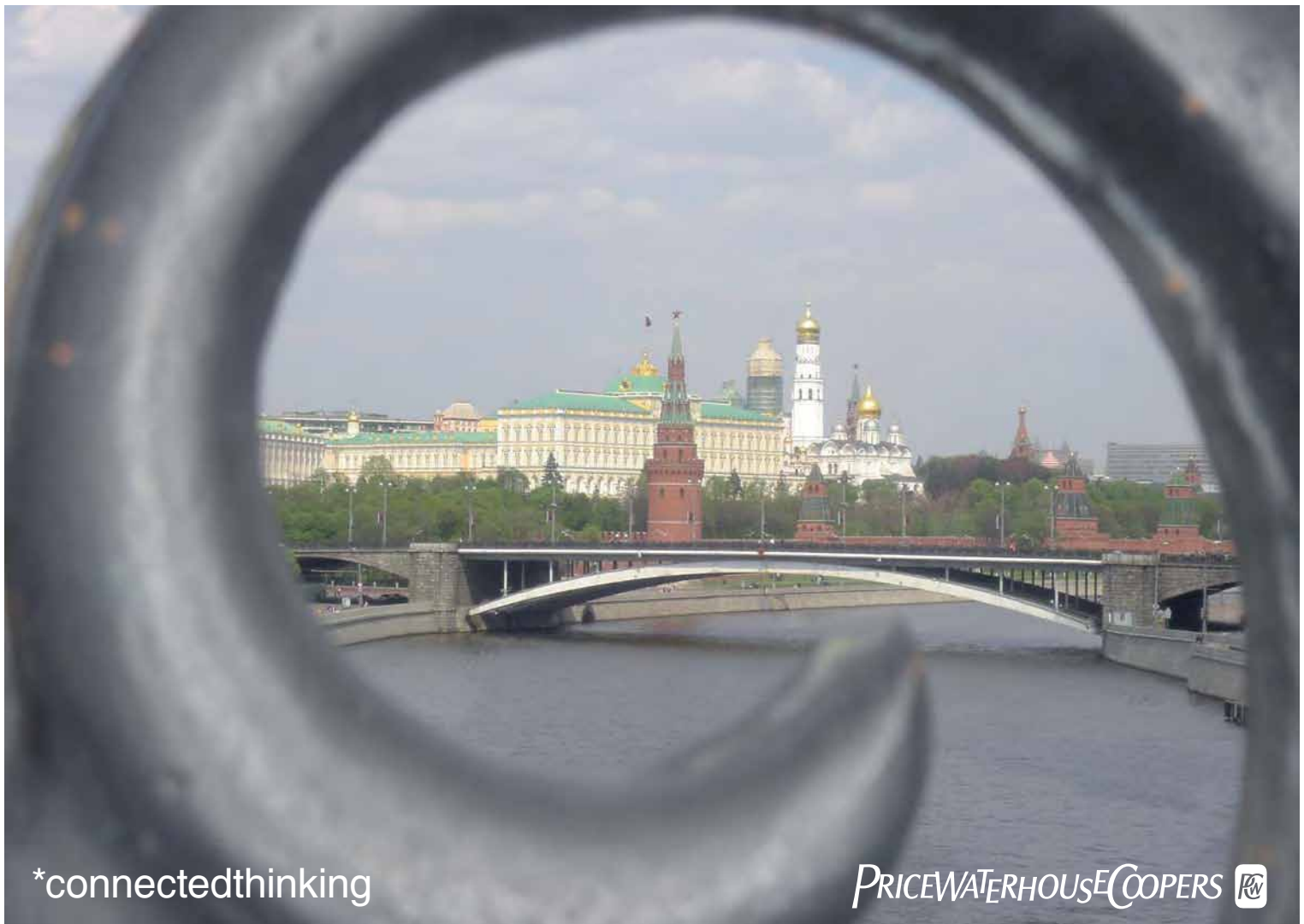


2008 edition

# Doing business and investing in the Russian Federation\*



\*connectedthinking

PRICEWATERHOUSECOOPERS 

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# 1. Russia: country profile



## 1.1. Introduction

### Geography and climate

Russia is a vast country extending over much of the northern part of Eurasia. With an area of 17,075 million km<sup>2</sup> (6.6 million mi<sup>2</sup>), Russia is the largest country in the world. To the west, Russia borders Ukraine, Belarus, Poland and the Baltic countries; to the north, Finland and Norway; to the south, Georgia, Azerbaijan, Kazakhstan, Mongolia, China and North Korea. Russia has coastline on three oceans: the Arctic, the Atlantic and the Pacific.

Russian topography is very diverse: from tundra in the north to semi-arid in the south, with all variety of forests and grasslands from west to east. The climate is accordingly very diverse, with arctic and subarctic zones in the north and subtropical areas in the south. The majority of Russia, however, has a continental climate.

The Russian Federation comprises 85 federal subjects, which are grouped into seven federal districts that are administrated by envoys of the president. There are 13 cities with a population of over 1 million: Moscow (the capital), St Petersburg, Novosibirsk, Nizhny Novgorod, Yekaterinburg, Samara, Omsk, Kazan, Chelyabinsk, Rostov-Na-Don, Ufa, Volgograd and Perm.

### History

Russia has been around for more than 11 centuries. The Russian Empire was abolished by the Bolshevik uprising in 1917 with the establishment of USSR, which incorporated 15 republics.

After a devastating victory in World War II, the Soviet Union consolidated its hold as a result of the Warsaw Pact and, being the dominant force behind the Eastern Bloc, entered into a long-lasting confrontation with the Western Bloc (the US and Western Europe) known as the Cold War.

In the late 80s, Mikhail Gorbachev's reform policy, known as "perestroika", led to the disintegration of the USSR in 1991. Russia, however, maintains strong business ties and good neighbourly relations with many former Soviet republics.

Today the Russian Federation is a federal presidential republic. In 2004, Vladimir Putin was re-elected president for a second term. In 2008 a new president should be elected.

## 1.2 Government structure

The 1993 Constitution declares Russia a democratic federative state based on rule of law and a republican form of government. State power in Russia is divided among the executive, legislative and judicial branches.

Executive power is exercised by the government, consisting of a prime minister, deputy prime ministers, and ministers. The president is actually legally distanced from all branches of power,

but he is most allied to the executive branch.

The legislature is the bicameral Federal Assembly, consisting of the State Duma (the lower house or parliament) and the Federation Council (the upper house). The State Duma is elected by direct popular vote for four-year terms. It drafts legislation and can amend the constitution and can file an impeachment against the president. Duma elections were last held in December 2007. The Federation Council approves or rejects laws adopted by the State Duma and appoints high court judges. The speaker of the Federation Council ranks third in the political hierarchy after the president and the prime minister.

The judicial branch comprises the three highest courts: the Supreme Court, the Constitutional Court and the Supreme (Commercial) Arbitration Court. The Supreme Court is the highest judicial body for all lower courts. It considers civil, criminal, and administrative cases. The Constitutional Court checks that laws or decrees do not contradict the constitution. The Supreme Arbitration Court is the final instance in commercial disputes and supervises lower arbitration courts and issues clarification on interpretations of laws.

## 1.3 Legal system

The Russian legal system is based on statutory law rather than case law. The main legal acts in the Russian Federation are the Constitution, federal constitutional laws, federal laws, presidential edicts, governmental regulations, laws of regional constituents of the Russian Federation. The Constitution recognises norms of international law and international treaties and agreements of the Russian Federation as part of Russia's domestic legal system. If an international treaty or agreement of the Russian Federation establishes rules other than those envisaged by domestic law, the rules of the international agreement apply.

## 1.4 People

### Population

Russia's well-educated workforce is an important asset for long-term growth. Its relatively low-cost and generally highly skilled workers are one of the main attractions for investors. Russia's population is approximately 142.1 million, of which 64% are of working age, 16% are below it, and 20% are above it. Approximately 55% of the population is female and 45% male.

Statistics show that Russia's population is steadily declining, but the government is trying to solve this problem through immigration policies and federal programmes to stimulate birth rates and reduce mortality.

Russia is home to 160 ethnic groups. According to the latest census, the majority are Russian (79.8%), with Tatar (3.8%) and Ukrainian (2%) being the next largest groups.

### Language

There is only one official language: Russian. Russian is also co-official in many former Soviet republics, and it is the most widely spoken Slavic language in Eurasia. English and German are the most commonly studied foreign languages in Russia. In most schools, English is compulsory.

### Religion

The dominant religion is Russian Orthodoxy. Almost 80% of Russians identify themselves as Orthodox. The second most widespread religion is Islam, with centres in Tatarstan, Bashkortostan, Dagestan and other regions. Other religions include Protestantism, Judaism, Roman Catholicism, Buddhism and others.

### Education

The Russian educational system is free. Primary and secondary education in Russia is compulsory and is seen as very in-depth: 97% of children get either a 9-year basic or 11-year complete compulsory education.

Currently, there are more than 2,000 institutes of higher education in Russia. The number of students getting higher or at least technical education has more than doubled since the mid-1990s. About 23% of the population has completed higher education. Russia has one of the highest rates of people with doctorate degrees in the world.

### Living standards

Although the estimated number of people receiving income below the minimum subsistence level in Russia is 14%, the income level in big cities approaches those in Central and Eastern Europe. As for Moscow and St Petersburg, the income of upper and middle management almost reaches that of developed countries.

## 1.5 Economy

### Overview

Starting in 1991 with the USSR's disintegration, Russia's GDP continuously declined until 1998. After the economic crisis in 1998, the Russian economy began to recover, with annual GDP growth at around 7% from 1999 to 2006. Driving this recovery are the sharp increase in prices for Russia's main exports (oil, petroleum products, gas, metals), the import substitution effect caused by the rouble devaluation in 1998, tax reform, a tightening of fiscal policy, and greater social and political stability. Still, much of the total output is produced by large industrial enterprises; the share of small and medium business in the total GDP is very small. Services accounted for 56% of GDP in 2006; industry 39% and agriculture 5%.

In 2006, real GDP increased by 6.7% to USD 985 billion, or around USD 1.73 trillion on a PPP basis, and industrial production was up by 3.9%. On the strength of Russia's economic recovery, Standard & Poor's Ratings Service assigned Russia a BBB+ long-term sovereign credit rating. Moody's Investors Service left Russia's investment grade rating at Baa2 with an outlook of stable. The Fitch rating agency assigned Russia a BBB+ rating.

In addition to high export commodity prices, recent economic growth is mainly due to an unprecedented boom in consumer-oriented sectors, especially in construction and services. In recent years, household consumption has been growing at nearly 10% per annum, driving all sectors related to consumer goods and services.

As of 22 June 2007, the amount of gold and foreign exchange reserves had reached USD 406.6 billion.

Inflation has remained largely under control in recent years, although this will continue to be a challenge for the government. In 2006, CPI inflation was 9%, down 1.9% from the previous year.

In 2006, foreign direct investments doubled from the previous year to exceed USD 30 billion (according to the Ministry of Economic Development and Trade). According to the Central Bank, USD 7 billion of that is repatriated Russian capital. Luxembourg, the Netherlands, Cyprus, the UK, Germany, the US, the Virgin Islands and France remain the main investors in the Russian economy. Mineral resource extraction, manufacturing, retail, finance, real estate, construction, transport and communications are the favourite targets for both domestic and foreign investments.

In May 2007, 5.1 million people in Russia were unemployed, or 6.9% of the labour force. The labour force numbered 74.8 million people, or 52% of the total population.

To maintain or even increase current economic growth, Russia has to continue investments in the modernization of equipment and infrastructure and significantly improve the threatening demographic situation. The latter could substantially benefit from the government's recently launched wide-scale National Priority Projects in healthcare, education and housing.

Russia's M&A market saw an impressive 111% growth in 2006, up from USD 53 billion to USD 111 billion, representing nearly 70% of Central and Eastern Europe's M&A market. Deal volume shot up 71% from 706 to 1,210 in 2006, of which 922 deals were completed by domestic companies. With 288 outbound deals, Russia was the most active outbound investor in CEE. It saw 142 transactions valued at over USD 100 million in 2006. The hottest industries were manufacturing (primarily metals), financial services, and energy and utilities. Russia closed 102 outbound transactions in 2006, with the main targets being Ukraine (22), the UK (8) and the US (7). A total number of 158 privatizations averaged at USD 9.1 million.

Domestic capital markets in Russia developed rapidly in 2006, a milestone year for the Russian IPO as more and diverse Russian companies sought to float. The IPO market volume has increased almost four-fold since 2005, reaching USD 17.7 billion in 2006, 76% of which was raised by four companies of a total 23. Some 61% of the total volume was raised on the LSE; the RTS and MICEX follow with 20% and 15%, respectively. The top industries were energy (66%) and metals (13%). In 2006, state-controlled oil group Rosneft surpassed the total figure for all 2005 offerings with its USD 10.4 billion flotation. This was the largest IPO in Russia and the fifth-largest IPO in the world. The Russian IPO market grew in the first half of 2007 at a truly unprecedented pace, becoming the largest market in Europe in the second quarter and the third-largest in the world, after the US and China. IPO market volume exceeded USD 25 billion. The main contributor to this success was Vneshtorgbank, with the country's second-largest float of USD 8.2 billion.

Eight Russian companies were listed among the Financial Times' 500 largest global companies by market capitalization in 2007, and 20 companies in FT Europe 500, with Gazprom ranking 6th in the world and 1st in Europe.

### Stabilization Fund and National Wealth Fund

Russia's Stabilisation Fund was set up on 1 January 2004 as part of the federal budget to provide budget deficit financing when it is essential. The fund may be used to cover the federal budget deficit and for other purposes if its balance exceeds 500 billion roubles (approximately USD 19.5 billion). Amounts spent depend on the federal budget law for the corresponding fiscal year. The fund accumulates revenues from oil exports and, as of July 2007, its aggregate amount exceeds USD 120 billion. The

fund's assets are invested in US dollars (45%), euros (45%) and pounds sterling (10%).

Beginning 2008, the Stabilisation Fund will be divided into the Reserve Fund and National Wealth Fund. The former will be maintained at a level not less than 10% of GDP to cushion the economy during any economic downturn. The latter would be composed of excess revenues from oil exports.

### Leading sectors

#### Energy, utilities & mining

Russia's energy industry comprises oil, gas, coal, shale and turf production, electricity generation, oil refining, centralized heating supply systems and power transmission networks.

Currently, Russia's energy, utilities, and mining sectors (especially in electricity and gas) face major reforms to encourage continued domestic and foreign investment and to solve challenges like high energy demands and export restraints.

Russia is an important player in international energy trade. Russia's energy reserves are among the world's largest; a country with less than 3% of the world's population, it controls around 7% of the globe's proven oil reserves, 26% of natural gas, 17% of coal, and 14% of uranium.

Oil and gas production remains the Russian economy's principal sector, accounting for 22% of GDP. It plays a leading role in generating state budget revenues and secures a positive trade balance. Some 66.2% of the country's exports are oil, petroleum products, and gas.

Russia is second on the list of the world's largest oil-producing countries, after Saudi Arabia, and the second-largest exporter. In 2006, Russia's oil production grew 2.2% on the year to 480.5 million tonnes. LUKoil, TNK-BP, Rosneft, and Surgutneftegas extracted the highest volumes of crude oil in 2006.

Russia is the world leader in natural gas reserves with 48 trillion cubic meters.

In 2006, gas production rose 2.4% on the year to 656.3 billion cubic meters. Gazprom, Russia's state-run natural gas monopoly, produces 84.2 % of Russia's natural gas and operates the country's natural gas pipeline.

Russia's total coal reserves are around 157 billion metric tonnes. After China, the US, India and Australia, Russia is the world's fifth-largest coal producer. National coal production reached 309.2 million tonnes per year in 2006 and rose 3.6% compared with 2005. Coal exports increased by almost 15% on the previous year. Russia's top coal-producing areas, accounting for more than 95% of total coal output, are the Siberian, Far East, and Northwest federal districts.

In the electricity sector, Russia relies on the 216.7-gigawatt generating capacity of over 440 thermal and hydropower plants and on a 2,500,000-kilometer (1,500,000-mile) power transmission network.

Thermal power (oil, natural gas, and coal-fired) accounts for roughly 66.5% of Russia's electricity generation, followed by hydropower (17.7%) and nuclear (15.8%).

In 2006, electric power output in Russia rose 4.1% on the year to 992.5 billion kilowatts per hour (kWh). Electric power consumption increased 3.7% on the year to 975.8 billion kWh.

The utilities sector is currently being deregulated. A reform programme is underway to dismantle the state-owned monopoly RAO UES (by July 2008) and divide it into separate generation, transmission and retailing units.

The overhaul aims to attract investment and induce mergers and acquisitions in what is the world's fourth-biggest power market.

### Metals

Along with oil and gas production, metallurgy is one of the Russian economy's key industries. Russia ranks first in the world in nickel production, second in aluminium production and export after the US, and fourth in steel production after China, Japan and the US.

According to official statistics, in 2006 the metal industry accounted for over 16% of Russia's total industrial production and around 10% of total foreign investment.

In 2006, metal industry production increased by 7.5% compared with 2005.

Exports of metals and metal products increased 22.6% on the year to USD 41.8 billion in 2006, of which USD 5.3 billion was exported to CIS countries (32.5%). The main exported product was rolled metal; its share accounts for 60%. Exports of ferrous metals decreased 0.5% to USD 18.6 billion, 22.7% of which was exported to CIS countries.

An expanding domestic demand for metal products from the machine building and construction sectors stimulated dynamic growth in the metals industry.

In 2006, Russian ferrous metals companies increased finished steel production by 5% to 70.8 million tonnes. The largest ferrous metals holdings are Mechel Steel Group, Evrazholding, Severstal Group, Magnitogorsk Iron & Steel Works, Novolipetsk Ferrous Metal Factory, and Tube Metallurgical Company.

The nonferrous sector is strongly export oriented: Russia exports up to 70% of its nonferrous metal production. The largest nonferrous metals holdings are RUSAL (Russian Aluminium, SUAL-Holding and Glencore), UMMC, Norilsk Nickel, and VSMPO-AVISMA.

The process of privatisation and asset consolidation in the metals industry is largely complete. Most metallurgical companies are vertically-integrated holdings, conducting exploration and extraction as well as refining and sales activities.

The Russian metallurgical industry is a success due to its relatively low production costs, the proximity to raw materials, improving technology and equipment and increasing international integration.

### Retail & consumer

The increasing purchasing power of the population is the main driver behind the recent dynamic growth of Russia's retail and consumer sector. It is one of the fastest-growing markets in Russia and attracts 24% of all foreign investment.

The retail industry's turnover in 2006 was around USD 317.4 billion. Russia is the fastest-growing retail food sales market in the world, with the potential to double in size by 2008. In 2006, Russia was ranked the second most attractive retail market in the Global Retail Development Index. The country has emerged as the big retail opportunity. Major international chains are expanding their presence in the non-food market, including IKEA, OBI, Leroy Merlin, Castorama; and in the food market, including Auchan, Carrefour, Metro, Rewe and Ramstore. However, Russian retail giants such as the X5 Retail Group, Magnit, Sedmoi Continent and the Kopeika chains continue to make up a significant share of the market. And despite the extensive growth of modern retail chains (both Russian and international), street markets and kiosks still account for almost two-thirds of Russia's retail turnover. This share of the market, however, is steadily declining.

Around 40% of Russians' income is spent on food, but income spent on household amenities, goods and services, medicine and medical services, recreation, education and cultural services is increasing steadily.

Multinational consumer companies are already either market leaders or significant players in many segments of the Russian consumer sector. The food and beverages industry is dominated by companies such as Danone, Carlsberg, Nestle, Mars, Pepsi and Coca-Cola. Strong international players in the personal care, cosmetics and household products markets are Unilever, Procter & Gamble, L'Oreal, Oriflame, Avon, Mary Kay and Henkel.

The main challenges faced by the retail and consumer sector in Russia are a lack of retail space in the major cities, heavy taxes, poor logistics, insufficient infrastructure, and bureaucracy. However, given increasing demand following the strong, sustainable growth in personal disposable incomes and intensifying competition in the market, some of these problems should be overcome in the future.

## Communications and IT

The Russian communications and information technology sectors are developing rapidly and represent 4.5% of the country's GDP. According to the Ministry for Information Technology and Communications, the communications industry's revenues grew by 19%, reaching USD 27.6 billion in 2006.

By the end of 2006, mobile telephone penetration by SIM cards exceeded 100%, while objective penetration came to around 80%. In 2006, Russia had a total 150 million mobile subscribers. Mobile penetration is growing particularly fast in the regions, stimulated by sharp competition among the three major national operators (Mobile TeleSystems, VimpelCom, and MegaFon). They are vying to buy up regional operators and develop new networks across the country and are actively expanding in the CIS and Europe.

The three largest Russian mobile operators have received 3G licenses. MTS promised to invest \$1 billion over the next three years, with the first services to be launched in 2007. MegaFon announced a similar investment, with services planned from 2008. VimpelCom has more modest plans, with investments of between \$300 million and \$350 million over the next 18 months.

The fixed-line segment is dominated by state-controlled Svyazinvest. Its privatisation has already been delayed several times.

The market for alternative operators is also developing rapidly in Russia. Market leaders, including Comstar United Telesystems, Peterstar and Golden Telecom, are growing fast and focusing on high-margin corporate and high-income household sectors.

In 2006, the government began liberalising the long-distance market by granting alternative operators licenses for international and intercity calls. The key emerging competitors to Rostelecom, the former state monopoly, are Transtelecom, Golden Telecom and MTT (Multiregional TransitTelecom). Deregulation has also induced a wholesale change in access and interconnection rules. The Calling Party Pays (CPP) principle was first introduced on the Russian telecoms market in July 2006. The regional telecom companies began collecting money from subscribers for zonal fixed-to-mobile calls, which had been free of charge before. New tariffs for local calls were introduced with, subscribers offered a choice of three basic tariff plans: unlimited, per minute and combined. The tariff rates are set by the operator within a range determined by the market regulator.

