

KPMG IN RUSSIA AND THE CIS

Doing Business in Russia: Your Tax and Legal Lighthouse

2012

kpmg.ru

Tax and Legal





Contents

Foreword	5	Business and Personal Taxation	24
Introduction to Russia	6	Tax system overview	24
Country facts	6	Tax registration requirements	24
Investment climate	7	Business taxation	25
Developments in innovation and modernization of the economy	8	Profits tax	
Living and working in Russia: useful tips	9	Withholding income tax	
		Value added tax	
Starting a Business in Russia	12	Social security contributions	
Legal structures for starting business in Russia	12	Property tax	
Direct sales		Other taxes	
Distributorship contract		Special tax regimes	30
Representative office or branch		Unified imputed income tax	
Russian subsidiary		Simplified tax regime	
Foreign investment law	14	Unified agricultural tax	
Russian regions, special economic zones	15	Personal taxation	31
Other business issues	16	Personal income tax	
Licensing requirements		Other taxes payable by individuals	
Land ownership		Financial Reporting	34
Transfer pricing		Russian accounting principles	34
Company and Labor Law	18	Statutory reporting requirements	36
Company law	18	Audit requirements	37
Labour law	20	Appendixes	38
Labour regulations		Chart of withholding tax rates	38
Employment conditions		Fines for tax and customs violations	42
Work permits for foreign nationals		KPMG's Tax & Legal: cutting through complexity	44
		Glossary of Terms	45



Foreword

Dear Reader,

This brochure has been prepared to provide a brief economic overview of Russia as well as to introduce the tax and legal issues that are important for those who are planning to do business in Russia. In particular, there is a brief discussion of the benefits of investing in the separate economic zones, including Skolkovo, the new “Russian Silicon Valley” near Moscow. Russian tax and civil legislation is constantly developing and there is sometimes no clear answer to what might be considered a simple question. Therefore, court cases and practice are important sources for interpreting legislation. All information is current as of January 2012. This brochure is not intended to provide tax or legal advice for any specific person or situation. Readers are strongly advised to seek professional assistance from advisors with experience in Russia.

About KPMG

KPMG is a global network of professional firms providing audit, tax and advisory services. We have 145,000 outstanding professionals working together to deliver value in 152 countries worldwide. We have been working for more than 20 years in Russia and have more than 3,500 professionals working at 18 offices in 7 CIS countries.



Introduction to Russia

Country facts

Country snapshot

Capital:	Moscow
Area:	17,075,400 sq km
Population (2011):	143 million
Cities over 1 mln:	12
President:	Dmitry Medvedev
Prime-minister:	Vladimir Putin
Currency:	Ruble (RUB)
Nominal GDP (2011):	USD1.83 trillion
Real GDP growth (2010):	+ 4,3 percent
GDP per capita (2010):	USD10,352
Number of regions	83
FDI (2010):	USD13.8 billion
Inflation (2011):	6.16 percent
Foreign Reserves (2011):	USD498.649 billion

- The GDP in 2011 grew by 4.3 percent to USD1.83 trillion
- Industrial output in 2011 was up 4.7 percent year-on-year (YoY).
- Unemployment rose to 6.1 percent in December 2011.



Investment climate

In recent years consumer activity in Russia has contributed to dynamic growth in retail, telecommunications and real estate development. Incomes are rising and consumer lending and mortgages are becoming more widespread. In 1999-2008 Russia experienced continuous, rapid economic expansion, with GDP growing approximately 7 percent annually. In 2008-2009 the global economic crisis hit the Russian economy, but the government's anti-crisis measures proved rather effective, and Russia emerged from the recession in 2009. Moreover, Russian First Deputy Prime Minister Igor Shuvalov voiced the hope that Russia's economy will completely recover from the global economic downturn by 2012, when the GDP growth rate is expected to reach pre-crisis levels¹. In 2009-2010 Russia's per capita GDP (USD11,110) was the highest among BRIC countries.

Russia is a geographically vast market, stretching over nine time zones. There are significant geographical disparities in the wealth distribution. Undeveloped infrastructure causes logistical challenges, especially outside of major cities. Conducting business may be impeded by burdensome regulatory regimes, inadequate intellectual property rights, inconsistent application of laws and regulations, lack of transparency, excessive government interference in business matters and other market access barriers, such as protectionism. The global economic crisis inhibited access to credit, but effective government measures have mitigated this issue. The Russian immigration and visa system is complex, requiring time and expertise for business travelers to obtain the necessary permissions.

