trust not a trust?* Legal update, October 2017 (Mar. 23, 2018, 2.00 p.m.) https://www.mayerbrown.com/files/Publication/9c1394c8-c6d0-45bc-9447-3b232cedf1be/Presentation/PublicationAttachment/f0f5b7e5-4e62-4dc2-bba9-b7c39b2a54d2/0517ldr-When-is-a-trust-not-a%20trust_Update.pdf

¹²⁴ Pravo.ru: *Visokii Sud Anglii razreshil Vziskivat' Spryatannii Aktiv Eks-Senatora Pugacheva* [The UK High Court Has Allowed to Recover Hidden Assets of Ex-Senator Pugachev] (Mar. 23, 2018, 2.00 p.m.) <https://pravo.ru/news/view/145064/>

¹²⁵ *JSC Mezhdunarodniy Promyshelnniy Bank v. Pugachev*, [2017] EWHC 2426 (Ch), Para. 35.

Deposit Insurance Agency (DIB, in Russian *Agentstvo Strakhovaniya Vkladov*), a Russian state corporation that was appointed as a liquidator, claimed that Mr. Pugachev had intentionally made the bank bankrupt by giving out non-performing loans (amounting to a total of 64 billion Russian roubles – over a billion US dollars) to various organizations that were owned and controlled by him.¹²⁶ In addition, he appropriated about 28 billion Russian roubles (about 500 million US dollars) that the Central Bank of Russia has given to Mezhprom bank as non-taxable loans.¹²⁷ Given these facts, a number of commercial and criminal lawsuits against Mr. Pugachev followed in Russia.¹²⁸ The purpose of these lawsuits was to determine the secondary liability of Mr. Pugachev and to make his assets a part of the collateral of the bankrupt bank. The Ninth Commercial Court of Appeals (Moscow) ruled that 76.6 billion Russian roubles (1.4 billion US dollars at that time) was to be recovered from Mr. Pugachev's personal assets.¹²⁹ The Russian Supreme Court affirmed this decision.¹³⁰

As the need to determine the assets (and their value) from which the sum can be recovered arose, it was discovered that Mr. Pugachev indirectly owns a number of offshores, including five New Zealand trusts.¹³¹ The assets of these trusts included various property in London and a villa in the Caribbean. These trusts were discretionary, and the various discretionary beneficiaries were Mr. Pugachev, his two adult sons, his current partner Ms. Tolstoy and their common children.

¹²⁶ Pravo.ru: *Visokii Sud Anglii razreshil Vziskivat' Spryatannye Aktiv Eks-Senatora Pugacheva* [The UK High Court Has Allowed to Recover Hidden Assets of Ex-Senator Pugachev] (Mar. 23, 2018, 2.00 p.m.) <https://pravo.ru/news/view/145064/>

¹²⁷ *Postanovlenie Arbitrazhnogo Suda Moscovskogo okruga ot 01.10.2015 N F05-10535/2011*, [Ruling of the Moscow Commercial Court from 1 October 2015 N F05-10535/2011];

¹²⁸ *Id.*, also *Postanovlenie deviatogo arbitrazhnogo apellionnogo suda ot 15.02.2018 N 09AP-68325/2017* [Ruling of the Ninth Commercial Court of Appeals from 15 February 2018 N 09AP-68325/2017];

¹²⁹ *Postanovlenie deviatogo arbitrazhnogo apellionnogo suda ot 24.06.2015 g. №09AP-24715/15* [Ruling of the Ninth Commercial Court of Appeals from 24 June 2015 #09AP-24715/15];

¹³⁰ *Opredelenie Verkhovnogo Suda RF ot 29.01.2016 N 305-ES14-3834* [Ruling of the Supreme Court of the Russian Federation from 29 January 2016 N 305-ES14-3834].

¹³¹ *JSC Mezhdunarodniy Promyshel'nyi Bank v. Pugachev*, [2017] EWHC 2426 (Ch), Para.1.

Mr. Pugachev was the first protector according to all trust instruments. The trustees were all newly incorporated New Zealand companies.¹³² DIB initiated proceedings in London (the place where Mr. Pugachev was living at that time) in order to recognize that Mr. Pugachev was the beneficiary and settlor of all trusts, and to recover the money from the trust assets.¹³³

There were two primary claims in the case: the illusory trust claim and the sham claim.¹³⁴ Under the first claim, the key point of the argument was that the trusts “were not effective in divesting Mr. Pugachev of his beneficial ownership of the trust assets”.¹³⁵ This was supported by his extensive role as a trust protector. Under the second claim, it was argued that trusts have no effect at all, and the assets were not held according to the terms of the trust deeds.¹³⁶

In analysing these claims, the court first considered an overlap that exists between illusory and sham trusts. Justice Birss found based on *Clayton v Clayton* (discussed in Chapter 1.2) that, when considering what powers a person has in relation to a trust, the task of the court is to determine the “true effect of the trusts”.¹³⁷ Justice Birss distinguished between the trust protector’s fiduciary powers (to be exercised in the interest of beneficiaries) and “purely personal” powers that can be exercised in the own “selfish” interests of the protector.¹³⁸ The relevant consideration was whether the protector had other roles within the trust.¹³⁹ In the case, Mr. Pugachev was a settlor and a beneficiary. The court found that Mr. Pugachev could exercise his rights freely for his benefit. That was supported by the following factors:

¹³² *Id.*, Para. 1-34 (facts of the case).