National internet penetration rates are rather low, with most estimates putting the rate somewhere around 25%. In 2006, the number of internet users was 25 million people. Revenue from internet services reached USD 3.6 billion in 2006.

Hardware is the major IT segment, accounting for more than 70% of the sector's revenue according to official statistical data, and is growing rapidly. Hardware sales grew by 23% and totalled USD 8.1 billion in 2006.

The software industry is also on the rise, with a growth rate of around 46% and sales reaching USD 2.2 billion in 2006.

In 2005, the Russian government initiated a pilot programme for IT parks, with about USD 1 billion to be invested by the state from 2007 to 2011. IT parks are planned for Moscow, Tyumen, Nizhny Novgorod, Kaluga, Novosibirsk, St Petersburg and the Republic of Tatarstan.

In July 2007, a federal target programme for the development of nanotechnology in Russia for 2008 to 2010 was launched, with volume of investments at USD 1 billion.

Government initiatives to support the IT industry also include possible additional tax breaks and the creation of a venture capital investment fund that is designed to finance IT and technology start-ups. Despite positive developments in the IT sector, software piracy remains very high in Russia.

## Automotive sector

In 2006, sales on the Russian automotive market rose 20% on the previous year to 2.06 million cars. This was the fifth highest sales volume in Europe, after Germany, France, the UK and Italy. Over the past five years, the demand for cars has tripled in money terms, from \$10 billion in 2002 to more than \$32 billion in 2006. The main reasons for such rapid growth are the steady increase in personal disposable income, better access to car loans and expansion of sales chains and dealership chains all over the country. The results of the first half of 2007 are 1.165m units sold and \$20.6 billion market volume, growth of 28% and 51% compared with the first half of 2006, respectively. Major industry experts anticipate further market growth and predict that in several years the Russian automotive market could become the largest in Europe.

Traditional Russian car manufactures are losing their market share to foreign brands that are imported or have assembly plants in the country. New foreign brands account for 78% of the market in money terms. The Russian Government has offered tax breaks to companies that start major assembly lines in Russia. Ford, Renault, GM, KIA, Great Wall, Hyundai, Fiat, SsangYong, and Isuzu are already assembled in Russia. Toyota, Suzuki, Nissan, Volkswagen, Peugeot/Citroen, Mitsubishi, Hyundai and others are constructing factories or have announced plans to set up assembly plants in Russia. An influx of foreign car component manufacturers in the next few years is expected. Practically the same tax remissions are on offer to large-scale car component producers.

## 1.6 Foreign trade

Russia's trade balance continues to move from strength to strength. Record foreign inflows from the current account, together with a significant strengthening of the capital account, dominate the Russian macroeconomic picture. Record volumes and prices on main exports in the energy sector and metals, first and foremost, conditioned a steady balance of payments. Export revenues increased by 24.7% to USD 304.5 billion in 2006.

The biggest problem for Russian exports is that they are dominated by inefficient commodities with low added value: 66.2% are mineral resources (oil, petroleum products, gas), 13.9% are metals. Machinery, equipment and transport vehicles account for only 5.5%, chemicals and rubber for 5.5%, and gems, precious metals and related goods for 2.6%.

Imports in 2006 reached a 15-year record growth rate (30.8% in 2006), mainly driven by increasing demand for both investment and consumer goods, due to the need for modernizing outdated equipment and an increase in real disposable income. Continuous rouble appreciation intensifies both physical and monetary volumes of Russian exports.

Almost all goods show an increase of imports, with machinery, equipment and transport vehicles accounting for nearly half of all imports. Food products and agricultural raw materials make up more than 15%; chemical products around 16%, footwear and textile production 3.7%.

Russia's main trading partners are Germany, Netherlands, Italy, China, Ukraine, Belarus, Turkey, Poland, Finland, USA, Kazakhstan, Japan, and South Korea.

At same time the trade balance growth rates have been falling. In the midterm, it is expected that imports will catch up with exports.

	2000	2001	2002	2003	2004	2005	2006	2007 9M*
<b>Exports</b>	105	101.6	107.2	135.9	183.5	243.6	304.5	<b>278.4</b>
<b>Imports</b>	44.9	53.8	61	75.4	96.3	125.3	163.9	<b>174.2</b>
<b>Trade Balance</b>	60.2	47.9	46.2	60.5	87.1	118.3	140.7	<b>104.2</b>

\* Estimates of the Ministry for Economic Trade and Development of the Russian Federation.

## 1.7 Tips for business visitors

### Visas

As is the case with any business trip, some advance preparation is essential before visiting Russia. Here we provide some useful information for visitors.

Every foreigner needs a visa to go to Russia. First, you need an invitation from an entity in Russia to get a Russian visa. Then you will need to take this invitation to the Russian consulate or embassy in the country of your passport or where you have residency. Your passport should be valid for more than six months after the end of the visa's expiry date. The whole process of receiving a visa normally takes up to 25 business days.

There are several types of visas for Russia, depending on the purpose of the stay. Business trip visas are for attending meetings, conferences and training only. They are valid for 90 days during any 180 day period. Employment visas are for people working in Russia and creating revenue for a Russian organization and are received on the basis of a work permit. Russian immigration rules change often so it is recommended to enquire with your local Russian embassy or consulate before applying for a Russian visa.

Upon crossing the Russian border, you will be asked to fill out a 'migration card'. The border guards will take one half upon entry to Russia. The remainder you should keep with you throughout your stay in Russia. The second half will be collected when you cross the border and leave Russia.

Foreign citizens who have entered the Russian Federation must register within three working days of the day of their arrival in the Russian Federation. If a foreign citizen has changed the place of his/her stay in the Russian Federation, he/she has to register within three working days of the day of arrival at the new place of stay.

People travelling to Russia should keep their passport, visa and other immigration documents with them at all times.

### Currency

The currency of the Russian Federation is the Russian rouble. The rouble is subdivided into 100 kopecks. The ISO 4217 code is RUB.

The exchange rates as at 19 December 2007 were: 1 USD = 24.72 RUB; 1 EUR = 35.58 RUB

Cash, traveller's cheques and credit cards are all accepted in Russia, but cash remains the preferred method of payment. Credit and debit cards have grown significantly in popularity in recent years, and cash machines are now numerous. Euros and dollars can be exchanged at official exchange offices.

## Business and social etiquette

Russian business customs tend to be formal. Introductions are respectful, business cards are exchanged and suits are worn. If you attend a meeting with a traditional Russian entity, the same level of people should be represented on each side of the table, i.e. Vice President from X and Vice President from Y, Deputy Director from X and Deputy Director from Y. Agendas are often circulated in advance as a courtesy. The handshake is used both on meeting and taking leave, mostly among men. Dealing with public and state officials can sometimes be time-consuming and requires patience and perseverance.

## Public holidays

Russia has the following public holidays:

- New Year Holidays (1 - 5 January);
- Russian Orthodox Christmas (January 7);
- Defenders of the Fatherland Day (February 23)
- International Women's Day (March 8)
- Spring and Labour Day (1 May);
- Victory Day (9 May);
- Russia Day (12 June)
- Unity Day (4 November)

If the holiday falls on a Tuesday or Thursday, the nearest Saturday or Sunday may be deemed an official work day in order for people to have three days off consecutively. The Russian government will normally publish these work day changes 2-3 months in advance of the holiday.

## Time zone

(UTC+2 to +12)

Summer (DST) (UTC+3 to +13)

Time differences between Moscow and some major cities.

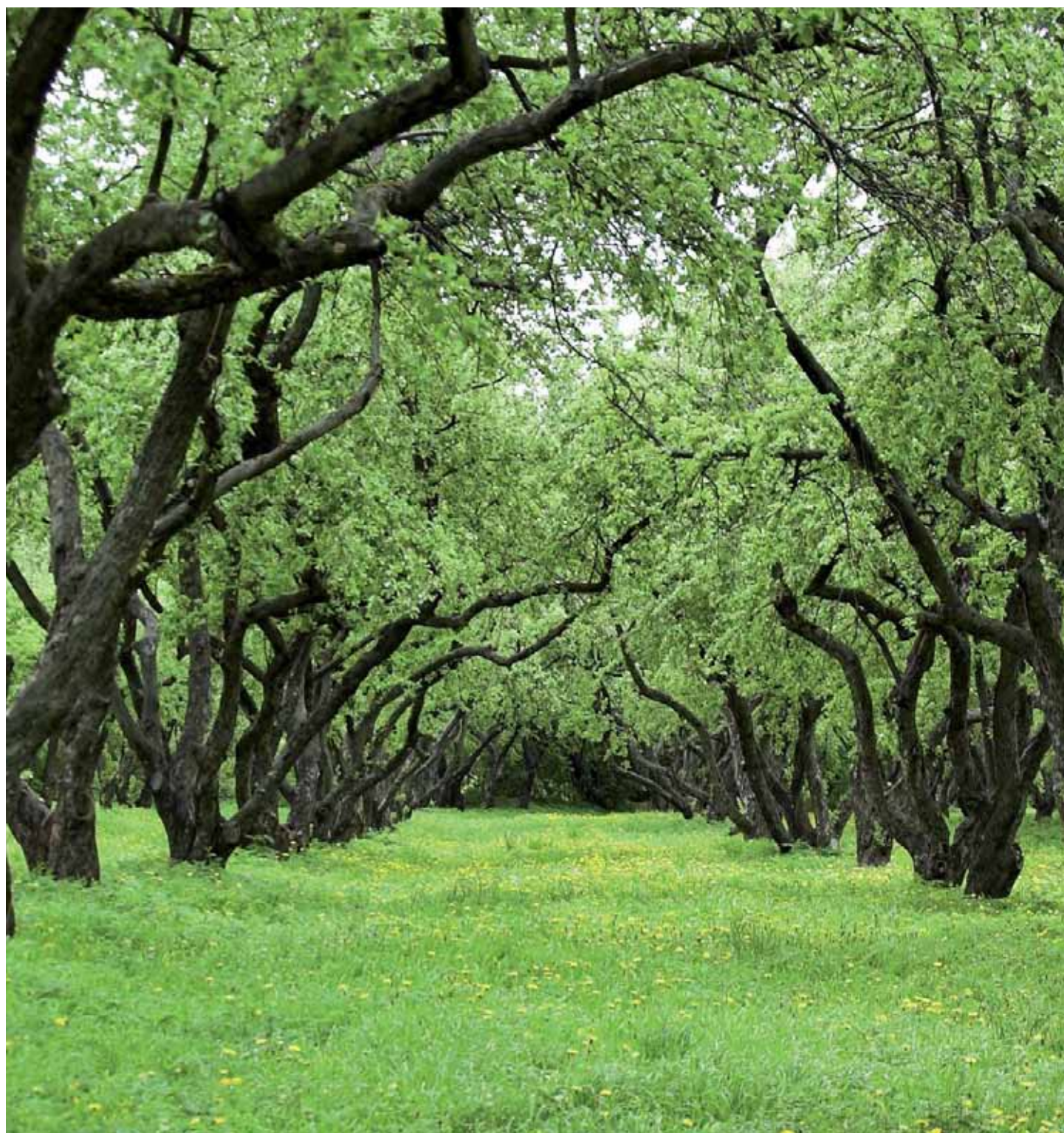
City	Time difference
London	-3
New York	-8
Hong Kong	+5
Singapore	+5
Zurich	-2
Shanghai	+5

## Living conditions

Living standards in Russia vary between the regions and the main cities. Prices in Moscow and St Petersburg are the highest in Russia. For foreign business people in particular Moscow is the world's most expensive city, according to the latest Cost of Living Survey by Mercer Human Resource Consulting. The survey covers and measures the comparative cost of over 200 items in each location, including housing, transport, food, clothing, household goods and entertainment.

Newly built housing in Russia's cities meets international standards. Rents are the equivalent or higher than those in other major world capitals such as New York, London, and Tokyo. A deficit of rooms in Moscow means that hotel accommodation is also very expensive.

## 2. Business environment



## 2.1 Business climate

In general the business environment in Russia is steadily improving since the transition from a centrally controlled planned economy to a free market. Economic growth is one of the fastest in the world, many reforms have been implemented, the tax system is becoming fairer and more transparent, Russia is increasingly integrated with global markets, most Russian and foreign companies operating in Russia enjoy double-digit profits, and customs has improved noticeably in recent years.

However, real progress remains to be made to reduce the effects of a suffocating bureaucracy, corruption and a judiciary lacking independence. That said, corruption in Russia is not worse than in other emerging markets.

### Economic policy

Economic policy in Russia is primarily aimed at social, political and economic stability, further development of the institutional structure of the market, and diversification of the economy. The government continues to initiate change and introduce new ways to develop the economy, such as concessions agreements, special economic zones, a sovereign investment fund, a development bank, a venture fund, a federal mortgage agency, etc. The state is increasing its role in the economy, but mainly only in the “strategic” oil and gas and defence sectors.

In 2005 the government initiated a much-publicised programme of National Priority Projects to develop social welfare and services in Russia through additional funding by the state in four areas: health, education, housing and agriculture.

In his presidential address on the budget in 2007, President Vladimir Putin stressed the importance of a conservative fiscal policy to prevent inflation, of developing a mid-term budgetary system, and of delegating more responsibility to lower levels of government. President Putin stated that government policy should focus on developing key areas, including new infrastructure, diversification of the economy, renewal of production facilities, housing, investment in nanotechnology, further development of the pension system.

This year the government introduced a three-year federal budget.

The Ministry of Economic Development and Trade presented in July 2007 its long-term social-economic development strategy for the country by 2020. It proposes different courses of action in three possible scenarios for Russia’s economic development. In the “slow” scenario, GDP grows by 3% a year and inflation increases. However, there is no additional government investment. The government will keep working on the current large projects. A raw-materials export scenario, based on a forecast of high oil prices, provides revenues from oil and gas exports as the main economic engine without any government investment. The third scenario (which is considered the most probable), prioritises the manufacturing of high value-added products, exports of machinery and equipment, and the creation of an environment of innovation funded by government spending.

## 2.2 International agreements

Russia is a major international power. The Russian Federation is recognised as being the successor to the former Soviet Union in international law: it has assumed the USSR’s permanent seat on the UN Security Council, membership in other international organizations, rights and obligations under international treaties, and property and debts. As one of five permanent members of the UN Security Council, Russia has a special responsibility for maintaining international peace and security. Russia has participated as a member of the Group of Eight (G8) industrialised nations since 1994, although the Finance Ministers/Secretaries of Finance and Leaders of the G7 central banks continue to meet several times a year, without their Russian counterparts.

Russia is a member of a large number of other international organizations, including the Council of Europe and the Organisation for Security and Co-Operation in Europe. Russia takes a special role in Central Asian organizations: the Commonwealth of Independent States (CIS), the Eurasian Economic Community (EurAsEC), the Collective Security Treaty Organization (CSTO), and the Shanghai Cooperation Organisation (SCO).

### Membership:

#### International Structures

- United Nations: Security Council, General Assembly, United Nations specialized agencies
- Group of 8 (G8)
- Council of Europe
- Organization for Security and Co-operation in Europe (OSCE)
- Permanent Court of Arbitration (PCA), also known as the Hague Tribunal

#### Regional

- Council of the Baltic Sea States
- Arctic Council
- Shanghai Cooperation Organisation
- Organization of the Islamic Conference (observer)
- CIS and CIS structures

#### Economic Organisations

##### Universal

##### Trade

- United Nations Conference on Trade and Development
- World Trade Organisation (observer)

#### Financial

- International Bank for Reconstruction and Development (World Bank Group)
- International Development Association (World Bank Group)
- Multilateral Investment Guarantee Agency
- International Monetary Fund

- International Finance Corporation
- Bank for International Settlements
- Paris Club

### Other

- World Intellectual Property Organization
- International Labour Organization
- World Federation of Trade Unions
- World Customs Organization
- International Organization for Standardization
- International Trade Union Confederation

### Regional

#### Trade

- Organization of the Black Sea Economic Cooperation
- Asia-Pacific Economic Cooperation Forum

### Financial

- European Bank for Reconstruction and Development

### Other

- General Confederation of Trade Unions

### NATO

On 27 May 1997, NATO and Russia signed the NATO-Russia Founding Act, which provides the basis for an enduring and robust partnership between the Alliance and Russia.

The creation of the Nato-Russia Council (NRC), unveiled at the Rome NATO Summit in May 2002, opened a new era in NATO-Russia relations, providing opportunities for consultation, joint decision, and joint action on a wide range of issues.

### EU

The bilateral basis for EU relations with Russia is the Partnership and Cooperation Agreement (PCA), which came into force on 1 December 1997 for an initial duration of ten years. The PCA established an institutional framework for regular consultations between the European Union and Russia. At the St Petersburg Summit in May 2003, the EU and Russia reinforced their co-operation by creating four 'common spaces' in the framework of the Partnership and Cooperation Agreement. It was decided to create a common economic space; a common space of freedom, security and justice; a space of co-operation in the field of external security; and a space of research and education, including cultural aspects. A new partnership agreement is under consideration, and is expected to be concluded in 2008.

### World Trade Organisation

The Working Party on the accession of the Russian Federation to the WTO was established on 16 June 1993. Russia is currently negotiating entry to the WTO.

## 2.3 Legal environment

If you are involved in a commercial or tax dispute in Russia, you can seek to resolve it and defend your rights in the state arbitration (arbitrazh) courts. The litigation process starts by filing a statement of claim with an arbitration court and the procedure is regulated by the Arbitrazh Procedural Code. The litigation timeframe depends on the matter under dispute, but in practice, a full-cycle litigation in three instances of arbitration courts takes from 9 to 12 months.

## 2.4 Regulations for business

### Competition policy

The government regulator of market competition policy in Russia is the Federal Antimonopoly Service (FAS). Its primary objective is to ensure compliance with anti-monopoly regulations set out in Russian competition law<sup>1</sup>.

The FAS has power to stop state aid from and/or agreements with the state that reduce competition, unfair competition, and abuse of a dominant position on the market.

To be legitimate, state aid, which means granting a commercial entity any privileges in the form of property, rights or priority access to information, must first receive the written approval of the FAS.

Any agreements or activity that may imply or lead to control over prices, price fixing, or a decrease/increase in prices, and thereby reducing fair competition, is prohibited.

Companies that dominate a market are prohibited from setting low or high prices, different prices on the same goods and forcing counterparts to accept disadvantageous contractual terms.

Violation of competition law may entail severe penalties for a company and its management. For instance, for certain violations in selling goods or services, the FAS may impose fines of up to 0.15% of the company's profit raised from transactions on the given market.

### Price controls

As a general rule, price controls exist only in natural monopoly industries, such as electricity, gas, railways, where companies must set prices in accordance with state tariffs.

However, if any company is seen as dominating a market, the FAS may regulate the company's prices if it finds that they are too high or low.

### Patents, trademarks and copyrights

Russia is a party to all major international agreements and conventions on intellectual property<sup>2</sup>.

From 1 January 2008, Chapter IV of the Civil Code of the Russian Federation comes into force and covers patents, trademarks and copyright issues, substituting all the previous legislation on these areas. It codifies numerous provisions of intellectual property legislation, introduces clear legal terminology and new intellectual

<sup>1</sup> Federal Law of the Russian Federation N 135-FZ "On Protection of Competition" of 26 July 2006.

<sup>2</sup> Including the Patent Cooperation Treaty, the Madrid Agreement Concerning the International Registration of Marks of 14 April 1891 and the Madrid Protocol of 28 June 1989 thereto, the Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks, the Berne Convention for the Protection of Literary and Artistic Works, and the Paris Convention for the Protection of Industrial Property.

property rights, resolves conflict of laws issues and generally strengthens protection of intellectual property rights. Russian civil law regulates the legal protection and use of inventions, utility models and industrial designs. Its provisions correspond with international treaties on the harmonization of patent legislation and the Patent Cooperation Treaty. Therefore, many of its provisions are similar to those in industrialized countries.

In Russia, an examination of merits is conducted to confirm the patentability of an invention. Discoveries, scientific theories and mathematical methods, methods and rules of playing games, solutions consisting only of the presentation of information or related only to the goods exterior, software, topologies of integral circuits, methods for human cloning and use of human embryo in production and business activity do not fall within the scope of patentable objects.

Legal protection of a trademark is provided on the basis of its official registration or under international treaties or conventions to which Russia is a party, including the Madrid Agreement Concerning the International Registration of Marks of 14 April 1891 and the Madrid Protocol of 28 June 1989 thereto. It is a statutory obligation for the trademark owner to actually use the trademark in its business activities. If the trademark owner fails to use it, an interested party can apply to deregister the trademark with the Chamber of Patent Disputes.

Copyright is generally granted to the author(s) of works of science, literature and art. Exclusive rights to reproduce, distribute, demonstrate, modify, etc. such works are granted to the authors for their lifetime plus 70 years after their death and are transferable and disposable. Software is also covered by copyright laws.

Intellectual property license or assignment agreements for patents or trademarks must be registered with the Federal Service for Intellectual Property, Patents and Trademarks of the Russian Federation. The registration requirement does not apply to copyrights. License agreements are not required if a third party wants to sell goods it bought from the trademark owner or if it has the trademark owner's consent to do so.

## 2.5 Property market

Russian law upholds and protects the right to own private property including land, buildings, premises (i.e. parts of buildings) and other types of real estate.

The introduction of the Land Code of the Russian Federation in 2001 is seen as a major improvement in the legal regulation of the property market and a key step of market reform in Russia. Currently, most land (unlike buildings and premises) is not privately owned, but held by federal, regional and local authorities. Owners of property built on land in state hands may purchase the land from the state, but many property owners prefer to lease land from the state instead.

The rights to real estate have to be registered (i.e. recorded in the State Register, which is a unified registry for the whole of Russia), as do any encumbrances on real estate (such as a mortgage,

lease, easement, etc.). It has become easier to obtain technical and registration documents for real estate with the recent introduction of a "one-window" system and internal standards for registration authorities.