¹³³ *JSC Mezhdunarodniy Promyshelnniy Bank v. Pugachev*, [2017] EWHC 2426 (Ch), Para.70.

¹³⁴ *Id.*, Para. 71-72.

¹³⁵ *Id.*, Para. 71.

¹³⁶ *Id.*, Para. 72.

¹³⁷ *Id.*, Para. 169.

¹³⁸ *Id.*, Para. 203.

¹³⁹ *Id.*, Para. 240.

- He was not constrained by the terms of the deed to act in the best interests of discretionary beneficiaries as a class;
- He was able to add/remove other beneficiaries as protector (i.e. he could make himself the sole beneficiary);
- He could veto trustee's decisions, as well as appoint and remove trustees without cause.¹⁴⁰

In light of the above, the court decided that the “true effect” of the trusts was “to leave Mr. Pugachev in control of the trust assets”, which did not divest him of his ownership, but instead allowed him “to retain his beneficial ownership”.¹⁴¹ Thus, the illusory trust claim was satisfied.

Under the sham claim, Justice Birss noted that the trust documents should be considered in order to determine whether there was an intent to create a trust (citing *Snook v London*, discussed in Chapter 1.2 of this thesis).¹⁴² The court held that Mr. Pugachev's intention was “not to cede control of his assets to someone else, it was to hide his control of them. In other words Mr Pugachev intended to use the trusts as a pretence to mislead other people, by creating the appearance that the property did not belong to him”.¹⁴³ In addition, the other trust participants had no intentions that were independent of Mr. Pugachev.¹⁴⁴ In principle, such scheme can qualify as a sham.

The court held that the trusts were illusory, since, even though they did not function as actual trusts, they still fulfilled their true intention, which was to retain control over the assets.¹⁴⁵ In case the court wrongly determined “true effect” of the trusts, they could alternatively be

¹⁴⁰ *Id.*, Para. 115-140, 234-239.

¹⁴¹ *Id.*, Para. 278.

¹⁴² *Id.*, Para. 145.

¹⁴³ *Id.*, Para. 424.

¹⁴⁴ *Id.*, Para. 401.

¹⁴⁵ *Id.*, Para. 436.

considered sham because “the settlor intended to use them to create a false impression as to his true intentions and the trustees went along with that recklessly”.¹⁴⁶ In any case, the court stated that no effect should be given to trust instruments.¹⁴⁷

This precedent is important as it introduced a simpler way of determining whether discretionary trusts are real, by the “true effect of the trust” test. This test is objective and, arguably, easier to apply than the subjective intention and other previously used tests. In fact, this test expands the scope of disclosure, since a wide category of trusts can be considered illusory based just on their “true effect”. This is the first major decision where a discretionary trust structure could not hide the ultimate beneficiary, and it means that all trusts of this type are now potentially subjects to disclosure. This, in turn, means that the creditors will be able to reach more assets of their debtors, and the avoided taxes will have to be paid as well. Both major functions of an offshore trust – to shield the assets and to avoid taxes – will not be fulfilled under the disclosure mechanism set by the case. There will be fewer and fewer opportunities to hide assets in offshore trusts. The case is now a precedent in the UK, and it will also serve as a guideline for other countries (especially common law states). Given the success of the disclosure claims in this case, it is quite likely that the number of similar cases will increase in the future.

This decision falls within the general international tendency of expanding disclosure policies. The violation of UK or Russian disclosure rules in particular were not the claims in this case, however, clearly there was no disclosure in accordance with the standards described in Chapter 2 of this thesis. The case deals with the determination of beneficial ownership, which in itself implies that the real ownership structure of the trusts was vague and undisclosed to the authorities. While BEPS Actions and the domestic rules based on them expand disclosure policies

¹⁴⁶ *Id.*, Para. 437.

¹⁴⁷ *Id.*, Para. 442.

in theory, decisions like this one show that offshore trust schemes do not work well anymore in practice as well. In addition, this decision shows the positive trend in cooperation between the countries (which is one of the BEPS Actions aims), since the UK High Court supported the Russian decision on recovering the debts of Mezhprom bank from Mr. Pugachev's personal assets, and made the recovery of a bigger sum possible by considering him the settlor and ultimate trust beneficiary.

While this case illustrates the general direction of development of disclosure policies, there are more tendencies that allow to determine the main axes of their development for the next few years. These tendencies are discussed in the next part of this chapter.

3.2. Current Tendencies in the Development of Disclosure Rules in the Russian Federation and the United Kingdom

As it has been mentioned above, the general international trend today is the expansion of the scope of disclosure policies. This can be concluded from the case discussed in the previous subchapter, where the court took an expanded approach to determining the beneficiary of a discretionary trust, based on the “true effect of the trust” test. Another tendency is the restriction of reporting standards, which is illustrated by some of the policies discussed in chapter 2, like the proposal to make all UK beneficiary registers public. The newest OECD initiatives, as well as some legislative and regulatory changes in the UK and Russia, also follow these trends. They aim at making all tax avoidance/asset shielding arrangements fall under disclosure rules, disclosing the precise ownership structure and the ultimate beneficiary of such arrangements as early as possible.

As the OECD strives to increase tax transparency, its primary focus now is on the exchange of information between countries. The OECD jointly with G20 has established a Global Forum on Transparency and Exchange of Information for Tax Purposes, whose main aim to promote the

uniform standards for the exchange of fiscal and financial information between tax authorities, and to encourage such exchange.¹⁴⁸ There are two types of exchange: exchange of information on request (EOIR) and automatic exchange of financial account information (AEOI).¹⁴⁹ The EOIR is an earlier initiative that existed since the 2000s. It created a framework for tax authorities to make inquiries about “the offshore affairs of their taxpayers” in the relevant tax authorities of other countries.¹⁵⁰ The scope of the information to be provided under this standard is very broad (any “foreseeably relevant information”), and is typically related to legal and beneficial ownership, as well as accounting records.¹⁵¹ However, it was noted that, although the EOIR is a good method for promoting transparency, the need to specifically request information places a restriction on it, as it allows to investigate the taxpayer only when there are already suspicions regarding tax avoidance.¹⁵² The recently adopted AEOI, in contrast, allows tax authorities to be informed in advance about potential cases of tax avoidance. The AEOI has been the focus of the Global forum for the past four years. Under this standard, certain institutions (banks, funds and certain trusts) automatically disclose financial information of all non-residents to their tax authorities, which in turn exchange this information with the tax authorities of the taxpayer’s country of residence.¹⁵³ This exchange occurs under the common reporting standard (CRS, mentioned in Chapter 2.1), which lists legal and technical requirements for the exchange.¹⁵⁴ Since the CRS and automatic

¹⁴⁸ OECD, Global Forum on Transparency and Exchange of Information for Tax Purposes, *Tax Transparency 2017: Report on Progress* (2017), Paris.

¹⁴⁹ *Id.*, at.7.

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

¹⁵² OECD, Meeting of the Council at Ministerial Level, *Declaration on Automatic Exchange of Information in Tax Matters* (Adopted at the Council Meeting at Ministerial Level on 6 May 2014).

¹⁵³ OECD, Global Forum on Transparency and Exchange of Information for Tax Purposes, *Tax Transparency 2017: Report on Progress* (2017), Paris.

¹⁵⁴ Such as the financial information to be disclosed, the institutions that disclose it, the types of taxpayers that fall under CRS, the ultimate beneficial ownership of all structures and procedural issues. *Id.*, at 8.

exchange standards are the same for all participating governments, this method facilitates the reporting of information, minimizing the costs of exchange. In order to participate in the exchange, countries sign the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, along with the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information.¹⁵⁵ The latter has 98 participants to this date, while the countries may alternatively conclude bilateral agreements as well.¹⁵⁶ The first automatic exchanges took place in September 2017, among about 50 pioneering jurisdictions (the UK among them). Further, 53 jurisdictions (including Russia) will commence automatic exchanges in 2018.¹⁵⁷ In order to prevent the attempts to avoid automatic exchange the OECD Model Disclosure Rules were published on 9 March 2018. These rules give a definition to an “opaque offshore structure” (which includes various methods of hiding beneficial ownership) and introduce the requirements to report information about such structures for intermediaries (discussed in detail in Chapter 2).¹⁵⁸

Russia and the UK are both participating in the automatic exchange, in addition, each country has its own policies that also aim at enhancing disclosure standards. Since the UK is usually one of the pioneering jurisdictions as far as the implementation of the OECD recommendations and disclosure rules are concerned, it sets the standards for a number of common law countries that base their legislation on the UK model.¹⁵⁹ Positive UK experience can be used

¹⁵⁵ OECD and Council of Europe, *Multilateral Convention on Mutual Administrative Assistance in Tax Matters: Amended by 2010 Protocol*, OECD Publishing (2011), Paris; OECD, *Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information* (Mar. 26, 2018, 2.00 p.m.) <http://www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/>.

¹⁵⁶ OECD: Automatic Exchange Portal, (Mar. 26, 2018), <http://www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/>)

¹⁵⁷ *Id.*

¹⁵⁸ OECD, *Model Mandatory Disclosure Rules for CRS Avoidance Arrangements and Opaque Offshore Structures*, OECD (2018), Paris.

¹⁵⁹ For example, in 2017 Hong Kong introduced PSC regulations identical to those of the UK. Mayer Brown JSM: *Hong Kong Legislation on Significant Controllers Register to Take Effect in March 2018* (March 26, 2018, 2.00 p.m.) <https://www.mayerbrown.com/hong-kong-legislation-on-significant-controllers-register-to-take-effect-in-march-2018-01-26-2018/>

by civil law jurisdictions as well. Thus, the UK tendencies have a crucial importance for the entire disclosure framework.

The main tendency of the past few years is the restriction of disclosure rules. In addition to propositions to make all registers public (including trusts) and to create a separate register for overseas entities (discussed in Chapter 2), new requirements and enhanced penalties were introduced when the UK decided to undertake automatic exchange and CRS obligations.¹⁶⁰ Up to 2015, the UK used incentive-based system for disclosure, which offered reduced penalties or guarantees of non-prosecution in case of voluntary disclosure of offshore liabilities (including those which should have been, but were not disclosed in the past).¹⁶¹ Starting from 2016, the UK introduced a different approach, which demands more information about offshore structures, increases penalties for non-compliance and failure to disclose, and does not offer any guarantees from criminal prosecution.¹⁶² A “Worldwide Disclosure Facility”, created in 2016, offers “a last chance to come forward” before the hidden information will become known under the AEOI in any case.¹⁶³ This facility can be used by anyone (the taxpayer or his tax advisor, agent or trustee) who wants “to disclose a UK tax liability that relates wholly or partly to an offshore issue”.¹⁶⁴ Such “issue” includes personal tax liabilities or those of an offshore company or trust. All disclosure procedures are online, effectuated through a digital disclosure service. The information to be disclosed includes all relevant taxpayer and entity data that is needed to calculate the tax to be paid and the penalties for non-payment (similarly to disclosure rules discussed in Chapter 2), including

¹⁶⁰ HMRC: HMRC Warns Offshore Tax Dodgers (Mar., 26, 2018, 2.00 p.m.)