Apart from the registration with the State Register, the main technical and legal information on land plots (their measurements, boundaries, buildings standing thereon, etc.) must be recorded in the state land cadastre.

A recently adopted Law (effective 1 March 2008) on the State Real Property Cadastre introduces a unified state cadastre of real property and a procedure for providing property information to owners and any third parties.

Although the Land Code provides that if a building and the underlying land are owned by the same person, it is impossible to sell them separately, the land and the facilities located on it are treated as separate legal interests and may be owned by different persons.

In general, Russian law neither imposes major restrictions on foreigners nor makes distinctions between foreigners or Russian legal entities with foreign interest and Russian legal entities/citizens in relation to ownership of land (except for agricultural land, land located near the Russian border, and certain other territories yet to be specified).

The vast majority of land (outside cities and populated areas) is still categorized as agricultural land which means it cannot be used for development and/or industrial purposes. To use these lands for a purpose other than agricultural production, the owner must first have the land reclassified to another category in accordance with its proposed intended use.

Russians and foreigners may acquire land held by the state or municipalities for development and construction. The Land Code allows the state or municipal authorities to refuse to grant land if the land in question may not be alienated or privatised, or the land is reserved for state or municipal needs and in some other cases specifically stated in the law.

Apart from the requirements of land legislation, a prospective developer has to comply with planning regulations which are rather complex and may differ depending on where the project is implemented. The new Town Planning Code adopted on 29 December 2004 introduced clearer and more transparent regulations governing the issuance of construction permits and permits for putting facilities into operation. From 1 January 2007, multiple expert examinations previously required for review of project design documentation and issuance of construction permits have been replaced by a single state examination (or "state expertise") to be carried out by a state authority.

Real property and certain rights to real property can be pledged. All pledges to real property must be registered. Unless the pledgor and the pledgee enter into an agreement on levying execution (to be authenticated by a notary), it is only possible to levy execution in court. If the pledgee levies execution against pledged property, the property has to be sold through an auction. Russian law allows securitization of loans backed by real estate pledges and legislation on mortgage-backed securities is developing rapidly.

## 3. Foreign investment



## 3.1 Foreign investment

### Investment climate

Russia is increasingly considered a country with a stable investment climate. It has witnessed a big increase in foreign direct investment inflows over the last couple of years. A large and rapidly growing domestic market, rich human capital, natural resources and political stability are the key drivers of FDI growth. The domestic boom is beginning to attract significant volumes into consumer-related segments of the economy.

Constraints on foreign business are being abolished and the regulatory environment has improved. However, several sectors remain closed to foreign investment. Current regulations restrict foreign involvement in the banking sector, and under a proposed new law, the government will restrict foreign access to 39 strategic sectors of the Russian economy, including nuclear energy, natural monopolies, military and special machinery, space, and subsoil development.

Russia has taken considerable steps to improve the general business climate:

- The Russian rouble is now freely convertible and reserves and special accounts for transactions have been abolished
- Key legislation on natural resources (Law on Subsoil, Water Code, Forestry Code) was amended for more clarity and transparency
- A new (fourth) chapter of the Civil Code introduces full codification of the laws governing intellectual property in Russia—copyright and adjacent rights, trademarks, legal protection of software, and exclusive rights
- A new Law on Competition sets the legal framework for anti-monopoly measures and uniform standards for protecting fair competition in the commodity and financial markets
- The Law on Foreign Investment was improved to allow foreign companies in special economic zones to reduce the local portion of profits tax from 17.5% to 13.5% for operations within the special economic zone
- Amendments to the Tax Code improve tax controls, better organize tax audits and the flow of tax documents, encourage taxpayers to pay taxes and duties, and strengthen guarantees on taxpayers' rights and legitimate interests

### Corporate transparency

Corporate governance is a key indicator of the competitiveness of business and of a country's economic climate. Russia has seen improvement in corporate governance over recent years. Several major Russian companies meet international and US accounting standards on information disclosure and have introduced constant communications with shareholders and analysts. However, there is still plenty of room for improvement in

Russian corporate governance, and in corporate transparency in particular.

The financial and non-financial disclosure requirements of Russian legislation are consistent with EU and IOSCO (International Organization of Securities Commissions) standards.

Overall, Standard & Poor's Governance Services index of transparency among the largest Russian companies by market capitalisation (according to the Russian Transparency and Disclosure Survey 2006) has increased to 53% from 50% in 2005, 46% in 2004, 40% in 2003, and 34% in 2002. However, there have been no dramatic improvements in disclosure policies in Russia recently.

A breakdown by sector indicates that telecommunications remains the most transparent. The most notable rise in transparency was in the food, consumer, and retail sector. The disclosure level of Russian banks remains low, especially when compared with their international counterparts, but 2006 saw a significant improvement of transparency in the largest Russian financial companies.

Privately owned companies are the most transparent, although some of the more progressive state-owned companies would be on a par.

Russia has experienced an IPO boom over the last two years. This has driven greater transparency, though some of the companies that have completed international IPOs over the past year pursue a policy of minimal disclosure.

There is a greater scope of information available in English and broader disclosure on corporate web sites.

There has been no significant progress among first-tier companies, the 54 largest by market capitalisation. Those companies that had been public and scored low on transparency in the past tend gradually to adopt higher standards of transparency and catch up with the rest.

### Shareholdings and ownership

A sharp increase in disclosure of shareholder rights and investor relations procedures is mainly due to companies' efforts to follow the recommendations of the Russian Code of Corporate Conduct, which focuses strongly on disclosure of companies' governance procedures and shareholder rights.

The share of disclosed private stakes in the total level of non-government ownership reached 34% this year, compared with 28% a year earlier.

Unlike in developed markets, disclosure of beneficial ownership is voluntary for shareholders in Russia, and there aren't very many volunteers, especially among the ultimate beneficial owners of large stakes. Russian companies are commonly

affiliated with each other via their shareholders, who do not disclose such information for fear of anti-monopoly regulations, investigations, and corporate raiders.

### Financial information

Financial information remains a relatively weak area of disclosure for Russian companies, but 2006 saw improvement in the disclosure of IFRS financial statements and notes. Not all companies report their annual financials under IFRS or US GAAP, but the situation is gradually improving.

The most critical areas of weakness in disclosure practices include detailed information about related-party transactions (e.g., exact terms and indication whether such transactions are carried out on market terms), exhaustive ownership disclosure (e.g., disclosing every shareholder owning over 10%), auditor engagement (scope of services, non-audit services, and remuneration), ownership structures of affiliates and subsidiaries, and details and principles of board and executive remuneration.

The ownership structures of Russia's 70 largest public companies remain highly concentrated. Majority companies have at least one block holder whose stake in the company exceeds 25%. In addition, many firms are (beneficially) majority-owned by a single shareholder or controlled by a group of shareholders who are parties to a formal shareholders agreement. Concentration of ownership has declined in 2006 in the private sector, while government ownership has increased.

### Regulatory legislation

Russia's Law on Foreign Investments establishes the rights of foreign investors to their investments, the earnings and profit gained on them and the terms and conditions for foreign investors' business in Russia.

### Foreign ownership restrictions

**Ownership of shares:** Generally, a foreign company is permitted to own 100% of a Russian company. Russia has a few sectors in which foreign ownership is limited: banking, insurance, military production and supplies, media, space exploration, aviation and agriculture. Currently, the authorities are considering introducing limitations in the oil and gas sector.

**Ownership of assets:** Except for a limited number of restrictions, a foreign company may own or lease buildings, structures, land plots (except for agricultural land) and other assets, including intangible assets such as patents and trademarks.

### Acquisition of shares: issues to consider

**Title to shares:** A buyer should make sure that: the seller holds the title to the shares; the shares have been duly authorised, validly and properly issued and distributed in accordance with all Russian laws and the foundation documents (this issue is the most critical for a privatised acquiring company); the shares are fully paid; and the seller has received all necessary corporate approvals.

When acquiring newly issued shares, a subscriber should monitor the process of share issuance, including share registration with the Federal Service for Financial Markets.

**Corporate law requirements:** If a buyer (together with its affiliates) acquires more than 30% of voting shares in an open joint-stock company, the buyer must make a public offer to the remaining shareholders of the company to acquire their ordinary shares at the fair market value. If, as a result of such acquisition, the buyer (together with its affiliates) purchases more than 95% of the company's voting shares, the buyer must, at the request of the remaining shareholders of the company, purchase their shares in the company at the fair market value.

The owner of 95% of the company's voting shares may, in turn, squeeze out minority shareholders by demanding to sell all shares held by them.

**Anti-monopoly approval:** Any individual, legal entity or group of persons acquiring more than 25%, 50% or 75% of the voting shares in a joint stock company or more than 1/3, 50% or 2/3 of participatory interest in a limited liability company is required to obtain prior approval from the FAS if:

- 1) the aggregate balance value of the assets of the acquirer and its group exceeds RUB 3 billion, and the balance sheet value of the assets of the target and its group exceeds RUB 150 million;
- 2) the aggregate revenue of the acquirer and its group from the sale of goods for the past calendar year exceeds RUB 6 billion, and balance sheet value of the assets of the target and its group exceeds RUB 150 million; or
- 3) the acquirer or the target (or any company of its group) has over 35% of the corresponding market and so is included into the respective state registrar.

**Registration of shares transfer:** Transactions with shares of a joint-stock company require registration in the shareholders' register in order to ensure their transfer. The register can be maintained either by the company or by a professional registrar. Registration of the transfer usually takes from one to three days.

Transactions with participatory shares of a limited liability company require amending the foundation documents of the company and subsequent state registration. This procedure may take from seven to ten days.

### Acquisition of assets: issues to consider

**Title to assets:** A buyer should perform thorough due diligence on the seller's title to target assets, especially if such assets were privatised in the past.

This should not be limited to a search of real estate registers, patents and trademarks, but should also include a review of supporting documents: agreements, acts of acceptance, permissions, etc.

A buyer's solicitor should also conduct a careful review of encumbrances associated with the target assets being acquired.

**Anti-monopoly approval:** Prior anti-monopoly approval is required to acquire assets worth more than 20% of the book value of all the seller's fixed and intangible assets if:

- 1) the aggregate balance value of the assets of the acquirer and its group exceeds RUB 3 billion, and the balance sheet value of the assets of the target and its group exceeds RUB 150 million;
- 2) the aggregate revenue of the acquirer and its group from the sale of goods for the past calendar year exceeds RUB 6 billion, and the balance sheet value of the assets of the target and its group exceeds RUB 150 million; or
- 3) the acquirer or the target (or any company of its group) owns over 35% of the corresponding market .

**Registration of real estate transactions:** Transactions with real estate (acquisition, lease, mortgage and others), patents and trademarks require state registration. It normally takes 20 to 30 days to register a transaction and subsequently transfer the rights to the assets.

### Foreign exchange issues

Russian currency control legislation generally does not impose restrictions on foreign investments in Russia. In particular, foreign companies may freely lend money to Russian companies and individuals that are Russian residents or acquire shares of Russian companies. However, Russian residents should meet certain technical requirements for making/receiving payments under these transactions, one of which is registering deal ID documents for loans from non-residents.

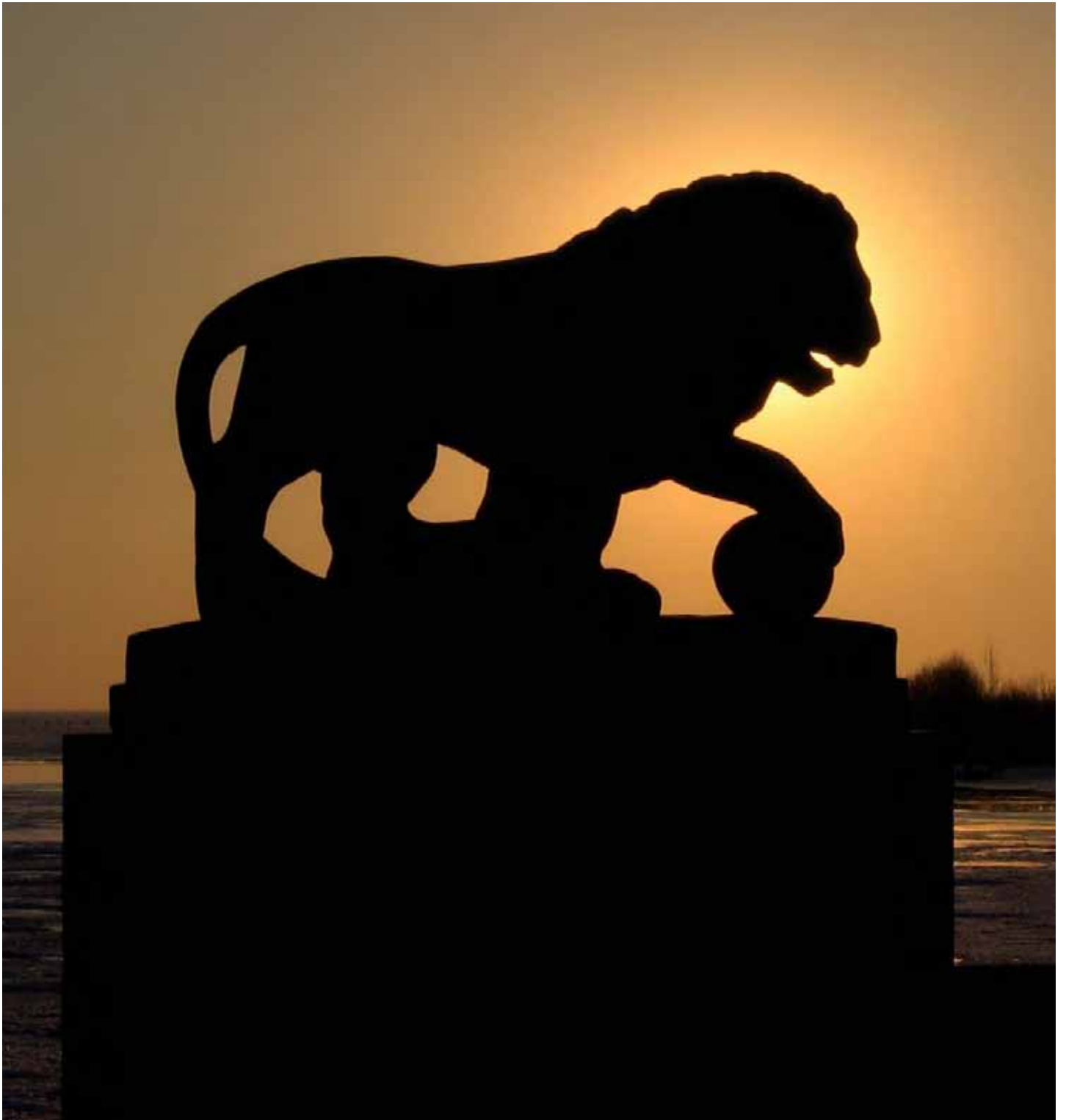
## 3.2 Privatisation

Recent amendments to the Land Code and the Law on Implementing the Land Code are important in terms of land privatisation, supporting the concept of one owner for a building and the land beneath it. The main amendments are:

- owners of privatised buildings located on state or municipally owned land may privatise this land up until 1 January 2010. New pricing guidelines for privatising land have been established
- pricing guidelines for land privatisation with respect to owners of buildings that have always been private property have also been established
- cities with over 3 million inhabitants have special land privatisation rules, which include possible restrictions on the construction and reconstruction of a land plot. This restriction may be lifted upon payment of a fee commensurate to or even exceeding the price of the land plot
- legal entities that hold land plots in permanent use must switch to a lease arrangement or privatise this land before 1 January 2010. Failure to fulfil this requirement may result in a considerable fine
- guidelines for the privatisation of land beneath linear objects (electric power lines, pipelines, etc.)

Most of the provisions of this law enter into force in by December 2007.

## 4. Banking, finance and insurance



## 4.1 Banking system

### Banking market

The Russian banking sector has developed rapidly in recent years, reflecting a strengthening economy. Increasing disposable incomes, higher confidence in banks and a greater financial awareness among the population were among the main factors contributing to this growth. Banks' assets have increased eight times since 2000 and totalled USD 730 billion as of October 1 2007.

The sector is highly segmented. The top 20 banks control 65% of assets. Over the past few years, major Russian banks have attempted to reposition themselves as retail or universal banks. Banks currently offer only a limited range of commercial and retail products (compared to those in the EU and the US), but new financial products are being introduced to the market.

### Central Bank of Russia

The principal function of the Central Bank is to protect the rouble and ensure its stability; it is the sole issuer of roubles. The Central Bank sets and pursues a single state monetary policy and exchange rate policy, manages currency circulation, acts as the lender of last resort for credit institutions and manages the bank refinancing system, sets the rules for conducting banking operations, manages most categories of state budget accounts, issues licenses to, regulates and supervises all credit institutions in Russia and promotes and monitors the proper functioning of payment systems.

The Central Bank cooperates with international banking institutions, including the IMF and the World Bank. It also collaborates on the domestic financial market with the Federal Insurance Supervisory Service and the Federal Service for Financial Markets to exchange information and to maintain adequate surveillance over the financial market in general. The State Duma is currently considering a proposal to unite the supervisory functions of these three institutions under one regulatory body.

### Federal Service for Financial Markets

The Federal Service for Financial Markets (FSFM) is the federal executive body that controls and supervises activity in the financial markets, including stock exchanges, and issues relevant regulations. It also regulates the investment of pension savings. The FSFM's key objectives are to maintain stability in the financial markets, make the markets more efficient and attractive to investors, increase market transparency and reduce investment risks. It regulates the activities of financial market participants and establishes the conditions for issuance and trading securities.

### Commercial banks

Credit institutions operate under the authorisation and strict supervision of the Central Bank of Russia. The Russian banking sector is one of the fastest-growing and investment-attractive segments of the Russian economy. In 2006, the sector grew even faster than the economy.

The banking market has changed in recent years following the growth of domestic banks and the influx of foreign banks into Russia. Foreign banks are investing at a fast pace, most of them by acquiring existing banks.

There are over 1,100 banks in Russia. State-owned Sberbank—a monopoly and the country's largest bank—has a significant advantage over competitors due to its size and extensive network of about 1,000 branches throughout the country. As a result, Sberbank dominates the Russian banking sector with a market share of 53% in deposits, 35% in retail lending, 32% in commercial lending, and 25% in aggregate assets, as of 1 April 2007.

The Russian financial sector is becoming noticeably more similar to those in developed economies, where most transactions are made through the banking system, not in cash. Increasing consumer confidence in the banking system was supported by the approval of the Deposit Insurance Law. The rapid growth in the retail sector resulted in demand for retail loans. The banking boom in Russia has increased industry penetration to levels comparable to those in Eastern Europe, but there is still substantial room for expansion. In 2006 banking industry penetration, measured as total loans outstanding as a proportion of GDP, at over 30% reached that of Eastern European countries. In January 2007, consumer loans reached USD 76 billion and increased by 234% from 2004. The rapid growth of loans also means that credit risk is increasing, although banks generally still report very low levels of non-performing loans.

In 2006 the Russian government introduced full rouble convertibility from 1 July. All previous restrictions on currency inflows and outflows were abolished. This was one of the noteworthy improvements made in the financial system over the past year.

Foreign investors used to face some restrictions on purchasing Russian banks' shares. From January 2007, resident and non-resident investors were given equal rights: now both are required to notify the Central Bank when purchasing more than 1% of a bank's shares and only need to receive its permission when purchasing more than 10%.

However, some restrictions on the activity of foreign banks in the Russian banking market remain:

- A limit of 50% on all foreign participation in the Russian banking system;
- Foreign banks are not permitted to open branches in Russia. Foreign participation in the Russian banking sector is permitted only in the form of creating new banks or buying existing Russian banks.

The booming banking sector in Russia has attracted portfolio investors to the market. The number of M&A deals in the Russian banking sector, especially involving foreign participation, has risen recently. M&As in the financial services sector totalled 225 in 2006, second only to the manufacturing sector (according to the PwC CEE M&A Survey 2006).

Banks have only recently made an appearance on Russia's securities market, unlike in other emerging markets.

This situation improved after the initial public offerings of Sberbank and Vneshtorgbank, but the Russian market badly lacks liquid banking shares, as all other Russian banks have quite small freefloats. This low liquidity (excluding Sberbank and VTB) has created a deficit of bank shares on the Russian market. Sberbank accounts for about 8% of the capitalisation of the Russian security market, VTB for about 3%.

### Securities

The Russian securities market is represented by two major stock exchanges: the Russian Trading System (RTS) and the Moscow Interbank Currency Exchange (MICEX). RTS is for trading shares, while MICEX is for trading bonds.

The RTS Stock Exchange is Russia's leading stock exchange in terms of product offerings. More than 590 securities have been put up for trading by 369 issuers on the RTS Classic Stock Market as of 4 July 2007. The RTS Stock Exchange also calculates the RTS Index, widely used as an indicator for the Russian securities market.

Daily trades on MICEX are held in stocks and bonds of about 350 issuers. More than 550 professional participants in the securities market trade on MICEX. MICEX organizes stocks transactions, foreign exchange trading and is developing the derivatives market. On a daily basis, over 900 securities of 500 issuers are traded on the exchange. In 2006, the estimated volume of transactions totalled USD 1,924.82 billion. MICEX is the largest exchange in Russia, the CIS and Eastern Europe.

### Pensions and pension funds

Pension reform is currently under way in Russia with mixed results. Reforms are designed to encourage individuals and employers to invest in future pensions through certain changes in taxation, better regulation of private pension funds and a wider ability to invest pension reserves.

Since 2004, people can transfer the accumulative part of their state pension contributions to asset-management companies or private pension funds.

The Federal Service for Financial Markets regulates management companies and private pension funds that invest pension savings in the securities market. Pension savings are protected through control of the market by regulators (the Ministry of Finance and the Federal Service for Financial Markets), the specialised depository and the Public Council for Investing the Accumulative Part of Pension Funds. The Federal Service for Financial Markets checks market participants' compliance with legislative requirements and can annul or suspend the licenses of companies in breach of these requirements.