<https://www.gov.uk/government/news/hmrc-warns-offshore-tax-dodgers>

¹⁶¹ HMRC: Worldwide Disclosure Facility Guidance (Mar., 26, 2018, 2.00 p.m.)

<https://www.gov.uk/guidance/worldwide-disclosure-facility-make-a-disclosure#introduction>

¹⁶² *Id.*

¹⁶³ *Id.*

¹⁶⁴ *Id.*

the maximum value of offshore assets at any time in the last five years.¹⁶⁵ After the notification of HMRC, further details may be requested, and after the investigation is complete all payments must occur. There are two types of penalties: for failure to disclose and for inaccurate information.¹⁶⁶ The penalties vary from 10% to 200% of the tax liability, based on the lost tax revenue, intentions of the taxpayer (whether there was a conscious intent to conceal or a mere mistake), and the jurisdiction where the taxable income was created.¹⁶⁷ In the case of serious tax crime, criminal prosecution may also occur.¹⁶⁸ The disclosure facility functions in its current state until September 30, 2018, and then penalties will be restricted based on the Requirement to Correct standard.¹⁶⁹

Requirement to Correct (RTC) is a new obligation for UK taxpayers introduced in 2017. The taxpayers have to correct anything related to their offshore assets, companies or trusts (income, structure, activities) which does not comply with the requirements of current legislation before 30 September 2018 in order to avoid increased penalties.¹⁷⁰ These penalties will concern not only the obligation to pay taxes, but also for failure to correct specifically, and will start at 200% of the tax liability (with addition of 10% of the asset value and reputational penalties for the most serious cases).¹⁷¹ The disclosure must be made not only by the taxpayer, but also by any “interested person” – a person who helped to arrange tax avoidance.¹⁷² This means that RTC applies also to trustees, which should carefully consider all distributions to UK resident beneficiaries, and in case

¹⁶⁵ *Id.*

¹⁶⁶ HMRC Compliance Checks Series: Higher Penalties for Offshore Matters, CC/FS17; Accessed at <https://www.gov.uk/guidance/worldwide-disclosure-facility-make-a-disclosure> (Mar., 27, 2018, 2.00 p.m.).

¹⁶⁷ HMRC Compliance Checks Series: Penalties for Failure to Notify, CC/FS11; Penalties for Inaccuracies in Returns and Documents, CC/FS7a. Accessed at <https://www.gov.uk/guidance/worldwide-disclosure-facility-make-a-disclosure> (Mar., 27, 2018, 2.00 p.m.).

¹⁶⁸ *Id.*

¹⁶⁹ Finance (No.2) Act 2017 (UK), Sec. 67, Schedule 18.

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.*

of failure to report any deficiencies they will be held liable to the same extent as beneficiaries.¹⁷³ This demonstrates that the UK is in line with the OECD recommendations as far as the requirement for third persons to disclose is concerned, which was mentioned by BEPS Actions and now is a part of the Model Disclosure Rules.¹⁷⁴

Russia is not as fast at following the international trend of expanding disclosure rules as the UK. The CFC rules of the tax code to this day remain the main disclosure instrument.¹⁷⁵ Moreover, since they apply only from 2015 and the entire disclosure system is new to Russia, it is possible to assess only the first outcomes of their application. The results are positive, but insignificant taking into account the scale of tax avoidance in Russia. According to the statistics of the Tax Service of Russia, by the end of 2017 about 10 000 CFC notices were filed on controlling interest in foreign companies, and about 550 – in foreign trusts, revealing control over 26 000 foreign companies and more than 1000 trusts.¹⁷⁶ As a result of enacting CFC legislation, more than 6 billion Russian rubles were paid in taxes.¹⁷⁷ Although there is no official statistics in regard to the extent of tax avoidance in Russia, experts claim that these results are modest and that CFC legislation led only to the disclosure of the most obvious offshore structures owned by big

¹⁷³ HMRC: Requirement to Correct Tax due on Offshore Assets Guidance (Mar., 27, 2018, 2.00 p.m.), <https://www.gov.uk/guidance/requirement-to-correct-tax-due-on-offshore-assets/>.

¹⁷⁴ OECD, Model Mandatory Disclosure Rules for CRS Avoidance Arrangements and Opaque Offshore Structures, OECD (2018), Paris.

¹⁷⁵ See *Nalogovii Kodeks RF, chast'1, gl. 3.4 (1998)* [NK] [Tax Code, part 1, section 3.4, (1998)].

¹⁷⁶ FNS: *Podvedeni Resultati Primeneniya Nalogoplatelschikami Pravil KIK v 2017 Gody* [Federal Tax Service: The Results of Using CFC Disclosure by the Taxpayers by 2017] (Mar., 27, 2018, 2.00 p.m.), https://www.nalog.ru/rn77/news/activities_fts/7144772/.

¹⁷⁷ *Id.*

companies.¹⁷⁸ However, in 2018 the “transitional period” for introducing the practical application of CFC rules in Russia ended.¹⁷⁹ As a result, a few rules were supposed to become stricter in 2018:

- Participation in a foreign entity must be reported if the income from this entity is 10 million Russian rubles (174.5 thousand US dollars) or more (it used to be 30 million rubles before 2018);¹⁸⁰
- Financial and criminal penalties were introduced for non-compliance with the reporting standards. Financial penalty is at 20% of the unpaid tax (but not less than 100 thousand rubles or 1750 US dollars), and criminal penalties apply in case of a particularly large unpaid amount, as determined by the rules of the Russian criminal code;¹⁸¹
- It was supposed to be no longer possible to liquidate a CFC and transfer its assets to the controlling person without paying taxes.¹⁸²

Such restrictions of the CFC regime could bring good results, however, in 2018 Russian government has taken a controversial measure in an attempt to repatriate capital that cancels most of the above restrictions. A new tax amnesty period, which lasts from 1 March 2018 until 28 February 2019, was introduced by the amendments to the tax code.¹⁸³ Under the amnesty, it is

¹⁷⁸ Maksim Simonov, *SHANS DLYA OFFSHOROV. VIZHIVUT LI KONTROLIRUEMIE INOSTRANNIE KOMPANII V ROSSII?* [A CHANCE FOR OFFSHORES: WILL CONTROLLED FOREIGN COMPANIES SURVIVE IN RUSSIA?] (Mar., 27, 2018, 2.00 p.m.), Forbes.ru:<http://www.forbes.ru/finansy-i-investicii/358077-shans-dlya-ofshorov-vyzhivut-li-kontroliruemye-inostrannye-kompanii-v>

¹⁷⁹ *FZ “O Vnesenii Izmenenii v 1 I 2 chast NK RF (v chasti nalogoolozheniya pribili KIK I dohodov inostrannih organizatsii)”*. 24.11.2014, N376-FZ [Federal Law “On the Amendments to Parts 1 and 2 of the Russian Tax Code (Related to the Income from CFC and the Income of Foreign Entities), 24.11.2014, N376-FZ].

¹⁸⁰ *Nalogovii Kodeks RF, chast’1, gl. 3.4, st. 25.13 (1998)* [NK] [Tax Code, part 1, section 3.4, art.25.13 (1998)].

¹⁸¹ *Id.*, section 16. *Ugolovni Kodeks RF, st. 198-199* [Criminal Code of Russia, art. 198-199].

¹⁸² *Nalogovii Kodeks RF, chast’1, gl. 3.4, st. 25.15 (1998)* [NK] [Tax Code, part 1, section 3.4, art.25.15 (1998)].

¹⁸³ *FZ “O Dobrovolnom Deklarirovanii Fizicheskimi litsami aktivov I schetov (vkladov) v Bankah I o Vnesenii Izmenenii v Otdelnye Zakonodatelnye Akti RF”*, red. 19.02.2018 N140-FZ [Federal Law on the Voluntary Disclosure of Assets and Bank Accounts by Natural Persons and on the Amendment of Some Legal Acts of the Russian Federation, N140-FZ, version from 19.02.2018].

possible to declare CFC participation and avoid penalties for any non-compliance that took place before 1 January 2018.¹⁸⁴ It is also possible to liquidate a CFC and transfer its assets/capital to a Russian tax resident without paying income tax.¹⁸⁵ Thus, these provisions effectively cancel most of the restrictions that were supposed to take place after the transitional period of the CFC rules, prolonging a taxpayer-friendly regime for 1 more year. It can be concluded that Russia still takes an incentive-based approach to the disclosure of CFC ownership (as the UK before 2016). Generally, it is believed that guarantees from prosecution and tax exemptions are more appropriate for encouraging the taxpayers to disclose their CFC ownership than extensive penalties. At the same time, this is not in line with the obligations undertaken to implement BEPS Actions, which indeed aim at the restriction of the disclosure regime. Such incentives certainly contribute to the general ineffectiveness of the current CFC legislation.

As far as compliance with the OECD standards is concerned, Russia is still participating in the automatic exchange of information. In November 2017, the OECD standards on automatic exchange were implemented into the tax code by the federal law, and the first exchange will be completed by 30 September 2018.¹⁸⁶ Russia expects to receive the information regarding the income of its taxpayers or their passive offshore vehicles from 73 countries.¹⁸⁷ This may disclose a lot of unreported CFC ownership and income, thus, in the end it is still preferable for the taxpayers to declare their CFC participation before the automatic exchange.

In conclusion, the main tendency today is to broaden the scope of disclosure rules, while restricting penalties for non-compliance with them. The OECD automatic exchange initiative is a

¹⁸⁴ *Id.*

¹⁸⁵ *Id.*

¹⁸⁶ FZ “*O Vnesenii Izmenenii v Chast 1 NK RF v Svyazi s Realizatsiey Mezhdunarodnogo Avomaticheskogo Obmena Informatsiei I Dokumentatsiei Po Mezhdunarodnim Gruppam Kompaniy*”, 27.11.2017, N340-FZ [Federal Law on the Amendment of Part 1 of the Russian Tax Code in Relation to the International Exchange of Information and Documents on the International Groups of Companies, 27.11.2017, N340-FZ].