As of 1 January 2007, there were 289 private pension funds in Russia. The pension reserves of private pension funds increased in 2006 almost 1.5 times and totalled USD 14.9 billion. But growth could be even stronger: more than 90% of all pension accruals are still under the control of the state's Vneshekonombank, which is the country's default asset manager.

## Money laundering

From 2001, a number of measures were implemented to bring anti-money laundering legislation into line with international standards, as were organizational and administrative measures to enforce the law. This helped to increase the number of uncovered cases of money laundering, though it remains an important issue for the Russian economy. Almost RUB 7 billion (USD 270 million) in illegal income was laundered last year.

Russian authorities are tightening control over cash flows by improving the current anti-money laundering legislation to introduce:

- special control over transfers of funds between individuals if the amount is equal to or exceeds RUB 600,000
- special control over transactions with immovable assets if the amount is equal to or exceeds RUB 3,000,000
- closer control by the Central Bank over the banking system and licence withdrawal.

Financial institutions, including banks and leasing companies, have had to introduce special monitoring and reporting functions and report to supervisory bodies regularly.

## 4.2 Foreign currency market and foreign currency rules

Until 1 July 2006, Russian currency legislation provided restrictions on certain currency transactions between Russian resident companies/individuals and non-residents, including credit (loan) transactions, securities trading, contributions to charter capitals of foreign entities and advance payments on certain import transactions.

These restrictions have been lifted and generally the transactions may be performed freely.

However, there are still some requirements with regard to making payments under foreign trade contracts and credit (loan) agreements between non-residents and residents.

To make payments under these contracts, Russian companies shall compile transactions passports and provide banks with documents representing the legal basis for the currency operations. There are also some requirements concerning settlements under these transactions, including repatriation to Russia of proceeds by Russian residents under foreign trade contracts.

Russian currency legislation establishes notification and certain reporting requirements for Russian residents who open foreign bank accounts. Russian residents' use of foreign bank accounts is restricted; they can receive funds in foreign bank accounts in connection with a limited list of operations.

## 4.3 Specialized financial institutions

### Factoring

In recent years, factoring in Russia has changed from a service offered by banks to a separate financial business. Overtaking other Central and Eastern European markets, the factoring business in Russia was estimated at USD 11 billion in 2006 and is expected to double in 2007. The range of factoring services and their quality are gradually approaching global standards.

The market remains largely under-regulated, without an official supervising body. Factoring legislation is to be improved specifically in the field of licensing: Although banks, which make up 52% of the market, are subject to regulation and licensing by the Central Bank, there are no clear licensing requirements for factoring companies.

Factoring market concentration remains very high: five market players control 80% of the market. And market players segmented further in 2006.

### Leasing

The Russian leasing market created almost USD 17 billion in 2006. Leasing is gradually becoming one of the key mechanisms of capital renewal and the main means for purchasing important assets such as agricultural machinery and equipment, breeding cattle, aviation, automobile and railway transport.

For the last four years, the leasing market has grown by over 50% a year. This trend is expected to continue in the future. The market's large growth potential is due to the huge demand, which in turn is caused by the high level of capital asset amortization in the Russian economy and midsized businesses' need for long-term financial resources. Leasing companies are more flexible lessors than banks as they no longer require licences, have no special supervising body for leasing activities or special requirements for leasing companies (e.g., capital adequacy requirements).

Leasing companies continuously face problems with VAT recovery and bear significant costs from resolving tax disputes in court and from the resulting uncertainties and risks. This issue has become acute to the extent that it influences leasing companies' business plans.

## Insurance

The Federal Insurance Supervisory Service (FISS) regulates and controls insurance companies and insurance brokers.

The prime functions of the FISS are to supervise insurance companies' financial standing; to ensure that insurance companies observe prudential norms specific to the insurance activity; to authorise insurance companies and insurance brokers and to impose penalties for non-compliance.

According to results for 2006, insurance premiums made up less than 3% of GDP. The size of the Russian insurance market was USD 22.5 billion, an increase of 23% from 2005. The insurance market portfolio is comprised of the following segments: property 37.3%, liability 2.7%, obligatory medical insurance 33.3%, third party motor liability 10.5%, life insurance 2.6%, personal lines 12.6% and other obligatory lines 0.8%.

As of 1 April 2007, there were 913 insurance companies in Russia. Some of the top companies are Rosgosstrakh, Ingosstrakh, Sogaz, RESO-Garantia and Rosno. The top 10 insurers controlled around 50% of the market in 2006.

The number of insurers is gradually decreasing. The market expects drastic changes, as many small insurance companies are to leave the market. The charter capital ceiling for insurers was raised on 1 July 2007. Insurance companies are obliged to follow minimum capital requirements: RUB 30m (approx. USD 1m) for non-life insurance activities, RUB 60m (approx. USD 2m) for life insurance activities, and RUB 120m (approx. USD 4m) for reinsurance activities. The law obliges insurers to separate life insurance from other types of insurance. Many small insurers have already lost their licences, but the insurance market has yet to see a real purge.

Throughout 2006, insurance companies developed regional networks to reach customers in more remote areas of Russia.

The introduction of obligatory third-party liability automotive insurance has boosted the market.

## 4.4 Capital markets

### General

The capital market and transactions with securities in the Russian Federation are primarily regulated by the Federal Law "On the Securities Market" (the "Law on Securities") of 22 April 1996 and the Federal Law "On Protection of Investors' Rights and Interests on Financial Markets" of 5 March 1999. Offerings of corporate securities are regulated by the Federal Law "On Joint Stock Companies" and by a number of regulations issued by the Federal Service for Financial Markets (FSFM)—the Russian securities market watchdog.

### Securities in Russia

Under Russian law, a security must be specifically recognised as such in the Russian Civil Code or other relevant laws. The Civil Code recognises shares, bonds, promissory notes, cheques, deposit and saving certificates, bills of lading, options on shares and Russian depository receipts as security instruments.

Most corporate securities should be registered with the FSFM before their placement and allotment.

Registration of an issue usually takes approximately thirty days and requires the disclosure and filing of certain information and documents with the FSFM.

In a limited number of cases, the Law on Securities requires the issuer to register an issue prospectus. Companies that have at any time registered a prospectus are subject to capital markets disclosure requirements.

## Fundraising

A Russian company may raise funds by issuing equity or debt securities. Equity securities may be offered to the general public only by open (public) joint-stock companies. Shares of closed joint-stock companies and limited liability companies may not be offered to the general public.

In 2006, the procedure of public offering of shares on Russian stock exchanges was simplified and new amendments to the legislation were aimed at bringing public offering rules in line with international standards.

Under the new rules, the number of shares to be floated on foreign exchanges was capped at 35% of the overall issued shares in the company.

The issuance and trading of bonds is governed by the Securities Law, which distinguishes between secured and unsecured bonds. Secured bonds must be fully secured with a third-party guarantee or surety, or with a pledge (or mortgage) over the issuer's and/or third party's securities or immovable property. Only companies which have existed for a minimum of two years may issue unsecured bonds.

The issue of regular bonds should be registered with the FSFM. Recent amendments to the Securities Law introduced a new financial instrument—exchange bonds. The issuer of exchange bonds need only notify the FSFM. However, there are certain requirements to be met. Russian joint-stock companies may also issue bonds convertible into shares.

Together with bonds, Russian companies make extensive use of promissory notes for debt financing. The Russian Federation is a party to the Convention Providing a Uniform Law for Bills of Exchange and Promissory Notes.

The Securities Law also introduced a new type of securities – Russian depository receipts (RDR). RDR certify holders' rights to a specified amount of shares or bonds of a Russian or foreign issuer.

## 5. Importing and exporting



## Tips for exporters

- Generally, under exports and imports between a foreign company and a Russian company, the Russian company is responsible for the customs procedures.
- In order to import goods into Russia and clear them through customs an importer has to make all customs payments due in accordance with the chosen customs regime and comply with other requirements established by customs legislation (e.g., certification requirements).
- Importation of certain goods (e.g., pharmaceuticals, meat, etc.) requires licenses.
- Russia has several special economic zones that offer customs benefits.

## 5.1 Customs policy

Russia's customs policy has seen several key areas of development:

- Lowering of customs duty on imports of technical equipment;
- Simplification of the customs clearance process;
- Tighter customs control after customs clearance of goods;
- Further development of customs integration in the Commonwealth of Independent States (CIS).

## 5.2 Import restrictions

Certain imports to Russia require permission and certificates (e.g., of conformity, sanitation), licences and other approvals. They should be submitted to the customs authorities for clearance.

The Russian Federation imposes an anti-dumping duty on certain goods (i.e., metal pipes from Ukraine).

## 5.3 Customs duties

### Classification of goods

The Russian tariff classification system is based on the internationally adopted Harmonized Commodity Description and Coding System.

### Valuation rules

The customs valuation procedure is established in line with GATT/WTO principles and is generally equivalent to the DAF/Russian border transaction value of the goods concerned.

## Rates

Import duty applies to most goods. The majority of customs duty rates in Russia are ad valorem (i.e., a percentage of the goods' customs value). There are also specific duties for certain types of imports, calculated by volume, weight or quantity. Some duties have a combined rate incorporating the above two types of duty and, therefore, the tax base may vary.

Base customs duty rates vary widely, from 100% on spirits to 0% for some printed matter and some other priority imports. Zero duty applies, for example, to a wide range of equipment and machinery. On average, duty rates fall between 5% and 20% of goods' customs value. The base rates specified in the legislation apply to countries that have been granted Most Favoured Nation status. Some goods from "developing" and "least developed" countries may be imported at 75% of the base rates or zero rates, respectively. However, these are limited to raw materials and handmade goods. Goods originating in other countries will be subject to duty at double the base rates.

The following are exempt from customs duty: transit goods; goods imported by individuals for personal use (worth not more than approximately USD 2,500 and weighing less than 35 kg); cultural valuables; means of transport involved in the international movement of goods and passengers; humanitarian aid and some others.

## Free trade agreements

Russia has adopted free trade agreements with countries of the Commonwealth of Independent States (CIS). Goods originating from CIS countries (e.g., Ukraine) are exempt from customs duty for import to Russia (subject to certain conditions). Russia, Belarus, Kazakhstan, Kyrgyzstan and Tajikistan form a Customs Union, and goods originating from these countries are not subject to customs duty within it.

## Excise tax

Certain categories of goods are subject to excise tax for import to Russia (e.g., alcoholic beverages, cigarettes, cars, motorcycles with a capacity of over 150 horsepower, etc.). Generally, the excise tax rates are specific (i.e., the rates are based on the volume, weight or other characteristics of goods).

## Import VAT

For most goods, the import VAT rate is 18% of the customs value, inclusive of customs duty and excise (if any). Food, a certain range of children's goods and a limited range of other goods may be subject to 10% or 0% VAT.

### Customs processing fees

Customs processing fees are established as a flat fee and vary from approximately EUR 15 to EUR 3,000 per customs declaration depending on the customs value of imported goods.

### Payments

Customs payments are generally paid before or when submitting customs declarations to customs.

## 5.4 Temporary import relief

Goods may be imported under a temporary import customs regime, normally for a period of up to two years. Generally, goods are permitted for temporary importation if it is possible to identify them upon their re-export. Temporary importation requires permission from the customs authorities. Upon expiry of the period for temporary importation, goods shall be moved out of Russia or placed under another customs regime (e.g., release for free circulation).

Temporary importation requires periodic customs payments of 3% per month of the total customs payments due had the goods been imported for free circulation. Upon export of the goods, these customs payments are not refunded. Customs has the right to require security for customs payments (e.g., a deposit, pledge, bank guarantee, etc.).

Goods which qualify as fixed assets for production purposes may be admitted and subject to a 3% monthly customs payment for a temporary import period of 34 months if the Russian user does not yet have property rights (e.g., for leasing). After this period, the goods are considered released for home use. In these instances, the interest on customs duty and taxes is not payable by instalments. Temporarily imported goods can only be used by a person who has obtained customs' permission for their temporary importation.

## 5.5 Customs duties incentives

### Charter capital contributions

Fixed production assets imported as a charter capital contribution by a foreign investor are free from customs duty. The goods must not be excisable and should be imported within the timeframe established for the formation of the charter capital.

Customs authorities can check to ensure the correct use and further disposal of goods exempted from customs duty.

A VAT exemption is also available for technical equipment imported as a charter capital contribution.

### Tolling

Goods imported into Russia for processing may be placed under an inward processing (IPR) procedure (subject to certain conditions).

Under IPR, goods (e.g., raw materials) imported for processing are eligible for full exemption from customs duty and import VAT, provided the processed/finished goods are subsequently moved out of Russia within a deadline agreed on with customs. No export customs duty is charged upon the export of finished goods from Russia.

IPRs must be authorised by customs. Only a Russian company may apply for an IPR.

### Special Economic Zones

A number of Special Economic Zones (SEZ) with a free customs regime have been established in Russia. Imports to SEZs are free of duty and VAT, i.e., foreign goods are delivered to and used within the SEZ free of import customs duty and VAT. When foreign goods or products of their processing are subsequently released into free circulation to the rest of Russia, import customs duty and VAT are payable. If the goods manufactured in a particular SEZ are exported to foreign countries, they will be subject to export duty, if applicable. Foreign goods which were imported into the SEZ but not processed may be re-exported without payment of export customs duty.

## 5.6 Documentation and procedures

### Registration of importers and exporters

There is no established procedure for registering importers/exporters with customs. However, in practice certain documents may be required by customs prior to importation (charter documents, tax registration certificate, etc.).

### Documentation

Russian customs regulations establish a comprehensive list of documents required for customs clearance purposes. In practice, the set of documents to be submitted to the customs authorities may vary depending on the character of imported/exported commodities, conditions of the transaction, etc.

### Declaration of the customs value

The customs value of imported goods is declared in a Declaration of the Customs Value. The customs value should be properly confirmed by the appropriate documents. The list of such documents may vary depending on the terms of a particular transaction. While the Russian customs regulations set a general list of documents required for confirmation of the customs value, the list is not exhaustive.

If the customs authorities disagree with the customs value declared by an importer, they may adjust it.

If the customs authorities disagree with the customs value declared by an importer they may seek to negotiate with the importer an adjustment of the customs value. Should the importer refuse to adjust the customs value, the customs authorities may adjust the customs value themselves.

## 5.7 Warehousing and storage

Goods which are subject to customs control (e.g., imported goods which have not yet cleared through customs) can be temporarily stored at special warehouses before they are released by customs. The period for storage should not exceed two months, but an importer can ask the customs authorities to extend it to up to four months.

Warehouses for temporary storage are usually located near customs offices.

## 5.8 Re-exports

Goods which have been imported into Russia may be re-exported provided they haven't been released for free circulation in Russia. They are re-exported without payment of export customs duty.

## 6. Business entities



## 6.1 Legal framework

Companies setting up operations in Russia commonly find themselves in circumstances where a formal legal opinion is required for basic issues that in Western countries would be resolved very easily and usually free of charge, but which in Russia can dramatically change the feasibility of a deal.

Foreign investors sometimes underestimate the need to follow important guidelines. This may have serious consequences when doing business in Russia. A summary of the general legal framework for investors so that their investments in Russia can be as effective as possible. Familiarisation with these basic principles may save considerable time and expense later if a projected business structure (commonly accepted elsewhere) is not advisable or even possible in Russia. The current legislative framework for investment and business in Russia is described below.

### Civil Code

Chapter 1 of the Civil Code governs certain types of business organizations and their conception. It covers requirements for foundation documents, name, location, governance and state registration of legal entities. It defines branches and representative offices and governs reorganization and liquidation.

Joint-stock and limited liability companies are governed separately by the Federal Laws “On Limited Liability Companies” No 14-FZ of 8 February 1998 and “On Joint-Stock Companies” No 208-FZ of 26 December 1995.

### Registration

The introduction on 1 January 2004 of a “one-window” registration procedure for Russian legal entities has not streamlined the business registration process. In Moscow, the situation deteriorated with a new requirement stating that only the CEO or director of a founding company may file a state registration application and retrieve the registration certificates, in person—no representation by proxy is allowed. This has drawn out the registration timeframe considerably.

If the CEO or director cannot come to Russia to file the application in person, it should be sent by registered mail (not by courier) to the Russian registration authorities, who process the application and return it either to the address of the founding company or of the entity being incorporated.

The registration process may take several weeks, or even months, to complete.

“Shelf” companies are generally not available, and the incorporation process can take from two to three months.

Preliminary approval of the Federal Anti-monopoly Service or a subsequent notification is required in certain cases. As of 1 January 2006, the state duty to register a Russian legal entity is 2,000 roubles (approx. USD 80). There is no processing fee for registration.

## 6.2 Choice of entity

Foreign investors can choose from a number of different forms of business representation in Russia, from Russian legal entities to representative offices and branches of foreign legal entities. Russian legal entities may be established in various forms, including joint-stock companies, limited liability companies and partnerships.

Representative offices of foreign entities are strictly limited to conducting only liaison and support functions. Branch offices are nowadays only allowed to be involved in commercial activities, though they were allowed a much broader range of activities in the past. Many investors opt for branch offices at the outset because these entities are able to engage in almost any kind of commercial activity, are easier to establish and are subject to less onerous reporting requirements. At the same time, for many investments, including joint ventures, production plants, licensing, customs or privatisation issues, a Russian legal entity may be better suited to an investor’s needs.

## 6.3 Forms of business entities

Currently, the following forms of commercial legal entities (for-profit) may be incorporated in Russia:

- Full partnerships;
- Limited partnerships (“kommandit” partnerships);
- Limited liability companies;
- Additional liability companies;
- Production co-operatives;
- Joint-stock companies (open and closed);
- Unitary enterprises (state-owned legal entities not available to foreign investors).

Of the above, only the joint-stock company resembles a corporation, but the limited partnership and the limited and additional liability companies also limit the liabilities of investors to the extent described below.

## 6.4 Joint-stock company

In accordance with the Russian Civil Code, the joint-stock company's capital is divided into a definite number of shares. The participants of the joint-stock company (the shareholders) are not liable for the company's obligations and accept the risks of losses in connection with its activity within the limit of their respective stakes.

Russian law provides that only joint-stock companies may issue stock, which is deemed as securities and is subject to registration. Russian legislation describes "open" and "closed" joint-stock companies, which are broadly equivalent to public and private companies. Public companies must disclose certain financial and other information annually.

A company may be created as a new company or by reorganising an existing legal entity (consolidation, division, spin-off or a change in legal form, etc.). A company is considered created from the date of its state registration.

The share capital of a joint-stock company is composed of the nominal amount of shares acquired by the shareholders. The minimum "charter" (share) capital for open and closed joint-stock companies is 1,000 and 100 times the minimum monthly wage\* respectively.

General provisions concerning the management structure of the joint-stock company are contained in the Federal Law on Joint-Stock Companies and the Civil Code. The higher management body of a joint-stock company is the General Meeting of Shareholders, which must assemble at least once a year. According to the Russian Civil Code, a company with over 50 shareholders must have a board of directors. The company's executive body may be collegiate (board, directorate) and/or "one-man" (director, general director). The executive body of a joint-stock company shall carry out the day-by-day management of the company's activity and shall report to the board of directors and to the general meeting of shareholders.

In accordance with the Federal Law on Joint-Stock Companies (article 21), a joint-stock company may be liquidated voluntarily or by court order in the procedure or on the grounds established by the Civil Code.

The liquidation of a company shall result in its termination, with no transfer of rights and obligations by succession to other persons.

## 6.5 Limited liability company

Under the Civil Code, a limited liability company is established by one or several persons whose charter capital is divided into shares according to the constituent documents.

In this type of company, the liability of each participant is limited to the value of its contribution. Each equity holder in a limited liability company has the right at any time to withdraw from the company and to receive an amount equal to its pro rata share of the net assets of the company (provided the company is solvent). For foreign investors contributing significant amounts of time and money to a joint venture at the start-up phase, this aspect can be a problem.

The charter capital of the limited liability company shall determine the minimum size of the company's property guaranteeing the interests of its creditors. The minimum charter capital of a limited liability company is 100 times the minimum monthly wage.

The management structure of the limited liability company is similar to that of a joint-stock company.

## 6.6 Full and limited partnership

A full partnership is similar to the American general partnership, in which partners bear (full) joint and several liability for the partnership's obligations. A participant in a full partnership may not be a full partner in any other partnership.

A limited partnership, which is closer to the European kommandit partnership, has both full partners and partners whose liability is limited to amounts equal to their contributions. A full partner in a limited partnership may not be a full partner in another partnership and its liability is the same as for full partners described above.

Partnerships under Russian law are generally regarded as legal entities and are taxed accordingly. Contractual agreements for joint activity do not create a legal entity, although they share some of the characteristics of a general partnership, and there are special rules governing their tax treatment.

\* The term "minimum monthly wage" is used by the government as a ratio to calculate different payments, fines, penalties etc, and does not reflect the real minimum wage. As of 1 January 2007, the minimum monthly wage (for calculating different payments, fines, penalties, etc.) is 100 roubles (approximately USD 4.0).

## 6.7 Branches

A branch or representative office of a foreign legal entity needs to register with the authorities. However, in contrast to Russian legal entities, the process of registering a branch or representative office of a foreign company involves several federal and local authorities. To register, branches and rep offices need to go through the following steps:

- accreditation with federal and local bodies. Accreditation is in effect mandatory, since the local banks and administrative authorities may not recognise the branch/representative office without it.
- Tax registration;
- Registration with state statistic authorities, obtaining statistics codes;
- Registration with non-budgetary (Pension and Social Security) funds;
- Opening bank accounts.

Many investors confuse the concept of a branch and an accredited representative office, which is a mistake as they have certain important differences. An accredited representative office is not a Russian legal entity but an officially recognized extension of a foreign legal entity. Russian law restricts the scope of an accredited representative office's activities to certain types of representational functions.