¹⁸⁷ FNS [Russian Tax Service] (Mar., 27, 2018, 2.00 p.m.), https://www.nalog.ru/rn77/news/activities_fts/7144772/.

big step in this direction, and it is expected to bring positive results by disclosing most of the undeclared ownership of offshore companies and trusts, as well as the income from such structures. The Model Disclosure Rules 2018 will also contribute to this initiative, as they require all persons connected to an offshore structure (such as intermediaries) to disclose the information about this structure. The UK is faster at following the international trends than Russia. It has already conducted its first automatic exchange in 2017, and the general policy of the HMRC is the restriction of disclosure standards, making them more demanding and introducing stricter penalties for non-compliance. Russia, on the other hand, while trying to adhere to the international standards, still uses its own incentive-based system in trying to get the taxpayers to disclose their CFC participation and income. This system has not been very effective, and the next part of this chapter will focus on recommendations for the improvement of current Russian policies, as well as general recommendations in regard to the disclosure of beneficial ownership.

3.3. Recommendations on the Future Development of Disclosure Policies in the Russian Federation and the United Kingdom

The research conducted for this thesis has revealed some issues concerning modern disclosure rules. This part gives recommendations on how to address these issues. It starts with the general conceptual improvements and then discusses in what ways the UK experience can be useful for Russia.

Effective disclosure of beneficial ownership in offshores requires cooperation between states and the uniformity of their disclosure rules. If the definitions, rules and requirements are uniform (like the CRS) the disclosure will be most effective with minimal costs. By contrast, if the understanding of fundamental concepts and rules varies, the international cooperation may be more difficult to achieve. One of the biggest issues of modern international disclosure rules is that they

do not contain a uniform and universal definition of beneficial ownership. On the one hand, the OECD intentionally left wide discretion in the interpretation to national legislation, in order to better adapt the concept of beneficial ownership to economic and legal realities of a particular country.¹⁸⁸ On the other hand, such discretion led to the situation where the definitions of the countries are very different, and what is considered beneficial ownership in one country does not qualify as such another. Moreover, some civil law countries do not have the concept of beneficial ownership in their legal systems, and they only introduced it following the OECD standards for disclosure. However, since these standards are unclear, the definitions of the abovementioned countries also lack clarity (as in Russia, where the tax code mainly uses the term “controlling person” when obviously referring to beneficial ownership). Therefore, it is recommended to create a model uniform definition of beneficial ownership, based on the guidelines provided by the judiciary and the Commentary to the OECD Model Tax Convention on Income and on Capital.¹⁸⁹ Such definition should also provide the list of relevant criteria for determining beneficial ownership (such as use, enjoyment and control). Although these criteria have already been determined, they are scattered in various legal instruments, and bringing them together in one definition would make it easier for countries to implement the international standards.¹⁹⁰ Furthermore, two different definitions should be adopted for beneficial ownership in foreign companies and trusts, as the participation and control in these legal structures is measured differently. The absence of clear distinction leads to the fact that in Russia, for instance, beneficial ownership of both foreign companies and trusts is discussed in the same articles of the Tax code

¹⁸⁸ OECD, Commentaries on the Articles of the Model Tax Convention, 2014.

¹⁸⁹ See *Indofood International Finance Ltd v JP Morgan Chase Bank NA London Branch* [2006] STC 1195, OECD, Commentaries on the Articles of the Model Tax Convention, 2014.

¹⁹⁰ See OECD Model Tax Convention on Income and on Capital, full version, 2014; Model Mandatory Disclosure Rules for CRS Avoidance Arrangements and Opaque Offshore Structures, OECD (2018), Paris, BEPS Action 12.

“Controlled foreign companies”, and sometimes it is not clear whether certain provisions of the tax code apply to trusts, companies or both.¹⁹¹ The same lack of clarity exists in relation to some other definitions. For instance, an offshore structure in different documents is named a “wholly artificial arrangement”, “passive offshore vehicle”, and “opaque offshore structure”.¹⁹² It can be seen from the definitions of these concepts (discussed in the previous chapters of this thesis) that several terms essentially mean the same thing. Therefore, it is recommended to avoid the unnecessary use of synonyms for legislative purposes, leaving only one term for every similar concept.

Russia and the UK both have disclosure rules in place, but the UK has a wider and a more developed framework in comparison with Russia. Several positive UK practices can be introduced in Russia. First, the disclosure requirements for trusts and for controlled foreign companies should be separated in different subchapters of the tax code. While the UK has separate disclosure requirements for trusts and controlled foreign companies and lists specifically what, when and how should be reported in case of each, Russia has all requirements for both foreign companies and trusts in Chapter 3.4. of the Tax code (which contains only 3 articles).¹⁹³ Separating these requirements in different subchapters would help to avoid the confusion that the taxpayers experience when trying to figure out what information to include in their notices. A foreign trust is not the same legal structure as a controlled foreign company, therefore, it is not desirable to keep them under the same “Controlled Foreign Companies” heading.

Second, a big step towards transparency in the UK was taken by introducing public registers of beneficial ownership. Although at the moment such registers exist only for companies,

¹⁹¹ See *Nalogovii Kodeks RF, chast'1, gl. 3.4(1998)* [NK] [Tax Code, part 1, section 3.4,(1998)].

¹⁹² See OECD Model Tax Convention and Model Disclosure Rules.