A branch's legal status differs substantially from that of a representative office. For example, under Russian law, a registered branch of a foreign legal entity (but not a representative office or unregistered branch) is treated as "an enterprise with foreign investment". Therefore, while a registered branch can hold a licence to conduct regulated activities (such as oil field development), a representative office or unregistered branch may not.

The state duty for branch accreditation as of 1 January 2007 is RUB 60,000 (approximately USD 2,400). In addition, accreditation bodies also charge a processing fee from between USD 500 and USD 2,000, depending on the period of accreditation (from one year to five years, respectively).

## 6.8 Representative office

An accredited representative office is not a Russian legal entity but an officially recognised extension of a foreign legal entity. Although Russian law seems to suggest that the scope of an accredited representative office's commercial activities would be limited to certain types of representational functions, in practice many foreign firms conduct additional commercial activities that, according to a strict interpretation of the law, should only be conducted through a registered branch or Russian company.

For the accreditation of a representative office, accreditation bodies charge a processing fee ranging from USD 1,000 to USD 2,500, depending on the period of accreditation (from one year up to three years, respectively).

## 7. Labour relations and social security



## 7.1. Labour relations

### Employer/employee relations

In accordance with the Labour Code, an employer can be an individual or a legal entity. In instances established by federal law, the employer may be an entity which has been vested with the right to conclude employment contracts. Representative offices and branches are not considered employers.

### Unions

Union activity is regulated in accordance with the Federal Law on Professional Unions, their Rights and Guarantees of Activities.

After the collapse of the Soviet Union in 1991 and the formation of a market economy during the 1990s, the role of trade unions decreased significantly.

Today, unions in Russia are becoming more active and wielding more power on employers. Under the Labour Code, the employer should take the opinion of the trade union into account when adopting certain internal regulations (i.e., internal policies) or dismissing trade union members.

### Labour code

Employer-employee relations are governed by the Labour Code of the Russian Federation (which came into force on 1 February 2002) and other special laws. In 2006, the Labour Code was significantly amended, primarily to correct wording ambiguities.

The Labour Code establishes that employment relations of all employees working in Russia shall be governed by Russian legislation (regardless of their citizenship or status, or that of their employers, unless otherwise stipulated by an international agreement of the Russian Federation).

The law provides employees with minimum guarantees which cannot be worsened or limited by any employment contract. Any provision in an employment contract which deteriorates the position of the employee will not be enforceable.

The Labour Code heavily regulates employer/employee relations. There are safeguards to protect employees against dismissal or termination of their employment contract by the employer (prior notice, severance allowances), a harmful working environment and excessive working hours. Employment legislation makes it very difficult for the employer to dismiss an employee on disciplinary grounds.

## 7.2 Working conditions

### Wages and salaries

Salary must be paid in Russian roubles twice a month as specified by the work regulations of an organization, a collective bargaining agreement or an employment contract.

Salaries may not be lower than the minimum monthly salary established by Russian legislation. The minimum monthly salary is regularly adjusted.

Currently, the statutory minimum monthly salary (including for foreign nationals) is RUB 2,300 per month (approximately USD 90) as of 1 September 2007.

### Employment contracts

A written employment contract setting out the terms of employment must be concluded with each employee and shall be drawn up in two copies, each of which shall be signed by the parties.

The employer shall be obliged to draw up a written employment contract with the employee no later than three business days from the day on which he is actually admitted for work.

The Labour Code (Article 57) establishes mandatory requirements for the content of the employment contract.

As a general rule, employment contracts are concluded for an indefinite period. A fixed-term employment contract may also be concluded, but it cannot be concluded for more than five years, and only in those circumstances specifically provided for by the Labour Code. Moreover, recent court practice shows that the employer must prove and substantiate the reasons for a fixed-term employment contract in the event of any dispute. Otherwise, the employment contract shall be deemed to have been concluded for an indefinite term.

Under Russian employment law, job duties and obligations should be defined in the employment contract. This is very important, since an employee cannot subsequently be required to perform tasks outside the scope of duties described in the employment contract.

In accordance with Russian employment law, employers are required to issue an internal order each time an employee is hired, transferred to a new job, granted a vacation, disciplined or dismissed, among other situations. Moreover, employers should adopt a certain set of internal regulations compliant with Russian law.

## Working hours

- Employers are required to keep a record of all time worked by each employee, including overtime.
- The standard working week in Russia is 40 hours over a five- or six-day week. For certain categories of employees, the number of working hours should be reduced.
- Law strictly defines limits and rates for overtime and holiday/ weekend work.
- On the eve of public holidays, the working day should be one hour shorter.

## Paid holidays

All employees are entitled to a minimum of 28 calendar days of annual paid leave. Normally, vacation entitlement is granted to employees after they have worked at a company for six months continuously.

The Labour Code requires that employees plan their annual vacation by December of the preceding year. The Labour Code further requires that employees notify their employers in writing at least two weeks before any vacation commences. An employee's vacation allowance should be paid to the employee at least three days before vacation is due to start.

## Equal opportunities

It is prohibited to impose, directly or indirectly, any restrictions or privileges on the basis of gender, race, skin colour, nationality, language, origin, material, social and employment status, place of residence (including whether or not a person is registered at his place of residence or place of stay) or other circumstances not related to the business qualities of employees, except in instances provided for by federal law. Any discrimination in the establishment and adjustment of salary rates and other conditions of payment for labour are prohibited.

## Termination of employment

An employer may terminate employment only on the specific grounds provided in the Labour Code and other federal laws. Employers must strictly comply with specific procedures and documentary requirements provided by the Labour Code when terminating employment for any reason. The Labour Code gives additional protection to specific categories of employees, including minors, female employees, employees with children, trade union members, and various other categories. An employee must give two weeks' notice of resignation.

Because of the detailed and varied termination requirements, legal advice should be sought before dismissing an employee.

## 7.3 Social security

### Coverage

Social and health security covers pensions, unemployment, maternity and child benefits, illness and other social services.

### Employees' contributions

Employees currently do not pay Russian social taxes—employers make all contributions.

### Employers' contributions

Russian social taxes were substantially reduced from 1 January 2001. Currently, companies pay the following on employee compensation:

- **Unified Social Tax (UST)** is comprised of numerous elements, including the Social Fund, the federal budget, and various medical funds (federal and territorial). UST is generally levied on employees' and contractors' total remuneration at regressive rates starting at 26% for low income employees, down to 2% for high income employees. UST is allocated across these elements in varying proportions in accordance with the status/income level of the individual.
- **Obligatory Pension Insurance (OPI)** contributions also accrue on employees' and contractors' total remuneration at regressive rates, depending on the cumulative remuneration; the amount of this contribution is effectively credited against the federal budget portion of UST.
- **Mandatory Accident Insurance (AI)** against work-related accidents. Rates vary from 0.2% to 8.5%, depending on the level of professional risk associated with the employer's activity.

Here are some key points to consider:

- Special conditions for foreign nationals were abolished in 2003. All components of the Unified Social Tax must now be paid on expatriates' remuneration.
- OPI contributions only apply for Russian citizens or foreign nationals permanently residing in Russia (for example, with a residence permit). The total amount of social taxes payable on compensation of a foreign national who is temporarily staying in Russia is, however, not reduced by this exemption from OPI contributions; rather, the amount due to OPI is redistributed across the various components of UST.
- Income paid to contractors is exempt from the Social Fund portion of the Unified Social Tax and so effectively reduces the amount of UST payable. Accident Insurance (AI) is not payable if the civil contract does not stipulate accident insurance coverage.

## 7.4 Foreign personnel

### Accommodation

It is possible to find accommodation in Moscow that conforms to Western standards. There are many apartments or houses which can be rented or bought by expatriates to suit their needs.

Foreign employees can bring their families to live in Russia. Accompanying family members can obtain Russian visas on the basis of their spouse's employment. There are also schools which cater to children of expatriate employees.

### Restrictions on employment

There are no restrictions on the number of foreign employees in a company or on how long they can be employed in Russia, except in the case of representative offices and branches of foreign companies, which are subject to quotas established by the immigration bodies.

There are some limits to the types of activities foreign employees can carry out in Russia (e.g., a foreign individual cannot work in public service, as pilots in command in civil aviation, etc.).

### Fiscal registration number

There is no requirement to obtain a fiscal registration number for a foreign employee.

### Residence permit

There is no requirement to obtain residence permits for foreign personnel to work in Russia. Foreign employees are authorised to stay and work in the Russian Federation for as long as their work visa is valid.

### Work permit

According to the current Russian legislation, all expatriate employees have the right to work in Russia if they hold individual work permits. An employer is entitled to employ foreign employees only if it holds an employment permit (i.e., permission to employ foreign personnel). Employers must obtain an employment permit prior to applying for individual work permits for their foreign employees.

Employment and work permits are generally issued for one year and for a particular region.

Please note that this procedure does not apply to foreign nationals permanently residing in Russia on a residence permit or several categories of foreign employees engaged, for instance, in assembling technical equipment delivered to Russia.

The Russian immigration authorities (Federal Migration Service) refuse to issue employment and work permits on the basis of secondment agreements. Only a direct employment contract governed by Russian labour law between an employer and an employee can be the basis for obtaining both employment and work permits.

Once a foreign employee obtains his/her individual work permit, he/she will be entitled to stay and work in Russia only on the basis of a work visa. The FMS have become more stringent in checking that foreigners' visas comply with the purpose of stay in Russia. A business visa is issued specifically for the purpose of conducting negotiations, concluding or extending business contracts, or participating in auctions, exhibitions and other business events.

Failure to comply with immigration rules could bring fines of up to RUB 800,000 (approximately USD 31,000) per foreign employee.

## 8. Accounting and audit requirements



## 8.1 Accounting

### Introduction of International Financial Reporting Standards

Russian Accounting Rules (RAR) are not yet in line with International Financial Reporting Standards (IFRS), although Russian accounting reforms based on IFRS have been introduced.

In 1998, the Russian government adopted a programme to reform Russian accounting in accordance with IFRS. In line with this programme, new Russian Accounting Standards (RAS) are being introduced. These standards regulate major aspects of accounting, as well as the presentation and disclosure of information (such as accounting policies, fixed assets, intangible assets, inventories, income and expenses, related parties, segment information, government grants and others). The new RAS have introduced fundamental accounting assumptions and requirements, such as going concern, consistency of accounting policies, accrual basis, prudence, substance over form, cost-effectiveness and others, thus bringing Russian practice closer to international practice. Practical interpretation of the requirements and assumptions under RAR may be different from IFRS (e.g., RAR are often form-driven).

In 2004, the new Accounting Development Concept was adopted, outlining fundamental changes to be introduced in accounting regulations and their schedule. The concept envisages mandatory preparation of consolidated financial statements by public and other public interest companies in accordance with IFRS. Stand-alone accounts will be prepared by companies in accordance with Russian accounting rules, to be developed on the basis of IFRS. The concept also includes certain measures to develop the accounting profession, in particular, delegating the development of accounting standards to professional organizations, while state authorities still decide whether to adopt them or not.

It is expected that the procedure for preparing consolidated financial statements will be established by a Federal Law "On Consolidated Financial Statements", a draft of which is being discussed by the State Duma. Under the new Law, consolidated financial statements of public companies will be prepared solely under IFRS, whose recognition and translation into Russian will be approved by the government. Consolidated financial statements shall be subject to audit and publication.

### Accounting principles in Russia

Russian accounting practice has already moved a long way from the central-planning model towards a market-economy model and, consequently, towards international accounting practice. Although accounting principles and procedures are gradually becoming more harmonised with IFRS, there is still a long way to go. Some significant differences continue to exist, and in some cases there are no specific rules under RAR for certain areas.

The main differences between national accounting rules and IFRS are presented below.

- The concept of inflation accounting does not exist.
- Consolidated financial statements are treated as secondary to the stand-alone statutory financial statements of a company and are often not prepared.
- There are no rules for accounting for the impairment of some assets.
- Nor is there a specific rule for business combinations.

Overall, the accounting profession is still in the formation stage.

### Significant accounting differences between Russian accounting standards and IFRS<sup>5</sup>

One of the major differences between Russian accounting and international practice lies in the understanding of the term "accounting" itself. In Russia, the term has a primary meaning of bookkeeping and a secondary connotation of financial reporting. Therefore, Russian Accounting Rules give extensive coverage to bookkeeping procedures, rather than financial reporting rules.

Russian accounting may differ from that required by IFRS because of the absence of specific Russian rules on recognition and measurement in the following areas:

Provisions in the context of business combinations accounted for as acquisitions	IFRS 3
Consolidation of special purpose entities	SIC 12
The restatement of financial statements of a company reporting in the currency of a hyperinflationary economy in terms of the measuring unit current as of the balance sheet date	IAS 29
The translation of the financial statements of hyperinflationary subsidiaries	IAS 21
The treatment of accumulated deferred exchange differences on disposal of a foreign entity	IAS 21
De-recognition of financial assets	IAS 39
The recognition of operating lease incentives	IAS 17, SIC 15
Accounting for defined benefit pension plans and some other types of employee benefits	IAS 19
Accounting for an issuer's financial instruments	IAS 32, IFRS 2, IFRS 7
Accounting for derivative financial instruments	IAS 39
Hedge accounting	IAS 39
Accounting for long-term assets held for disposal	IFRS 5

There are no specific rules requiring disclosures of:

The fair values of financial assets and liabilities	IAS 32, IFRS 7
The fair values of investment properties	IAS 40
Certain segment information (e.g., a reconciliation between the information by reportable segment and the aggregated information in financial statements, significant non-cash expenses, other than depreciation and amortization, that were included in segment expense and, therefore, deducted in measuring the segment result – for each reportable segment)	IAS 14
Summarised financial information on associates	IAS 28
Extensive disclosures on business acquisitions/disposals	IFRS 3
Significant management judgements made in the process of applying the entity's accounting policies and key sources of estimation uncertainty	IAS 1, IAS 36

There are inconsistencies between Russian Accounting Rules and IFRS that could lead to differences for many enterprises in certain areas. Under RAR:

Goodwill is calculated by reference to the book value of acquired net assets	IFRS 3
Proportionate consolidation may be used for subsidiaries in which the parent holds 50 percent or less of the voting shares	IAS 27
The useful life of property, plant and equipment is usually determined using periods prescribed by the government for tax purposes	IAS 16
Finance leases are generally defined in legal terms and the right of capitalisation is given to a lessor or a lessee by a contract	IAS 17
The completed contract method can be used for the recognition of revenues under construction contracts when the outcome of a construction contract can be estimated reliably	IAS 11
Trading, available-for-sale and derivative financial assets are not recognised at fair value	IAS 39
Trading and derivative liabilities are not recognised at fair value	IAS 39
Any financial investments are not required to be carried at fair value	IAS 39
Provisions can be established more widely or less widely than under IFRS, and there is no requirement for discounting	IAS 37
The correction of errors is included in the determination of the net profit or loss for the reporting period, but separate disclosure	IAS 8
Revenue recognition rules do not differentiate between exchanges of goods of a similar nature and value and exchanges of dissimilar goods, and do not discuss adjustment for the amount of cash or cash equivalents transferred in exchanges for dissimilar goods	IAS 18

In certain enterprises, the following issues could also lead to differences from IFRS:

Some parent companies do not prepare consolidated financial statements under IFRS	IAS 27.10
In the definition of control, it is not required that the ability to govern decision making be accompanied by the objective of obtaining benefits from the entity's activities	IAS 27
Certain subsidiaries may be excluded from consolidation beyond those referred to in IFRS	IFRS 3
A subsidiary that is a bank may be excluded from consolidation if it is dissimilar from the rest of the group	IAS 27
Certain set-up costs that have been paid by a company's founder can be capitalised	IAS 38
Internally generated brands and similar items can be capitalised if the enterprise has an exclusive legal right	IAS 38
Inventories are generally carried at cost rather than at the lower of cost and net realisable value	IAS 2
The realisable value of inventories can be measured without deduction of selling costs	IAS 2

## Statutory requirements

Accounting in Russia is regulated by state authorities. The regulatory framework for Russian accounting has three levels. The first level includes the Federal Law "On Accounting", the Civil Code, the Federal Law "On Joint-Stock Companies", etc. The second level of the regulatory framework consists of Russian Accounting Standards, the Chart of Accounts and other accounting regulations. The Central Bank of Russia is responsible for setting standards for banks and other credit institutions, while the Ministry of Finance performs this function for all other companies. The accounting policies of a given company are developed based on the legislation and regulations of the first two levels. Each company keeps its accounting books and prepares its financial statements in accordance with its approved accounting policies.

## Preparation of financial statements

**Form and content of statutory financial statements:** The only financial statements acceptable for filing purposes are stand-alone statutory financial statements of a legal entity registered in Russia.

The structure, presentation, procedures for preparation and other aspects of statutory financial statements are stipulated in the Russian Accounting Standard "Financial Statements of a Company". Financial statements should be prepared in Russian roubles and in the Russian language, and a company must submit its annual statutory financial statements to:

- Its stockholders, in accordance with its foundation documents;
- The state statistics authorities;
- The state tax authorities.

Basic annual statutory financial statements, called Accounting Reports, include: a balance sheet, a profit and loss account, and notes to both (for example, the cash flow statement and the statement on changes in equity constitute a part of the notes).

For qualifying small businesses, a simplified set of accounting rules is allowed.

The reporting year of a Russian company is the calendar year.

## Some important aspects

**Balance sheet:** On the face of the balance sheet, all assets and liabilities should be classified into current and non-current depending on their maturity date. Assets and liabilities should be classified as current if their maturity date is within twelve months of the balance sheet date or within the operating cycle if the latter exceeds twelve months. All other assets and liabilities should be classified as non-current.

**Intangible assets:** The categories of intangible assets are defined by the relevant accounting standard. Amortization of an intangible asset shall be charged over its useful life by one of the following methods: straight-line method; sum-of-the-units method; or diminishing balance.

An asset without a specified useful life may be amortized over twenty years, but not longer than the life of the company. Positive goodwill is included in intangible assets and amortized on a straight-line basis over twenty years.

Amortization of negative goodwill is accounted for as operational income and is written down to the financial results of the company evenly over twenty years.

**Property, plant and equipment:** Property, plant and equipment shall be recognised at historical cost. To offset the effect of inflation on the fixed assets base, a company has the right to perform revaluation of the historical value of fixed assets and accumulated depreciation once per year (at the beginning of the year) or less often, but still on a regular basis.

The depreciation of fixed asset items may be carried out by one of the following methods: the straight-line; diminishing balance; sum-of-the-year-digits; or sum-of-the-units. The useful life is determined by a company according to its accounting policy.

**Investments:** Investments should be initially recorded at the cost incurred by the investor, including amounts paid to a seller under a contract, fees paid to intermediaries in relation to an acquisition and other similar items. Short-term foreign currency securities are shown at the exchange rate of the given foreign currency established by the Central Bank of Russia as of the balance sheet date. Long-term foreign currency securities are not revalued.

Investments in publicly listed stocks should be revalued at their market value on a regular basis. A provision is created at the reporting year-end for financial investments in non-listed stocks if they are steadily declining.

**Inventories:** Inventories are initially recognised at cost. The cost of inventories (by type) can be assigned by using different cost formulas in the event they are transferred for production or otherwise disposed of. The following cost formulas are allowed: specific identification; average cost; first-in, first-out (FIFO). Last-in, first-out (LIFO) is prohibited starting with financial statements for 2007. Finished goods are valued at actual cost, standard cost or direct costs. Work in progress can be valued at standard cost, direct costs, cost of raw materials and semi-finished goods, or actual cost (for unique production only). For reporting purposes, inventories should be measured at the lower of cost and net realisable value if (1) the price of inventory decreased during the reporting year, or (2) if inventory became obsolete or partially damaged. Provisions for impairment of inventories are created at the reporting year-end. In the balance sheet, inventories are shown net of the provision.

**Receivables:** Provisions for trade receivables that have not been settled on the due date and are not secured by appropriate guarantees (under Russian legislation, such receivables are classified as doubtful) are created at the reporting year-end. In the balance sheet receivables are shown net of the provision.

**Legal reserve:** A legal reserve is created by a company in accordance with its foundation documents and may be used for a limited number of purposes (e.g., to cover the loss of the reporting year). The year-end balance of the legal reserve is carried forward into the next reporting period. Joint-stock companies shall make a legal reserve in the amount of no less than 5% of the charter capital; joint-stock companies shall contribute no less than 5% of their annual net profit to the legal reserve until this fund is finally created.

**Finance lease:** Russian legislation stipulates that risks related to assets held under finance lease are borne by the lessor, unless the lease contract provides otherwise. For accounting purposes, the finance lease contract must define whether the lessor accounts for and depreciates an asset held under finance lease and the lessee accounts for such an asset off-balance sheet, or vice versa.

**Business expenses:** All regular business expenses for accounting purposes are taken in full into the calculation of the profit (loss) for the reporting year. Such expenses include, for example, business travel expenses, advertising expenses and payments made under insurance contracts. For some of these expenses, adjustments are needed in order to calculate profit for tax purposes. Consideration should be given to differences between treatment of expenses for statutory accounting and tax accounting purposes.

**Borrowing costs:** Interest on loans is generally either recognised as an expense and taken in full to the profit and loss account or capitalised. Russian accounting requires the capitalisation of borrowing costs during the construction of a non-current asset. Interest costs relating to intangibles and securities can also be capitalised up to the moment the asset is recognised in the books.

**Cash flow statement:** Russian rules do not define the term “cash equivalents” and, therefore, cash balances per cash flow statement are reconciled to cash, rather than to cash and cash equivalents. Only the direct method is allowed.

**Explanatory notes:** The explanatory notes to the annual statutory financial statements must contain essential information about the company and the financial status thereof, comparability of the information for the accounting year and the preceding years, significant accounting policies and other significant information for potential users of financial statements. Any instances of non-compliance with the accounting rules must be reported in the explanatory notes with an appropriate explanation and discussion of the effect on the statutory financial statements. The notes must also announce changes in accounting policies for the following accounting year.