¹⁹³ See Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017/692, Regulation 44; Companies Act (2006), the UK; *Nalogovii Kodeks RF, chast'1, gl. 3.4(1998)* [NK] [Tax Code, part 1, section 3.4,(1998)].

it is likely that in the future trust registers will be public as well. It is recommended to make them public, as well as to create a separate public register of beneficial owners of overseas entities. Both of these initiatives are currently being discussed, and, taking into account the general tendency of disclosure expansion, they are very likely to be adopted by the UK government in the nearest future. In Russia, by contrast, there is no uniform and publically available register of beneficial ownership. The beneficial ownership information is registered with the tax service, and is available only to the authorities and a limited number of other institutions (mostly banks) upon request.¹⁹⁴ This makes it harder for the authorities, financial institutions, potential partners of an individual/legal entity and any other interested persons to find information regarding the participation and beneficial ownership of any foreign structures, while access to this information may be very significant both for the authorities and the creditors (as illustrated by *JSC Mezhdunarodniy Promyshelnniy Bank v. Pugachev*).¹⁹⁵ The absence of a uniform public register decreases transparency, and, thus, it is recommended that such register be adopted based on the UK experience.

Third, the technical side of disclosure requirements in the UK is more taxpayer-friendly than in Russia. Shortly after the adoption of any tax law or regulation, HMRC publishes official guidance for taxpayers, full and condensed (in the form of lists and tables).¹⁹⁶ This guidance explains in simple terms what the taxpayer's obligations are, and how to fulfill them. Furthermore, all forms for notification can be found online, and filing takes place online as well. Russia lacks clear "taxpayer-friendly" explanations of the legislative requirements (usually all explanations are

¹⁹⁴ See Tax Code, part 1, section 3.4.

¹⁹⁵ *JSC Mezhdunarodniy Promyshelnniy Bank v. Pugachev*, [2017] EWHC 2426 (Ch).

¹⁹⁶ See HMRC: PSC Register Summary Guidance, Requirement to Correct Tax due on Offshore Assets Guidance, Worldwide Disclosure Facility Guidance.

published in the official letters of the Ministry of Finance, which are difficult to understand for most people without a legal background), which leads to filing mistakes, and not all of the required forms can be easily accessed online.¹⁹⁷ It is recommended to adopt notification and filing guidance for taxpayers based on the UK example, and to make sure all relevant information can be found online.

Finally, Russia should take a clear and direct approach to the disclosure of beneficial ownership. The current approach may be described as controversial. While the UK is slowly, but inevitably moving away from the incentive-based disclosure system towards the restriction of reporting requirements and the increase of penalties, it seems that Russian authorities have not made up their mind yet. While CFC rules become more demanding and the automatic exchange of information commences in 2018 (which is in line with the OECD standards), the tax amnesty cancels most of the CFC restrictions, returning to the incentive-based disclosure system.¹⁹⁸ It must be noted that tax amnesties have not been very effective in the past in increasing the reporting of beneficial ownership of foreign entities. In addition, the budget loses tax income that could have been obtained by introducing stricter standards.¹⁹⁹ Therefore, it is recommended that the 2018-2019 tax amnesty should be the last one at least for the following decade. Russia should follow the general tendency of restriction and increasing sanctions, without cancelling the provisions of its own legislation by politically motivated decisions to spontaneously forgive all the taxpayers who did not declare their beneficial ownership of foreign entities and their foreign income.

¹⁹⁷ See, for example, the Letter of the Ministry of Finance on the Controlled Foreign Companies, 10.02.2017, N 03-12-11/2/9197.

¹⁹⁸ See *Nalogovii Kodeks RF, chast'1, gl. 3.4, (1998)* [NK] [Tax Code, part 1, section 3.4, (1998)]; *FZ "O Dobrovolnom Deklarirovanii Fizicheskimi litsami aktivov i schetov (vkladov) v Bankah I o Vnesenii Izmenenii v Otdelnye Zakonodatelnye Akti RF"*, red. 19.02.2018 N140-FZ [Federal Law on the Voluntary Disclosure of Assets and Bank Accounts by Natural Persons and on the Amendment of Some Legal Acts of the Russian Federation, N140-FZ, version from 19.02.2018].

¹⁹⁹ Maksim Simonov, *SHANS DLYA OFFSHOROV. VIZHIVUT LI KONTROLIRUEMIE INOSTRANNIE KOMPANII V ROSSII?* [A CHANCE FOR OFFSHORES: WILL CONTROLLED FOREIGN COMPANIES SURVIVE IN RUSSIA?] (Mar., 27, 2018, 2.00 p.m.), Forbes.ru:<http://www.forbes.ru/finansy-i-investicii/358077-shans-dlya-ofshorov-vyzhivut-li-kontroliruemye-inostrannye-kompanii-v>

The changes proposed above will make Russian disclosure procedures more uniform and taxpayer-friendly. Provided that Russia follows OECD standards (which should be clear and unambiguous), it is likely that more foreign beneficial ownership will be disclosed, and a higher standard of transparency will be achieved.

Chapter 3 Conclusion

The third chapter provided an overview of current tendencies in the development of disclosure rules and the recommendations for making these rules more effective. The general international tendencies today are the expansion of disclosure standards, the restriction of reporting requirements and the increase of penalties for non-compliance with the standards. The 2017 case of *Mezhprombank v. Pugachev* demonstrated that it is possible to disclose the beneficiary based on a simple “true effect of the trust” test, which expands the scope of disclosure. Furthermore, the OECD strives to increase transparency by introducing the automatic exchange of information between countries, which first takes place in 2017-2018. At the same time, some key OECD definitions (like beneficial ownership) still require clarifications.