Regulations prescribe rules of disclosure that are in many respects comparable with international practice. These include post-balance sheet events, contingencies, related parties, earnings per share, segment information, government grants, etc. However, the practical implementation and details of these rules may differ. Generally, the scope of disclosure in RAR financial statements is lower than in IFRS financial statements, but is increasing from year to year.

### Consolidated financial statements

There is a requirement in Russian accounting to prepare consolidated financial statements, but they are still treated as secondary to the stand-alone statutory financial statements and are often not prepared. Consolidated accounts can be prepared under either IFRS or RAR.

A decision to prepare consolidated financial statements under IFRS instead of RAR is made by the management of the parent company or its owners/shareholders. IFRS consolidated financial statements that are prepared instead of consolidated statutory financial statements must be provided to the owners/shareholders of the parent company.

Although the Russian consolidation rules introduce a procedural framework similar to IFRS, specific rules may differ (for example, in exceptional cases investments in subsidiaries and affiliates can be carried at cost) or may not address a number of practical issues.

### Publication of financial statements

According to the Federal Law “On Accounting”, a company’s annual statutory financial statements must be accessible to all interested users, including bankers, investors, creditors, buyers, suppliers, etc. Users can receive copies of the annual statutory financial statements upon payment of copying costs.

The Law on Accounting also establishes a requirement that statutory financial statements for certain categories of companies (for example, open joint-stock companies, insurance companies)

be published. Such companies should publish their statutory financial statements in newspapers and magazines that are accessible to the users of statutory financial statements, or distribute (among the users) a brochure containing their statutory financial statements, and also submit the statutory financial statements to regional state statistical authorities, in accordance with the company's registration, for further presentation to interested users.

The publication procedure for open joint-stock companies requires that balance sheets, income statements and audit reports be published. Prior to publication, statutory financial statements must be approved by an AGM and audited. Depending on the volume of operations and the size of the company, it may publish a balance sheet and income statement in short form or in full.

The deadline for publication is 1 June of the year following the reporting year.

## Offices of foreign companies

The Law on Accounting is applicable to branches and representative offices of foreign legal entities in Russia unless otherwise stipulated under international agreements concluded by the Russian Federation. In setting up and maintaining an accounting function (including the preparation of financial statements), foreign legal entities, branches and representative offices in Russia may choose one of the following:

- Rules existing in the Russian Federation (RAR);
- Rules existing in the country where the foreign legal entity is located, if such rules do not contradict IFRS, as issued by the IASB.

The choice of accounting rules by a foreign entity must be documented as an accounting policy.

If a foreign legal entity decides to apply RAR, it should fully comply with the requirements and procedures stipulated by the Law on Accounting, as well as other statutory regulations and instructions on accounting. Under this approach, accounting can be maintained under the rules adopted by the foreign company in addition to maintaining accounting under RAR.

If a foreign legal entity decides to apply rules other than RAR, it should comply with the requirements and procedures in effect in the country where the given foreign legal entity is located.

Irrespective of their choice of accounting rules, branches and representative offices of foreign legal entities must maintain tax accounting under the rules prescribed by the Russian Tax Code.

## Accounting profession profile

The Russian accounting profession is still in its initial development stage despite its long and affluent history: the first accounting vestiges date back to the 16th century, double entry has been used since 1722 and the first book on accounting was published

in 1783. The first attempt to set up an institute of chartered accountants in the early 20th century failed. The accounting profession was heavily controlled by the state in the Soviet Union. Chief accountants enjoyed special status as state supervisor over enterprises' business activities, their official powers and duties prescribed by government decree. The profession continued to develop, forming professional unions and associations. There were around 3 million accountants in the country by the end of the Soviet era.

The contemporary Russian accountant has lost its status as state supervisor. Nevertheless, accountants' special position is vested by the Law on Accounting—in particular, their direct subordination to the general director, bypassing all other intermediate positions, the right of second signature on all financial documents, the binding character of their instructions concerning document flows and the right to monitor the work of all personnel in the company.

Accountants graduate from higher educational institutions (universities and institutes), secondary and specialised schools (colleges, technical schools) and many private courses. Since the 1990s, the has delivered courses on IFRS and has developed a special IFRS diploma and training in the Russian language.

The concept of an independent professional accounting officer has not evolved yet in Russia; all accountants are hired employees in companies or accounting and audit firms. The Institute of Professional Accountants was established in 1997 and renamed in 2005 as the Institute of Professional Accountants and Auditors of Russia (IPAR)<sup>5</sup>. Since 2001, IPAR has been an active member of the International Federation of Accountants (IFAC).

Alongside with IPAR, accountants and auditors have set up a number of other organizations, the four largest of which, together with IPAR, have been officially recognised by the Ministry of Finance as advocates of the profession: the Audit Chamber of Russia, the Russian Chamber of Auditors, the Institute of Professional Auditors.

The new draft Law on Accounting and Law on Auditing enhance the role of professional associations. They give these associations the exclusive right to develop accounting standards, certify and maintain registers of auditors, control quality and provide advanced professional development training.

## 8.2 Chart of Accounts

In Russia, the process of classifying accounting facts is regulated centrally; a uniform Chart of Accounts created by government authorities is traditionally used. There are three main charts: 1) for commercial (business) companies, 2) for banks, 3) for non-profit organizations. The national Chart of Accounts is used, firstly, for working out typical accounting entries, and secondly, for preparing financial statements.

<sup>5</sup> IPAR is the leading self-regulating non-commercial organization in the country. Its members are accountants, auditors, trainers and corporate members: over 1,000 audit firms; more than 100 large industrial enterprises; over 400 educational-methodological centres. IPAR organises in-house training and distance learning to an advanced level for professional accountants; monitors the quality of work of its member audit firms and holds annual awards and competitions.

The first uniform Chart of Accounts appeared in Russia in the 1920s. It was intended for industry only and was revised periodically. In 1961 the first national uniform Chart of Accounts for businesses was created and put into operation. The latest Chart of Accounts was approved by Order No. 94n of the Ministry of Finance on 31 October 2001. It consists of about 60 accounts and 59 sub-accounts grouped into nine main sections.

The main sections of the Chart of Accounts are presented in the table below.

Main categories in the Chart of Accounts

Account Section	Number
Non-current assets	01-09
Inventories	10-19
Cost of production and work-in-progress	20-39
Finished goods and goods for resale	40-49
Cash and investments	50-59
Accounts receivable and payable	60-79
Equity	80-89
Financial results	90-99
Off-balance sheet accounts	001-011

Accounts included in the first eight sections, which are called balance-sheet accounts, are used in double-entry accounting. Section 9 includes special off-balance-sheet accounts reflecting various kinds of transactions that should be made beyond the double-entry system.

Each balance-sheet account has its own two-digit number (code), which is used in accounting ledgers and transactions. Off-balance-sheet accounts have three-digit numbers; they are declared by the Ministry of Finance and cannot be changed by a company. Some account numbers are not now in use but will be used in future revisions of the chart. Because of their complexity, most accounts are divided into sub-accounts. Each account or sub-account can be divided further into analytical accounts according, for example, to the number of suppliers.

Instructions “On the Application of the Chart of Accounts for Bookkeeping for the Financial and Economic Activities of Organizations” have been issued by the Ministry of Finance. Therefore, the Chart of Accounts, as well as the typical entries recommended in the instructions, are obligatory for all businesses. From time to time, the Chart of Accounts or the set of recommended entries are corrected, specified, and expanded.

On the basis of the Chart of Accounts and the supplementary instructions, an organization should approve a working Chart of Accounts containing a full list of accounts and sub-accounts needed for accounting purposes.

## 8.3 Audit requirements

### Investor considerations

- An annual statutory audit is mandatory for all companies meeting certain criteria set by Russian legislation.
- New Russian Standards on Auditing (RSA) are currently being developed.
- Russian Standards on Auditing are close to international practice.
- Licensing is mandatory for audit firms and auditors working independently.
- In order to conduct audit activities, auditors should hold an audit certificate.

### Companies subject to statutory audit

Under Russian auditing legislation, some companies must have their annual statutory financial statements audited. Commercial non-governmental companies whose annual statutory financial statements are subject to statutory audit include:

- All open joint-stock companies;
- Banks and other credit institutions, insurance companies, commodity and stock exchanges, investment funds, charitable and other (non-investment) funds, etc.;
- Other companies with annual sales exceeding 500,000 times the average official minimum monthly wage for the reporting year and companies with total balance sheet assets exceeding 200,000 times the average official minimum monthly wage for the reporting year (currently RUB 50 million and RUB 20 million, respectively).

In addition, annual statutory financial statements subject to publication must be audited by independent auditors prior to their publication.

Consolidated financial statements are not subject to mandatory statutory audit.

### Standards for audits required by law

The Federal Law “On Audit”, enacted in 2001, defines audit services, establishes the rights, obligations and liability of auditors and audit firms, discusses confidentiality and independence, and sets forth substantial compliance regulations.

In May 2005, the State Duma adopted in the first reading amendments to the Law on Audit which introduce significant changes to the audit profession. They propose to replace audit licensing with audit firms’ mandatory membership in self-regulated professional associations, to introduce mandatory quality control and to toughen the requirements on auditors’ independence. Auditing standards in Russia are expected to be in line with international standards.

PSAD	ISA	ISA
PSAD N 5.	ISA 500.	AUDIT EVIDENCE
PSAD N 6.	ISA 700 Combined with ISA 701.	THE INDEPENDENT AUDITOR'S REPORT ON A COMPLETE SET OF GENERAL PURPOSE FINANCIAL STATEMENTS
PSAD N 7.	ISA 220.	QUALITY CONTROL FOR AUDITS OF HISTORICAL FINANCIAL INFORMATION
PSAD N 8.	ISA 330.	THE AUDITOR'S PROCEDURES IN RESPONSE TO ASSESSED RISKS
PSAD N 9.	ISA 550.	RELATED PARTIES
PSAD N 10.	ISA 560.	SUBSEQUENT EVENTS
PSAD N 11.	ISA 570.	GOING CONCERN
PSAD N 12.	ISA 210.	TERMS OF AUDIT ENGAGEMENTS
PSAD N 13.	ISA 240.	THE AUDITOR'S RESPONSIBILITY TO CONSIDER FRAUD AND ERROR IN AN AUDIT OF FINANCIAL STATEMENTS
PSAD N 14.	ISA 250.	CONSIDERATION OF LAWS AND REGULATIONS IN AN AUDIT OF FINANCIAL STATEMENTS
PSAD N 15.	ISA 315.	UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT
PSAD N 16.	ISA 530.	AUDIT SAMPLING AND OTHER MEANS OF TESTING
PSAD N 17.	ISA 501.	AUDIT EVIDENCE - ADDITIONAL CONSIDERATIONS FOR SPECIFIC ITEMS
PSAD N 18.	ISA 505.	EXTERNAL CONFIRMATIONS
PSAD N 19.	ISA 510.	INITIAL ENGAGEMENTS - OPENING BALANCES
PSAD N 20.	ISA 520.	ANALYTICAL PROCEDURES
PSAD N 21.	ISA 540.	AUDIT OF ACCOUNTING ESTIMATES
PSAD N 22.	ISA 260.	COMMUNICATION OF AUDIT MATTERS WITH THOSE CHARGED WITH GOVERNANCE
PSAD N 23.	ISA 580.	MANAGEMENT REPRESENTATIONS
PSAD N 24.	ISA 000.	NATIONAL FRAMEWORK FOR ASSURANCE ENGAGEMENTS
PSAD N 25.	ISA 402.	AUDIT CONSIDERATIONS RELATING TO ENTITIES USING SERVICE ORGANIZATIONS
PSAD N 26.	ISA 710.	COMPARATIVES

Work on preparing these standards began in 2002, and as of 1 July 2007, the government had approved 31 Russian standards on auditing (PSAD in their Russian abbreviation).

RSA cover the most important audit issues and can generally be compared to international practice, following ISA:

PSAD N 27.	ISA 720.	OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS
PSAD N 28.	ISA 600.	USING THE WORK OF ANOTHER AUDITOR
PSAD N 29.	ISA 610.	CONSIDERING THE WORK OF INTERNAL AUDIT
PSAD N 30.	ISRS 4400 (Previously ISA 920).	ENGAGEMENTS TO PERFORM AGREED-UPON PROCEDURES REGARDING FINANCIAL INFORMATION
PSAD N 31.	ISRS 4410 (Previously ISA 930).	ENGAGEMENTS TO COMPILE FINANCIAL STATEMENTS

## Conclusion

While significant progress has been made in the area of accounting reform over recent years, Russia still lacks a full and comprehensive set of accounting and auditing standards. The government recognises this and is working on further accounting and auditing reforms.

## 9. Tax system and administration



## 9.1 Tax system

The Russian tax system is relatively new, and many tax concepts and issues that are standard in most market economies with longer taxation histories are just beginning to emerge in Russia. For that reason many concepts familiar to Western business people and tax specialists have yet to find their way into Russian tax legislation and practice. As new concepts are embraced by Russian authorities, they are in many cases applied differently than in the West, or in other countries with developing tax systems.

The overhaul of a patchy tax system brought into existence by the rapid transition to the market economy in the early 1990s began in 1999 with the adoption of the first part of the Tax Code. Today, tax reform has largely been completed in terms of codification and elimination of multiple tiers of regulations. A new 13% flat rate for personal income tax, reduced corporate tax (from 35% to a 24%) and reduced VAT (from 20% to 18%) were introduced.

The government plans to introduce certain anti-avoidance provisions (including controlled company legislation). In the meantime, guidance from the high courts lays out several anti-avoidance approaches, including the concept of unjustified tax benefits. The fiscal authorities are beginning to adopt these approaches and crack down on aggressive tax evasion. In doing so, they are beginning to use the substance over form approach. Overall, this is a rapidly developing area.

Certain other concepts are planned to be introduced, including profits tax consolidation and a significant upgrade of transfer pricing rules to bring them more in line with OECD guidelines.

### Administration of the tax system

Taxes, duty and fees are enacted by law and may be changed only by new legislation.

The Federal Tax Service, which is responsible for collecting taxes, is subordinate to the Ministry of Finance, which has overall responsibility for collection of state budget revenues and for setting tax policy.

Other tax law enforcement bodies include, in particular, the Federal Agency for Economic and Tax Crimes under the Ministry of Internal Affairs, which is responsible for investigating tax crimes.

## Registration requirements

Every legal entity must register with the tax authorities in its place of location, as well as in each location in which it has a branch, a representative office, other separate subdivisions, immovable property or transport vehicles.

A foreign legal entity is required to register with the Russian tax authorities in each location in which it carries out activity through a subdivision (regardless of whether the activity is taxable or not) for a period exceeding 30 days continuously or cumulatively during a calendar year. Special registration requirements apply for foreign legal entities which (a) own immovable property in Russia, (b) own transport vehicles in Russia, (c) have movable property subject to taxation in Russia, (d) have opened bank accounts with Russian banks.

## 9.2 Direct and indirect tax burden

According to the Federal Tax Service's official web site, indirect taxes compose about one-third of total taxes collected in 2006:

### Direct taxes collected in 2006 in Russia:

Mineral resources extraction tax	36.5%
Corporate income tax	17%
Unified social tax	10.5%
Other taxes	2.1%

### Indirect taxes collected in 2006 in Russia:

VAT	30.8%
Excise	3.1 %

The tax burden depends on the sector of the economy in which a company operates. According to the data of the Federal Service of State Statistics, the tax burden in 2006 was as follows:

Sector	Tax burden, % of turnover
Extraction of natural resources	45.1
Food production	13.1
Metals production	6.7
Automotive and components	5.5
Construction	11.9
Wholesale and retail	3.8
Hotel and restaurant	10.7
Telecommunications	16.5

### 9.3 Principal taxes

The Russian tax system provides revenues on three budgetary tiers: federal, regional and local. All taxes are legislated at the federal level, although regional and local authorities have the power to set (or reduce) rates and establish procedures for regional or local taxes. Lower-tier authorities cannot grant concessions with respect to taxes governed by a higher authority (i.e., regional authorities cannot grant concessions on federal taxes).

Major taxes currently payable by businesses and individuals in Russia:

<b>Federal Taxes</b>	<ul style="list-style-type: none"> <li>• Profit tax</li> <li>• Value-added tax (VAT)</li> <li>• Excise taxes</li> <li>• Personal income tax</li> <li>• Unified social tax</li> <li>• Mineral resources extraction tax</li> <li>• Payments for the use of natural resources</li> <li>• Water tax</li> </ul>
<b>Regional Taxes</b>	<ul style="list-style-type: none"> <li>• Property tax</li> <li>• Transport tax</li> <li>• Tax on the gambling industry</li> </ul>
<b>Local Taxes</b>	<ul style="list-style-type: none"> <li>• Land tax</li> <li>• Individual property tax</li> </ul>

Apart from the taxes listed above, a company may be subject to certain obligatory pension and social insurance payments and pollution charges. Customs duty is governed separately by the Customs Code.

### 9.4 Legislative framework

Taxes, duty and fees are enacted by law and may be changed only by new legislation. Bills are developed by the Federal Assembly's lower chamber (State Duma), then approved by the upper chamber (Federation Council) and signed into law by the President.

The Russian legal system does not include case law, and each court ruling technically binds only the parties involved. Nevertheless, the Supreme Arbitration Court and Constitutional Court issue rulings and guidance for the consistent application of laws and compliance with the main constitutional principles, and this guidance plays an important role in defining the approaches of taxpayers and the fiscal authorities.

### 9.5 Tax treaties

As of July 2007, Russia has signed and ratified 67 double tax treaties. These tax treaties are usually based on the OECD Model Treaty (although the UN Model Convention is also still applied by developing countries). Local Russian tax authorities generally do not have much experience in interpreting and applying double tax treaties.

Withholding taxes on interest, dividends and royalties are typically reduced by tax treaties. Starting 1 January 2002, treaty benefits can be claimed by any entity or person provided that the tax residence certificate of the foreign company is available (no advance clearance is required to apply a treaty's provisions).

Definitions of a permanent establishment in domestic law in most tax treaties are largely similar. However, the domestic definition does not require a place of business to be "fixed", unlike most treaties. Some tax treaties provide more favourable rules with respect to certain types of tax deductions when determining the amount of business profits taxable by the Russian Federation (e.g., the German treaty allows for unlimited deduction of advertising expenses).

### 9.6 Tax returns and payments

Companies are required to file tax returns with the tax authorities on a monthly, quarterly or annual basis, depending on the particular tax and the company's line of business. Some taxes (i.e., profits tax, property tax, unified social tax, etc.) are paid in monthly, quarterly or annual instalments, with a final adjustment made when annual tax returns are submitted.

Companies may choose to calculate profits tax either monthly (with payment of monthly advance payments calculated based on the actual profits received) or quarterly (with payment of equal monthly advance payments calculated based on profits received during the previous quarter). The final payment for the year is due by 28 March of the following year. The quarterly and annual returns should be filed within the same deadline as the payment due dates.

### 9.7 Assessments

The tax authorities do not issue tax assessments to enterprises. Instead, the company must pay the amount of tax indicated in the tax return.

### 9.8 Appeals

At present, taxpayers can challenge decisions and other actions (or failure to act) of tax authorities either with a superior tax office, or in court. From 2009, an appeal to a superior tax office will become mandatory before the matter may be brought to court.

## 9.9 Withholding taxes

In accordance with the general provisions of the Tax Code, income received by a foreign legal entity and not attributed to a permanent establishment (PE) in Russia is subject to withholding income tax in Russia (to be withheld at source). Withholding income tax rates are as follows:

- 15% on dividends and income from participation in Russian enterprises with foreign investments;
- 10% on freight income;
- 20% on some other income from Russian sources, including royalty and interest;
- 20% of revenue or 24% of margin in relation to capital gain (from the sale of immovable property located in Russia or shares in Russian subsidiaries where the immovable property located in Russia represents more than 50% of assets). Taxation of the margin (rather than the gross amount of income received from the above sales) can be applied only if proper documentary support of expenses is available.

Tax should be withheld by the tax agent and paid to the budget within three days of the date when the income was paid out.

Income tax withholding rates may be reduced under a relevant double taxation treaty, whose provisions may be applied based on confirmation of tax residence, to be provided by a foreign company to the Russian tax agent prior to the date of payment (no advance permission from the Russian tax authorities is required).

## 9.10 Tax audits

Tax returns are desk-audited by the tax authorities upon their submission. In addition, the tax authorities have the right to perform regular field audits of companies. Field audits should not last for more than two months (in some cases it may be extended to four months—for example in audits of “major” taxpayers or taxpayers that have several separate subdivisions—or extended to six months in exceptional cases), and may cover only three calendar years prior to the year of the audit. Once the tax period is audited, the tax authorities may not audit the same period again, except when a taxpayer is reorganized or liquidated, or the respective tax audit is performed as part of a superior tax office’s review, or if a taxpayer has filed an amended tax return with a reduced amount of tax due.

## 9.11 Penalties

The law covers a variety of tax violations and establishes penalties for each particular type.

Underpayment of taxes may result in a fine equal to 20% of the underpaid taxes (can be increased to 40% if intent can be proved). The late filing of a tax declaration carries a penalty of 5% to 10% of unpaid tax per each month of delay in submitting the tax declaration. A number of fixed fines are imposed on a taxpayer for failure to register with the tax authorities or a failure to supply them with the required information, etc. Failure to withhold tax may result in a fine of 20% for the tax agent.