Russia and the UK both participate in the automatic exchange and follow OECD standards, however, the UK takes a more restrictive approach, while Russia still keeps the incentive-based system of encouraging disclosure. Although some restrictions in the disclosure regime were introduced, they were essentially cancelled for the period of 2018-2019 by the tax amnesty. Such an approach is ineffective and it is recommended to abandon it in the future. It is also recommended to implement some other effective policies of the UK disclosure regime (such as the key distinction between beneficial ownership in companies and in trusts) in Russia. If these recommendations are taken into account, the effectiveness of beneficiary disclosure in Russia will increase significantly.

Conclusion

Tax avoidance is an important contemporary issue that has been addressed both on the international and national level. The OECD deals with the most topical concerns of the international community, while state governments adjust OECD standards to their economic and legal realities. The disclosure of beneficial owners of offshore trusts is crucial for preventing tax avoidance. This thesis contributed to the development of modern disclosure policies, making suggestions for their improvement based on the analysis of the most important disclosure rules and tendencies of the OECD and their implementation in Russia and the UK.

In defining beneficial ownership it is crucial to understand that the concept first developed in common law trusts and arose from “splitting” the ownership title between the trustee and the beneficiary. The trust structure has proven to be useful for property and asset management, and it has become very common. It also opened opportunities for asset protection and tax avoidance, which became widely used in offshore jurisdictions that are known for favourable tax regimes and lack of transparency as far as trust ownership structure is concerned. As new offshore trust schemes developed, the roles of settlor, trustee and beneficiary became mingled. As settlors intended to hide their assets without losing control over them, the problem of illusory and sham trusts arose. Settlers were often the same persons as ultimate beneficiaries, and, in addition, they exercised wide control over the trustees. In such context, the need for disclosure regulations became evident.

This need was addressed by the OECD. However, the OECD does not give a clear definition of beneficial ownership, only providing the criteria for its determination in various documents. These criteria include use and enjoyment of the trust income (meaning that the beneficiary is the final and ultimate income recipient) and control. The judiciary has also pointed out that the concept of beneficial ownership, while being based on the notion developed in trust law, should be broader for the purposes of international tax law. Such broad interpretation allows

to encompass a wide range of tax avoidance scenarios. It is recommended that, based on these findings, a new universal definition of beneficial ownership should be adopted by the OECD. It will increase the uniformity of the implementation of OECD standards in different countries. It will eliminate the problem of terminology confusion (as in many civil law countries, including Russia, no notion of beneficial ownership existed before its introduction in the context of OECD disclosure standards) and facilitate practical application of the disclosure rules.

The international framework for disclosure rules is set by the OECD BEPS Actions that aim at enhancing tax transparency worldwide. BEPS Action 3 (Controlled Foreign Companies) and Action 12 (Mandatory Disclosure Rules) define the types of foreign entities which can potentially be used for tax avoidance (trusts are among them), the criteria for beneficial ownership in them, and the requirements for disclosure of the information related to such foreign entities. According to the OECD standards, all trust participants must disclose the relevant information about the trust (ownership, income and activities), especially the beneficiaries, since they have tax liability based on their trust income. This approach was followed in Russia and the UK. In general, since both countries base their policies on the OECD rules, their disclosure rules are similar. The basic information to be disclosed is the same (including the information about the trust and its participants), and it has to be filed online annually in both countries. However, the UK has a wider range of regulations dedicated to disclosure and a separate set of rules for beneficiaries of foreign trusts, while Russia primarily regulates the disclosure of beneficial ownership in foreign trusts and companies by the same three articles of the tax code. The UK uses a more comprehensive system for disclosure, and it is recommended that Russia implements some of the UK policies. These include the separation of the rules on controlled foreign companies from the rules on foreign trusts, the introduction of public registers of beneficial ownership, and some technical improvements that

will ensure the accessibility of all information relevant to the reporting of beneficial ownership. Such changes, together with a clear direction of government tax policy, will improve the current disclosure framework in Russia.

The key contemporary tendency of the development of disclosure rules is the expansion of their scope (both in theory and in practice, as illustrated by *Mezhprombank v. Pugachev*), and the restriction of reporting standards and penalties for non-compliance. These trends are set by the automatic exchange of information proposed by the OECD and followed by both Russia and the UK. Further restrictions are expected to occur based on Model Disclosure Rules 2018 that expand the scope of reporting requirement to intermediaries. While the UK introduces new restrictions, such as the Requirement to correct, in Russia 2018 restrictions of the CFC regime were cancelled by the tax amnesty. Such an approach is controversial and not effective. Russia is still participating in the automatic exchange and the BEPS project, and it will have to fulfil its respective obligations. Therefore, it is essential that Russia follows OECD tendencies and recommendations.

Since the disclosure framework is developing very fast, the research similar to this one may be conducted in the future. There will be a need to assess the outcomes of the first automatic exchanges between the countries and possible new rules that may follow. Furthermore, it is important to analyse the results of the 2018-2019 tax amnesty in Russia, and to figure out whether CFC rules will be restricted after the amnesty. The general development of the UK rules may also raise new research questions, such as the usefulness of Worldwide Disclosure Facility and the Requirement to Correct. Finally, it should always be kept in mind that the more the disclosure rules develop, the more advanced techniques are invented to avoid them. As new issues in the area of tax avoidance arise, the disclosure framework may change significantly in the next few years. Therefore, research and recommendations in this area will always remain topical.

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