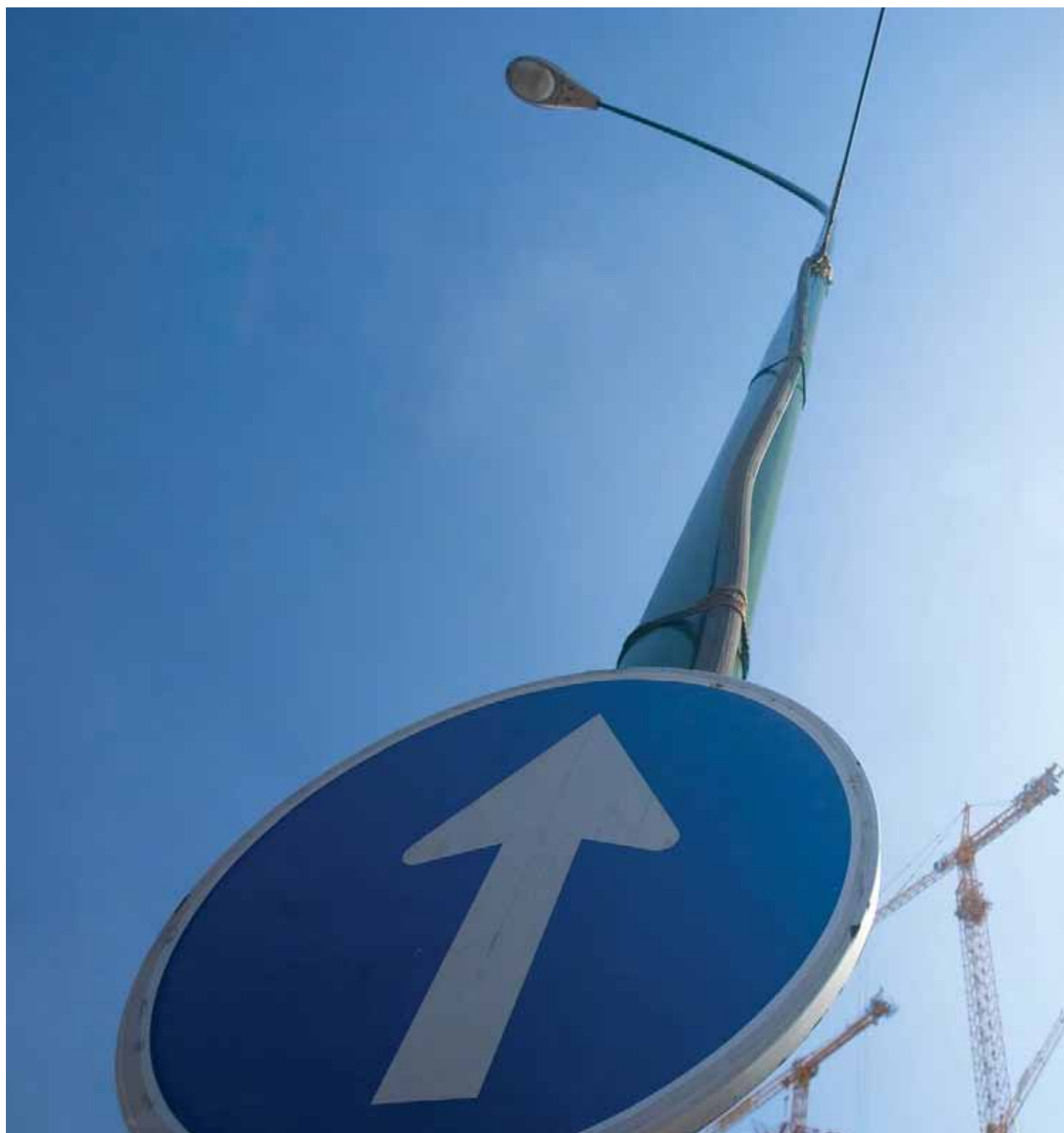
Interest for late payment is charged at a rate calculated as 1/300 of the Central Bank of Russia’s re-financing rate (10% per annum from 19 June 2007) per day. The amount of underpaid tax and late payment interest may generally be collected by the tax authorities without the consent of a taxpayer or a court. However, collection of penalties requires the ultimate consent of the taxpayer or a court ruling.

## 9.12 Advance tax clarifications and advance pricing agreements

Taxpayers have a right to apply to the Ministry of Finance or the tax authorities for clarification of Tax Code provisions. If a taxpayer follows such clarifications (issued individually or placed in the public domain with respect to similar facts and circumstances), it will be relieved of fines or late tax payment interest. However, it is difficult and time consuming to obtain these clarifications.

According to draft amendments to the Chapter I of the Tax Code, taxpayers will be able to conclude advance pricing agreements (APAs) with tax authorities on the pricing methodology that they can use. No APAs are available at present.

# 10. Taxation of corporations



## 10.1 Corporate tax system

### Taxable entities

Corporations and their shareholders are taxed separately. The profit tax rate for all taxpayers does not exceed 24% (but may not be less than 20%). The corporate income tax system distinguishes between resident legal entities, which pay tax on their worldwide income (credit relief is available for foreign tax paid up to the amount of the Russian tax liability that would have been due on the same amount under Russian rules), and foreign legal entities, which pay profits tax on income derived through a permanent establishment (at the rate of 24%) and are also subject to withholding tax on income from Russian sources not related to a permanent establishment (at rates varying from 10% to 24% depending on the type of income and the mechanism for its calculation—please refer to Section 9.9).

### Dividends received by Russian legal entities

From January 2008 dividends received by Russian legal entities from Russian or foreign legal entities will be taxed in Russia at a 9% flat rate (currently the dividends received by Russian legal entities from Russian companies are taxed at 9%, and at 15% from foreign companies).

Dividends received from “strategic investments” will be exempt from Russian income tax. An investment is considered strategic when:

- the owner (recipient of dividends) owns at least 50% of the capital of the payer of dividends, or owns depository receipts entitling it to receive at least 50% of the total amount of paid dividends;
- the share or depository receipts have been owned for at least 365 days on the day dividends are declared;
- the value of the investment is at least RUB 500 million (approx. EUR 14 million).

Dividends from companies residing in offshore zones with preferential tax regimes will not be eligible for the tax exemption. The list of the above offshore zones is established by the Ministry of Finance.

Tax on dividends from abroad withheld in the source country may be credited against Russian tax if there is a special provision in the relevant double tax treaty.

### Dividends paid by Russian legal entities

The standard 15% tax rate is applicable to dividends paid by Russian legal entities to foreign legal entities. The tax should be withheld by the Russian legal entity paying dividends. The tax may be reduced based on a relevant double tax treaty (typically to 10% or 5%).

### Territoriality

A company incorporated in accordance with the laws of the Russian Federation is considered a Russian tax resident.

Based on the Russian tax strategy for the years 2008-2010 published by the Ministry of Finance, in the future, resident status will depend on “place of management” and also “residence of shareholders”. If the company qualifies as a Russian tax resident according to these criteria, the difference between tax paid abroad and standard Russian corporate income tax will have to be paid to the Russian budget. These amendments to the Tax Code should be adopted in 2009.

### Representative offices / branches of foreign legal entities

Technically, representative offices of foreign companies are only allowed to conduct representation activities, while branches are allowed to conduct trade or business. Whether a foreign company creates a permanent establishment in Russia depends on the scope and nature of its activities, not its legal form.

### Permanent establishments

Foreign legal entities pay tax on profits attributable to a permanent establishment (PE). A PE is broadly defined as “a branch, division, office, bureau, agency, or any other place through which a foreign legal entity regularly carries out its business activities in Russia”. Russia’s various double taxation treaties may define a PE differently, which could result in tax relief in some cases. Conducting business through an agent may also create a taxable PE in Russia.

Profits of a PE are computed on substantially the same basis as Russian legal entities, including the composition of tax deductible expenses. The Tax Code does not specifically provide for deductibility of expenses incurred abroad by a head office with respect to its PE in Russia, although most double tax treaties provide for such a possibility. If a foreign legal entity conducts free-of-charge preparatory and/or auxiliary services for third parties, a PE is considered to have been formed, and the tax base is calculated as 20% of its expenses relating to such activities.

Foreign legal entities operating in Russia through a PE are to follow the filing and payment schedules established for Russian legal entities, although they do not make monthly advance payments and pay profits tax on a quarterly and annual basis only.

## 10.2 Incentives

The number of incentives available to taxpayers was scaled back dramatically as part of the codification process.

At present, taxpayers may enjoy incentives granted either by regional or local authorities with respect to taxes paid to their budgets, or by the legislation on special economic zones.

Regional incentives are granted to classes of taxpayers (typically large investors or entities operating in specific industries).

The extent of regional incentives and the willingness of regional authorities to grant them have been diminishing over time.

During 2006, under the Federal Law “On Special Economic Zones”, the following special economic zones (SEZ) were introduced:

- technical research and implementation zones for scientific projects;
- industrial production zones to develop industrial production;
- tourism-recreation zones for the development and effective use of Russian tourist resources.

Industrial production zone residents must make capital investments of at least EUR 10 million (including at least EUR 1 million in the first year). There are no similar requirements for residents of technical research and implementation zones or tourism-recreation zones.

SEZ residents are entitled to a number of tax benefits, such as reduced profits tax (from 24% to 20%), exemption from property tax for five years from the moment the property is recorded on the balance sheet; and exemption from land tax for five years from the acquisition of title to a plot. SEZs, except for tourism-recreation zones, will be treated as Free Customs Areas, i.e., foreign goods delivered to and used in the SEZ will be free of customs duty and VAT.

Even more significant benefits are currently available in the Kaliningrad and Magadan SEZ (they differ from other SEZs). In particular, Kaliningrad offers

- a profits tax exemption for the first six years of operations and profits tax rate reduction (12% instead of 24%) for 7-12 years;
- a property tax exemption for 1-6 years and tax rate reduction by 50% (i.e., 1.1% instead of 2.2%) for 7-12 years; regional tax exemptions and other benefits.

Magadan offers a profits tax exemption on investments in the development of production or social infrastructure up until 2014 and a property tax exemption for the first 5 years; regional tax exemptions and other benefits.

### 10.3 Taxable income

#### Tax base

There are some differences between taxable income and income reported in statutory accounts. Income from sale of goods, services and securities may be adjusted by the tax authorities in accordance with transfer pricing rules (taxable income may be based on market rather than actual prices). Only “controllable” transactions (e.g., transactions between affiliated companies or foreign trade transactions) are subject to transfer pricing analysis.

The accounting period in Russia is the calendar year. The taxable base is calculated on an accrual basis (only small-scale taxpayers are still allowed to use the cash basis).

Inventory valuation can be carried out by four methods: FIFO, LIFO, average cost and individual cost methods. The standard

profits tax rate of 24% is applicable to all types of income of corporations except for dividends (from 2008, it will be 9% or 0%. Please refer to section 10.1 Dividends) and interest income on state securities (15%, 9% or 0%, depending on the type of securities).

#### Securities

The key principles for the taxation of securities require that the sales price should not deviate substantially from the observable market price for publicly traded securities or the market value computed in line with Russian valuation rules for privately held securities. Only professional securities market participants have the right to deduct securities tax losses from income from other operations without any limitations. Other companies have to calculate financial results from operations with public and private securities separately and may not offset losses from a different basket.

#### Exempt income

Some types of income are exempt from profits tax:

- income in the form of property received from a parent which owns more than 50% of shares in the receiving party, or from a subsidiary of which the recipient owns more than 50% of shares;
- income from revaluation of fixed assets and securities;
- income in the form of property received as a contribution to the charter capital;
- income in the form of property received by a shareholder upon distribution of its subsidiary’s assets (within a contribution limit);
- certain other forms of income.

### 10.4 Deductibility of expenses

Expenses are generally recognized on an accrual basis. The main criteria for deductibility of expenses is that the expense is (a) economically justified, (b) properly documented, (c) incurred in the course of an income generating activity and (d) not specially mentioned in the Tax Code as non-deductible for tax purposes.

#### Depreciation

Two methods of depreciation are allowed: straight-line depreciation and reduced balance depreciation. The useful life of assets for tax purposes is established in the Classifier of Fixed Assets, adopted by the Russian Government. Accelerated depreciation is permitted for leased property (a special ratio of up to 3 may be applied).

From 2006, an “amortization premium” is allowed, which means that a taxpayer has the right to deduct 10% of the cost of fixed assets purchased (or constructed) in the month when depreciation started.

Intangible assets are amortized over the useful life of the asset (or ten years if the useful life of the intangible asset cannot be ascertained).

## Interest

Interest expenses are generally deductible within certain limits:

- 15% for loans in foreign currency
- the refinancing rate of the Central Bank of Russia (set as 10% per annum from June 2007) multiplied by 1.1 for loans in RUB

## Bad debts

Losses in the form of bad debts written off are generally deductible. Companies can use a bad debt reserve as well. The method of accrual for a bad debt reserve for tax purposes may differ from that in financial accounting because it is based only on the overdue payment period—if the delay exceeds 90 days, the full amount of the account receivable is expensed to the reserve.

## Employee remuneration

Employee remuneration is generally deductible. Documentation support is crucial for deductibility—all salary payments and bonuses are only deductible for profit tax purposes if they are described in labour contracts.

## Losses

Tax losses may be carried forward for ten years without limitations (i.e., they can be used to offset the entire taxable profit before a loss carry forward deduction). Carry back is not allowed. Losses from sale of securities can be credited only to the future income from sale of the same type of securities (publicly traded or privately held). Losses from the sale of fixed assets are recognized evenly during the remaining useful life.

## Non-deductible expenses

The Tax Code establishes a list of non-deductible expenses:

- cost of assets transferred free-of-charge;
- penalties paid to the budget of Russia;
- allowance accrued in financial reporting for revaluation of fixed assets or securities;
- some types of insurance expenses (except those specially mentioned in the Tax Code);
- employee remunerations not mentioned in labour contracts
- some other expenses.

Some types of expenses are subject to limitations on tax deductibility: entertainment expenses, certain types of advertising expenses, interest on loans and other expenses.

## 10.5 Related party transactions, transfer pricing

The tax authorities may examine the prices applied in “controllable” transactions:

- transactions between related parties
- barter transactions
- foreign trade transactions
- transactions in which the prices fluctuated by more than 20% within a short period of time

The prices used in these transactions may only be adjusted for tax purposes if they differ from the market price by more than 20%.

The three methods available to determine market price are (in order of preference): (1) comparable uncontrolled price (CUP) method, (2) resale-minus method and (3) cost-plus method. According to the Tax Code, the last method takes into account an operational rather than gross margin.

The transfer pricing provisions of the Tax Code are expected to be significantly changed (the draft amendments are available on the State Duma web site, but when they will be enacted is not known yet). First, a broad list of criteria for interdependence will be established. Second, the methods for determining the market level of prices will be extended. Third, special advance pricing agreements (APAs) with tax authorities on pricing methods will be available. Transfer pricing documentation will be required for transactions worth over RUB 1m (approximately EUR 28,500).

## 10.6 Foreign exchange

Foreign exchange gains and losses are recognised for tax purposes on an accrual basis.

## 10.7 Tax computations

Russian provisions for the elimination of double taxation generally take the form of credit for taxes paid in other countries. For personal income tax and for corporate tax on dividends, credit is granted only if a double taxation treaty is in force.

## 10.8 Energy, utilities and mining specifics

### Profits tax: deduction of expenses related to mineral resources development

The following tax deductibility rules apply for expenses connected with exploration and development of mineral resources:

- Expenses incurred in exploring and appraising mineral resource deposits shall be deducted evenly over a twelve-month period following the completion of the work.
- Expenses incurred in relation to the development of mineral resource deposits that prove to be unsuccessful shall be

recognised for tax purposes within a twelve-month period following notification of the relevant federal agency of the State Subsoil Fund.

- Expenses related to a “dry well” (including expenses related to abandonment of such wells) shall be recognised for tax purposes evenly over a twelve-month period following abandonment of each given well.
- Expenses incurred in preparing the relevant area for mining activities and in compensating damages to natural resources shall be deducted evenly over a five-year period.
- Expenses incurred in obtaining a license for the development of mineral resources, deposits, payments for geological information, levies for participation in a tender, etc. shall constitute the value of the license, which shall be treated as an intangible asset and depreciated within the period of the license.

### Mineral Resources Extraction Tax (MRET)

MRET, introduced on 1 January 2002, replaced mineral resource restoration payments, royalties and excise tax on the production of oil and gas condensate.

Specific rates apply for each type of mineral resources. For example: 4% for black coal; 6% for gold; 8% for diamonds and other precious and semiprecious stones; 17.5% for gas condensate; and RUB 147 for 1000 cubic meters of natural gas.

For crude oil, MRET is calculated as the amount of oil produced multiplied by a basic tax rate set in RUB per ton, subject to an adjustment based on a special coefficient (C) to reflect the dynamics of world oil prices and the RUB-USD exchange rate.

Starting 1 January 2005, the basic tax rate is RUB 419 per ton. The above coefficient C is applied on a monthly basis and starting 1 January 2005 is calculated as follows:

$C = (P - 9) * R / 261$ , where:

P is the average price per barrel for Urals-grade oil for the tax period; and R is the average RUB-USD exchange rate as determined by the Central Bank of Russia over the tax period (a month). For example, the rate of MRET for July 2007 was established as RUB 2,682 per ton.

If the depletion rate for a field equals or exceeds 80%, a special ratio (E) is added to the MRET formula:  $(419 * C * E)$ . The depletion rate is calculated as the accumulated volume of crude produced from the field (N) (including losses in the production) divided by the total volume of reserves ( $V = A + B + C1 + C2$ , in Russian Resources Classification).

The special rate is calculated as:

$E = -3.5 * N / V + 3.8$ , which as a result provides a reduction of the tax payable in accordance with the formula provided above by 3.5% for every 1% of depletion over 80% threshold.

Significant amendments have been introduced to the procedure for calculating MRET for greenfields and depleted fields. Starting 1 January 2007, a zero rate (so-called royalty holidays) is applicable to greenfields located in the Republic of Sakha, Irkutsk Oblast and the Krasnoyarsk region until they reach an accumulated extraction volume of 25 million tons, if the period of

development of the field does not exceed ten years, or is equal to ten years for licenses on development and extraction, or fifteen years for licenses on research, development and extraction. Such amendments are aimed at stimulating the development of new oil fields in Russia.

### Oil-related export duty

In early 1999, the government reintroduced export customs duty on crude oil and oil products. Export customs duty has been increasing steadily since the rise in oil prices. In September 2001, the Law on Customs Tariffs was amended to establish the procedure for determining the maximum rates of export customs duty for crude oil. The Russian government reviews export customs duty for crude oil every two months based on the average price of Urals blend. The average Urals crude oil blend price is calculated as the price for Urals blend on world markets (Mediterranean and Rotterdam) for the two months immediately preceding the current two-month period.

### Payments for the use of subsoil

Payments depend on the size of the license area provided to the exclusive user of the subsoil and apply to the size of the license area not including mining allotments. The current annual minimum and maximum rates of regular payments are set as follows:

- The rate for the right to prospect and evaluate oil fields ranges from 120 RUB/km<sup>2</sup> (50 RUB/km<sup>2</sup> for offshore areas) to 360 RUB/km<sup>2</sup> (150 RUB/km<sup>2</sup> for offshore areas);
- The rate for the right to explore oil fields ranges from 5,000 RUB/km<sup>2</sup> (4,000 RUB/km<sup>2</sup> for offshore areas) to 20,000 RUB/km<sup>2</sup> (16,000 RUB/m<sup>2</sup> for offshore areas).

### Excise tax on oil products

Currently, excise tax is charged on the following transactions involving gasoline, diesel fuel and motor oils:

- sale of oil products in Russia by oil product producers;
- import of oil products;
- other transfer of oil products in Russia by oil product producers, i.e.: (i) transfer of oil products for tolling; (ii) transfer of oil products by the producer to the owner under the tolling arrangements; (iii) transfer of oil products within a company for self-consumption, etc.

### Tax regime for investors under production sharing agreements (PSAs)

The PSA chapter of the Tax Code, introduced in June 2003, has established a special tax regime for PSAs. The new tax regime for PSAs may be applied only if the following requirements are met: no investor accepted the right to use a given subsoil plot on the terms of development under the general tax regime during a tender; the share of the Russian Federation in the total volume of extracted mineral resources is no less than 32% under direct product sharing agreements; and the given PSA provides for an increase in the state's share in profit production if improvements

are made to the project's investment performance indicators. The following specific features of the tax regime apply to investors under PSAs:

- Import of goods designated for performance of a PSA is exempt from import customs duty; export of mineral resources produced under a PSA is exempt from export customs duty;
- Profits tax is levied on the value of profit oil received by the investors and non-operational income less tax-deductible expenses which are not included in the recoverable cost. Cost of oil received by investors in compensation of recoverable costs is not taxable;
- The profits tax rate shall be determined in accordance with the provisions of the Tax Code as of the date when the given PSA takes effect and shall apply for the entire term the PSA is valid;
- The mineral resources extraction tax is 50% lower for natural resources (for oil and gas condensate subject to certain limitations) produced under a PSA;
- PSA investors are exempt from property tax on property used to conduct activities under the PSA.

The Law on Production Sharing Agreements, alternatively, provides for the possibility of concluding direct product sharing agreements under which the quantity of mineral resources produced is directly divided between an investor and the state, and the investor is not subject to profits tax or mineral resources extraction tax.

## 10.9 Other taxes

### Property tax

The property tax base includes only the book value of fixed assets reflected on the taxpayer's balance sheet (including property leased out). Intangible assets, inventories, work-in-progress and financial assets are not subject to property tax in Russia. The maximum property tax rate is 2.2%. Regional legislative bodies have the right to reduce the above rate, as well as to grant property tax exemptions.

### Excise

Excise taxes apply to the production and importation of cars, tobacco, alcohol, petrol and lubricants. Special excise rates for each type of excisable goods are established in the Tax Code.

## 10.10 Branch versus subsidiary

### Financing

Provision of funds and assets to a branch is not subject to profits tax, while contributions to a subsidiary are only tax free if they represent contributions to capital or provision of funds/assets to a more than 50%-owned subsidiary.

## Repatriation of cash

Repatriation of cash from a branch to the head office is made without restrictions after corporate profits tax is paid at the permanent establishment level. In contrast, repatriation of cash by a subsidiary is subject to Russian withholding tax (15% on dividends, 20% on interest, etc.) unless exempt or taxed at a reduced rate under a relevant double tax treaty.

## Tax consolidation

The main advantage of doing business through a subsidiary with several subdivisions is the possibility to consolidate their profits and losses for tax purposes. Such consolidation is not allowed for branches of a foreign company unless the activities of branches form a unified technological process and special approval of the Ministry of Finance is received (we are not aware that such approvals are granted in practice).

Consolidation of VAT is allowed for branches of both a subsidiary and a foreign company.

## Allocation of expenses

Branches with the status of permanent establishment in Russia are normally entitled to deduct the amounts of general and administrative expenses incurred by the head office under the provisions of the relevant double tax treaty, while a subsidiary can not deduct expenses incurred by the parent company.

## 10.11 Holding companies

From January 2008, the Tax Code establishes a favourable tax regime for holding companies located in Russia. The tax rate for dividends received by Russian holding companies from foreign subsidiaries will be reduced from 15% to 9%. A zero rate is applicable to dividends received by Russian holdings if the participation requirement is met regardless of who pays dividends (please refer to section 10.1 Dividends). The tax on dividends paid to foreign holding companies is paid at the rate of 15% (tax must be withheld by Russian subsidiaries on each payment and may be reduced in accordance with a relevant double tax treaty).

## 10.12 Thin capitalisation rules

According to the Tax Code, interest on loans received from foreign shareholders (as well as their Russian affiliates, or loans guaranteed by foreign shareholders or their Russian affiliates) owning more than 20% of capital is deductible provided the loans do not exceed 3 times the equity allocable to this shareholder (12.5 times for banks and leasing companies). If the loans exceed this limit, the excess part of interest on the loans will be qualified for taxation purposes as dividends paid to foreign shareholders.

Such dividends are not deductible for profit tax purposes and are subject to withholding income tax at the rate of 15% (treaty benefits may apply to reduce the rate).

# 11. Taxation of individuals



## 11.1 Territoriality and residence

### Tax residence

For both Russians and foreign nationals, tax residence is determined by the number of days a person is physically present in Russia.

According to new rules, effective from 1 January 2007, individuals are tax residents if they spend more than 183 days in Russia during any 12 consecutive month period (instead of 183 days within a calendar year, as under the previous rules). However, the Ministry of Finance clarifications imply that the “final” tax residence status of an individual shall still be defined by counting the days spent in Russia within the relevant calendar year. Thus the approach remains the same as under the previous legislation: in order to benefit from the 13% resident tax rate, a taxpayer should spend at least 183 days in Russia in a calendar year.

### Registration

Individuals do not have to register as taxpayers. Individual entrepreneurs do have to register themselves. Foreign nationals are not eligible to be considered entrepreneurs in Russia.

## 11.2 Taxable income

Taxable income is computed as gross income less exemptions and deductions.

The following categories of income are subject to taxation:

- income from employment
- income from independent activities
- income from property and property rights
- income from capital
- income from real estate transactions
- other income

Tax residents in Russia are liable to tax on their total worldwide income received during the calendar year at a flat rate of 13% (except for dividends and other limited categories of income). Benefits in kind (accommodation, provision of a car for personal use etc.) are treated as taxable income and are generally included at market value.

Tax residents pay 9% on dividend income and 35% on income derived from winnings, insurance benefits, “excess” interest on bank deposits and selected loans. The deemed “benefit” of receiving a loan at an interest rate lower than three-quarters of the Central Bank of Russia’s refinancing rate, for rouble-denominated loans, or lower than 9% for loans denominated in a foreign currency, is considered a “material benefit”. For foreign currency loans, taxable income is calculated as the difference between interest calculated at 9% and the amount actually paid and is taxed at a flat rate of 35%.

## 11.3 Non-taxable income

Certain statutory allowances, state pensions, certain compensation payments, alimony, certain types of gifts and material aid are exempt from Russian taxation.

## 11.4 Deductions

There are a number of deductions and exemptions employed in arriving at taxable income for tax residents, the majority of which are immaterial in terms of the derived tax savings.

## 11.5 Taxation of non-residents

Non-tax residents pay 30% tax on income received from Russian sources, including income from working in Russia, dividends from Russian companies, etc., though it may be possible to apply the relevant provisions of a double tax treaty to exempt certain types of income from Russian non-resident taxation.

## 11.6 Tax compliance

### Obligations of withholding agents

Income tax should be withheld at source by the employer (a “tax agent”) on all remuneration paid to individuals. Under the current rules, the responsibility to act as a tax agent lies with Russian legal entities, individual entrepreneurs and foreign legal entities that have created a permanent establishment in Russia. In addition to withholding obligations, employers must provide the tax authorities with information on income paid and tax withheld, and notify the tax authorities about income received by individuals from which tax could not be withheld at source.

### Tax returns for individuals

An individual is required to file an annual tax return with the Russian tax authorities if he/she:

- is self-employed;
- received income from which Russian tax was not withheld by a tax agent;
- received income from which Russian tax was withheld at the incorrect rate;
- is a Russian tax resident and received income from sources outside Russia; or
- is entitled to and intends to take an income tax deduction provided for under Russian law.

Personal income tax withheld by a tax agent is credited against the final tax liability for the year.

## 12. Value-added tax



The standard VAT rate is 18%. This rate applies to all goods and services that do not qualify for another rate or exemption (before 1 January 2004, the standard VAT rate was 20%).

A reduced rate of 10% VAT applies to some food, medical and baby products.

Some of the information covered in this chapter can also be found on [www.globalvatonline.com](http://www.globalvatonline.com), a PricewaterhouseCoopers global web site that provides a comprehensive guide to VAT information from over 70 countries.

## 12.1 Scope of VAT

A taxable transaction for VAT purposes is the supply of goods, services and works on Russian territory, as well as the importation of goods into Russia.

A taxable person is a legal entity or an individual entrepreneur. For import VAT purposes, private individuals may also be recognised as taxable persons.

The administrative authority is the Federal Tax Service.

### Place of supply of goods

Russia is deemed the place of supply of goods when either of the following conditions are met:

- the goods are located in Russia and are not shipped or transported; or
- the goods are located in Russia when shipment or transportation begins.

### Place of supply of services

The general rule is that works and services are supplied according to where the supplier has its place of activity. However, there are some exceptions:

- works and services connected with immovable and movable property (for example, repairs and maintenance) are deemed to be supplied in Russia if the property is located in Russia;
- services in the area of education, culture, art, tourism and sport are deemed to be supplied where physically performed;
- consulting, data processing, marketing, legal, accounting, advertising services; transfer of copyrights, licenses and similar rights; engineering services; types of provision of personnel and some agency services relating to procurement are deemed to be supplied in Russia if the buyer carries out its activity in Russia.

The rules determining whether a business has its place of activity in Russia are complex and should be assessed on a case-by-case basis.

## Import VAT

Goods imported into Russia are subject to import VAT.

Import VAT is recoverable if the usual VAT recovery requirements are met. However, foreign companies that are not tax registered in Russia are not entitled to recover Russian import VAT.

### Scope of reverse-charge VAT

If a foreign supplier of goods (or services) that are subject to Russian VAT is not tax registered in Russia, the Russian purchaser should act as a tax agent. The tax agent must calculate VAT, withhold it from the payment to the foreign supplier, and remit the withheld VAT to the Russian authorities.

The withheld VAT may be recovered by the Russian tax agent, provided it meets the recovery requirements.

## 12.2 Zero-rating

A zero VAT rate is applicable (but not limited to) to the following operations:

- export of goods outside Russia;
- transportation, loading/unloading and arranging of transportation, loading/unloading of exported goods performed by Russian organizations or Russian individual entrepreneurs;
- transportation, loading/unloading and arranging of transportation, loading/unloading of imported goods performed by Russian organizations or Russian individual entrepreneurs (except for Russian railway carriers);
- works (services) related to the transportation of goods in transit;
- some goods and services supplied to foreign diplomatic missions.

Using a zero VAT rate gives taxpayers registered with the Russian tax authorities the right to input VAT recovery.

## 12.3 Exempt supply

VAT exceptions apply to a very broad range of goods and services, including:

- the lease of premises to foreign lessees or to organizations accredited in the Russian Federation (applies only when the corresponding foreign state offers a similar relief to citizens of the Russian Federation and Russian organizations, or when stipulated by an international treaty (agreement) of the Russian Federation);
- certain banking transactions;
- sale of securities;
- transactions with medical equipment and medical services.

Exemption from import VAT is available for technological equipment and associated spare parts imported into Russia as in-kind contributions to the charter capital of an organization. This exemption applies to both domestic and foreign investors.

From 1 January 2008, the list of VAT exemptions will be extended to include the following:

- transfer of exclusive and non-exclusive rights to software, know-how, databases, inventions, etc. (trademarks are not covered by the exemption);
- certain research and development services;
- assignment of loan agreements.

### 12.4 Taxable amount

The taxable amount is normally defined as the market value of goods (services, works) supplied including the amount of excise duty and excluding the amount of VAT. If the Russian tax authorities consider that the price deviates from the market value of identical goods (services, works) by more than 20%, they may charge additional VAT.

When goods (services, works) are supplied for no charge, the price (and taxable amount) is to be defined as the market value of identical goods (services, works) excluding VAT.

The taxable value for import VAT purposes is defined as the value applied for customs purposes (including freight, insurance and other costs incurred prior to the customs border), increased by any applicable customs and excise duties.

### 12.5 Non-deductible input VAT

The following supplies are specifically denied input VAT deduction:

- VAT on works or services deemed to take place outside Russia,
- VAT on expenses related to non-VATable activities,
- VAT on expenses related to transactions which do not constitute a supply.

VAT cannot be deducted by foreign entities that are not tax registered with the Russian tax authorities.

### 12.6 VAT incentives

Goods declared for temporary importation may be granted full or partial relief from import VAT. When the temporarily imported goods are re-exported or released for free circulation, import VAT paid under the partial relief regime is potentially deductible as input VAT under the general rules.

### 12.7 Simplification measures

Import VAT deferral is possible when importing perishable goods and importing goods under international agreements.

### 12.8 VAT compliance

#### Registration

There is no separate VAT registration in Russia, but general tax registration includes registration for VAT purposes. Russian legislation provides each taxpayer with an identification number applicable for all taxes.

#### Invoicing requirements for domestic and export supplies:

An invoice for VAT purposes must contain certain obligatory requisites in order to recover VAT.

No separate invoicing requirements are established regarding export sales.

A VAT invoice should be issued within five days of goods shipment (supply of goods and services).

A duplicate copy of the invoice should be registered in a sales journal, and incoming invoices should be recorded in a purchases book.

No electronic invoices are accepted.

By agreement of the parties, the obligation of the recipient may be denominated in foreign currency.

#### VAT liability

The liability to pay VAT arises when the VAT return is filed.

VAT on sales should be paid on an accrual basis as of 1 January 2006. The time of supply for the supplier is the earliest of: the date of shipment (or, where the goods are not shipped, the date of the transfer of ownership) of the goods, the date of performance of the works or services, or the date of payment. For ongoing or continuous supplies of services, there are no specific rules determining the time of supply. In practice, the tax authorities look to associated documentation, such as acts of acceptance between the parties, to determine the time of supply for services.

For late payment, interest of 1/300 of the Central Bank of Russia refinancing rate is charged for each day of delay on the outstanding VAT amount.

For non-payment of VAT, a fine of 20% of the outstanding VAT is charged. The fine can be increased to 40% if the tax authorities consider that underpayment/non-payment of VAT was deliberate.

The Russian tax authorities are entitled to check a taxpayer's activities for three years prior to the year in which a tax audit is initiated.

## Reverse charge

The reverse charge (withholding) procedure is applicable to all goods (works, services) deemed supplied in Russia under the Russian VAT place of supply rules.

The Russian Tax Code stipulates that taxpayers who are registered in Russia are obliged to act as tax agents when they acquire goods (works, services) in Russia from non-resident entities and individuals who are not registered as taxpayers in Russia. The tax agent must calculate the VAT, withhold it from the payment to the supplier, and remit it to the authorities.

The Russian tax agent is entitled to recover the withheld VAT, subject to the conditions outlined below.

The following special requirements should be met by the Russian tax agent to recover withholding VAT:

- VAT was paid by the Russian tax agent on the same day as the payment to the foreign supplier was made;
- VAT was withheld from the payment to the foreign service provider.

Compliance with these requirements should be reflected in the transaction's supporting documents. Withheld VAT can be confirmed by a services agreement, which should contain a clause stipulating that the payment amount for the service provider includes Russian VAT. It is also important that invoices and acts of acceptance indicate a VAT amount included in the supplier's remuneration.

VAT invoices are normally required for recovery of input VAT. However, in a purchase from a foreign supplier which is not tax registered in Russia, the Tax Code does not provide for the obligation to issue a VAT invoice, either by the seller or the buyer. In practice, the tax authorities expect that the Russian buyer prepares a VAT invoice on behalf of a foreign supplier.

## Returns and payments

Currently, VAT returns should be filed with the Russian tax authorities monthly or quarterly. Quarterly returns can be filed by businesses with a turnover not exceeding RUB 2 million per quarter.

From 1 January 2008, all taxpayers will be required to file VAT returns on a quarterly basis.

The time limit for filing a VAT return and paying the VAT amount to the budget is 20 days from the end of the tax period.

## Refunds

VAT on goods and services (work) acquired in order to carry out VATable transactions is recoverable.

Input VAT related to both VATable and non-VATable activities should be allocated between these two types of activities. After allocation, the input VAT related to VAT exempt activities is not to be deducted, unless the related costs represent less than 5% of the total costs incurred by a particular taxpayer.

If a business is due a VAT refund, the amount due should first be offset against other existing tax liabilities of the same type or against liabilities of the next three months. If after the three-month period there is any balance left, in principle the taxpayer is entitled to a refund. Technically, a taxpayer is entitled to receive interest on the amount of any refund made after the established deadline.

In practice, VAT refunds are difficult to achieve in Russia and are usually only granted after lengthy court litigation.

There is no cross-border refund mechanism for non-registered businesses. Only entities that obtain a general tax registration in Russia are entitled to a VAT refund, provided the taxpayer has supplies which are subject to Russian VAT.

## 13. PricewaterhouseCoopers in Russia

### About PricewaterhouseCoopers

- A global organisation with offices in 150 countries. One of the world's leading employers of highly skilled professionals—more than 146,000 staff all over the world
- The largest professional services firm, with an unmatched portfolio of client companies
- An organization that recognises and meets its responsibilities to a broad community of stakeholders

Our mission is to build public trust and enhance value for our clients and their stakeholders. By building trust, we support the efficient and transparent functioning of financial and commercial markets around the world. By enhancing value, we help companies achieve their business objectives. We pursue this mission through industry-focused assurance, tax and advisory services.

### Key facts about PricewaterhouseCoopers Russia

- First established in Russia as early as 1913 and renewed its presence here in 1989
- The largest consultancy and audit knowledge business in the country (according to the rating agency Expert RA)
- Offices in Moscow, St Petersburg, Kazan, Yuzhno-Sakhalinsk and Togliatti
- More than 2,000 professionals

### Corporate social responsibility

PricewaterhouseCoopers Russia is expanding its corporate social responsibility program, which is focused on areas like education, culture and child welfare. For many years, the firm has helped orphanages, developed and implemented probation programs for university graduates, financed the restoration of cultural and historical monuments, and taken part in international charity programs aimed at collecting funds for underprivileged and orphaned children.

A new area of focus was recently opened—supporting Russian sport. As a starting point, the firm has chosen to officially sponsor the legendary Russian hockey team CSKA.

In 2005, PricewaterhouseCoopers' "Charity Instead of Gifts" programme was born. For two years in a row, the firm has reassigned its Christmas corporate gifts budget in favour of supporting charity work. In 2007, the program was handed over to Charity Aid Foundation in order to attract as many other companies as possible. This project not only helps solve concrete social problems, but also promotes a culture of corporate philanthropy in Russia.

### Our services

#### Assurance Services

- Audits to International Financial Reporting Standards (IFRS) and US GAAP
- Russian Statutory Audit

#### Advisory Services

- Transactions
- Performance improvement

#### Tax and Legal Services

- Global compliance services
- International tax structuring
- Transfer pricing
- Tax aspect of mergers and acquisitions
- Indirect taxation and customs
- Tax disputes resolution
- International assignment services
- Human resources services
- Legal services

#### Client training

#### Our industry practices

- Financial Services
- Energy, Utilities and Mining
- Consumer and Industrial Products
- Technology, Communications, Entertainment and Media

## Appendix A – Main macroeconomic indicators of Russia in 1999-2007 1H

	2001	2002	2003	2004	2005	2006	2007 1H
Gross domestic product (GDP) (USD billions)	306	345	431	592	764	985	545
Gross domestic product (GDP), % y-o-y	105.1	104.7	107.3	107.2	106.4	106.7	107.8
Fixed capital investments, % y-o-y	108.7	102.6	112.5	110.9	110.5	113.5	122.3
CPI, % y-o-y	18.6	15.1	12	11.7	10.9	9	5.7
Volume of industrial production, % y-o-y	104.9	103.7	107	106.1	104	103.9	107.7
Gold and foreign exchange reserves (USD billions)	37	48	77	125	182	303.7	406
FDI (USD billions)*	2.7	3.5	8	15.4	14.8	30.8	26.5

Source: Rosstat, Central Bank of Russia, EIU

\*Ministry of Economic Development and Trade

## Appendix B – Tax rates

Corporate income tax rates	<ul style="list-style-type: none"> <li>• 24% is the standard rate (regional authorities can reduce it by 4 percentage points for tax payable to the regional budget)</li> <li>• 9% or 0% is the rate on dividend income received from 1 January 2008 (currently, 9% or 15% rate applies); see section 10.1 Dividends</li> <li>• 15%, 9% or 0% is the tax rate on interest income on state securities (depending on the type of securities)</li> </ul>
Tax depreciation rates	Straight-line and reduced balance depreciation methods. The useful life of assets for tax purposes is established in the Classification of Fixed Assets approved by the Russian Government. Accelerated depreciation for leased assets. A 10% depreciation premium in the month when depreciation starts.
Withholding taxes	<ul style="list-style-type: none"> <li>• 15% on dividends and income from participation in Russian enterprises with foreign investments;</li> <li>• 10% on freight income;</li> <li>• 20% on certain other income from Russian sources, including royalties and interest</li> <li>• 20% of revenue or 24% of margin in relation to capital gain (for sale of immovable property located in Russia or shares in Russian subsidiaries where immovable property located in Russia represents more than 50% of assets). Taxation of margin (rather than the whole amount of revenue received from the above sales) can be applied only if proper documentary support of expenses is available.</li> </ul>
Personal income tax	<p><b>For residents:</b></p> <p>13% - standard rate (applied to the worldwide income of an individual)</p> <p>9% - for dividend income</p> <p>35% - for specific types of income (winnings, prizes and others)</p> <p><b>For non-residents</b></p> <p>30% - standard rate (applied to income received from Russian sources)</p> <p>15% - for dividend income (from 1 January 2008)</p>
Personal allowances (and/or credits)	<p>Main exemptions:</p> <ul style="list-style-type: none"> <li>• charity contributions</li> <li>• education expenses (from 1 January 2008, up to RUB 50,000 (approx. EUR 1,400))</li> <li>• income from sale of immovable and other property held for 3 years or more, or documented expenses</li> <li>• income from sale of immovable property and land plots held for less than 3 years in the amount of RUB 1m (approx. EUR 28,500), or documented expenses</li> <li>• income from sale of other property held for less than 3 years in the amount of RUB 125,000 (approx. EUR 3,500), or documented expenses</li> <li>• income spent on construction or purchase of premises (maximum RUB 1m - approx. EUR 28,500) and related interest payments. This deduction can be granted only once. The deduction can be carried forward up to full utilisation.</li> <li>• income from sale of securities in the amount of documented expenses or, for securities sold before 2007 and held for more than 3 years, full amount of income from sale.</li> </ul>
Tax on foreign nationals working in Russia	No special tax on foreign nationals working in Russia
Wealth tax	None
Estate and/or inheritance and/or gift tax rates	None (abolished from 1 January 2007)
Capital tax	None
Indirect taxes	<p><b>Value-added tax</b></p> <p>18% - standard rate</p> <p>10% - rate applicable to sale of some types of goods (basic food products, medicines etc.)</p> <p>0% - rate for export sales</p> <p><b>Excise</b></p> <p>Special excise rates are established for production and importation of cars, tobacco, alcohol, petrol and lubricants.</p>

## Appendix C – Useful sources of information

### Government resources

[www.kremlin.ru/](http://www.kremlin.ru/) – Official presidential site

[www.gov.ru/](http://www.gov.ru/) – Official governmental portal (Russian)

[www.duma.ru](http://www.duma.ru/) – Official site of the parliamentary lower house (Russian)

[www.council.gov.ru/eng/index.html](http://www.council.gov.ru/eng/index.html) – Official site of the parliamentary upper house

[www.cbr.ru](http://www.cbr.ru/) – Central Bank of Russia

[www.economy.gov.ru/wps/portal/english](http://www.economy.gov.ru/wps/portal/english) – Ministry of Economic Development and Trade

<http://www.rost.ru/> – National Priority Projects

### Associations and business groups

[www.amcham.ru](http://www.amcham.ru/) – The American Chamber of Commerce in Russia

[www.rbcc.com](http://www.rbcc.com) – The Russo-British Chamber of Commerce

[www.aebrus.ru/](http://www.aebrus.ru/) – The Association of European Businesses

[www.rspp.ru/](http://www.rspp.ru/) – The Russian Union of Industrialists and Entrepreneurs

<http://eng.tpprf.ru/> – The Russian Chamber of Commerce and Industry

[www.invest2russia.com](http://www.invest2russia.com); [www.b2russia.ru](http://www.b2russia.ru) – project aimed at facilitating investment exchange between Russia and global investors

### Other

[www.waytorussia.net/](http://www.waytorussia.net/) – Independent guide to Russia

[http://news.bbc.co.uk/2/hi/europe/country\\_profiles/1102275.stm](http://news.bbc.co.uk/2/hi/europe/country_profiles/1102275.stm) – BBC country profile

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