Russia is the world's largest country in terms of territory, with a consumer market of over 140 million people, vast natural resources, a highly educated workforce and technologically advanced research and production capabilities.

The Russian Federation consists of 83 constituent entities (46 oblasts (regions), 21 republics, nine krais (territories), four autonomous districts, one autonomous oblast and two federal cities (Moscow and St. Petersburg)). Formally, all of them have equal status. Regions (oblasts) and territories (krais) are areas in which the ethnic Russian population is the majority. Republics are ethnically based and have a slightly higher status, which, for example, allows them to have their own constitutions. Autonomous districts and the autonomous oblast are also theoretically ethnically based, but in reality the ethnic Russian population is the majority there.

In the early 1990s, the federal center was weak and in an attempt to keep the country together, the federal government and the regions reached a compromise in the form of bilateral power-sharing agreements. When Vladimir Putin was elected president in 2000, he started to strengthen the central government vis-a-vis the regions and introduced seven federal districts (Central, North-West, Southern, Volga, Ural, Siberia and Far Eastern). The federal government also began unifying the regional political structures and legislation. Since the mid-1990s the local population elected almost all regional governors, but in 2004, legislation was changed. Since then regional legislatures have appointed governors, who are recommended by the President of Russia.

Since Russia's regions have diverse income levels and industrial structures, even partial equalization of public goods provision across regions requires transfers from the rich (donor) regions to the poor ones. The principal rich regions are Moscow and a few natural resource rich regions in Siberia. Most of the southern and western regions, with the exception of St Petersburg and Leningrad oblast, are recipients of federal transfers.

The Russian regions have at their disposal a variety of measures for improving the regions' attractiveness to foreign investors, including:

- establishing an organisational structure for cooperation with foreign investors;
- providing financial and tax incentives;
- modernising and developing infrastructure;
- making use of public-private partnerships (PPPs).

The leading Russian rating agency Expert RA has been rating the investment climate in Russia's regions since the late 1990s according to their investment potential and risk. In 2009-10 the ten regions with the most potential, according to Expert RA, were Moscow, St Petersburg, Moscow oblast, Sverdlovsk oblast, Krasnodar krai, Khanty-Mansiysk autonomous district, Tatarstan republic, Krasnoyarsk krai, Perm krai and Nizhny Novgorod oblast. The regions with least risk were Lipetsk oblast, Rostov oblast, Voronezh oblast, St Petersburg, Tambov oblast, Krasnodar krai, Penza oblast, Stavropol krai, Kaluga oblast and Volgograd oblast.

Our study of regional foreign investment activity highlighted the fact that foreign direct investment (FDI) into Russia is highly concentrated: Moscow, St. Petersburg, Sakhalin and Arkhangelsk attract significant funds while 37 regions attracted less than USD100 million of FDI during 2006-2010.

¹ Igor Shuvalov's interview on "Vesti on Saturday", 22.01.2011, www.vesti.ru/doc.html?id=422457.



Our study demonstrated that there are only a few regions in Russia that have an ultra-high level of FDI:

- Moscow, St. Petersburg and the surrounding regions attracted FDI due to the high concentration of business activities and the size of local markets.
- Sakhalin and Arkhangelsk oblasts were highly attractive to FDI directed into the oil & gas sector.
- The only example where a favourable business environment was created expressly for foreign investors was Kaluga oblast, which attracted USD1.3 billion during 2006-2009.

In the first nine months of 2010 the regions leading in attracting foreign direct investments were Moscow, Kaluga oblast, Sakhalin oblast, Nenets autonomous district and Vladimir oblast. The leading position of Sakhalin oblast and Nenets autonomous district were due to major oil and gas projects while Kaluga oblast and Vladimir oblast were remarkably effective in creating favorable conditions for investors in manufacturing projects. In particular, in Kaluga oblast a special regional development agency was established more than five years ago and six “industrial parks” have been established in the region. Volvo, Volkswagen, Peugeot Citroen and Mitsubishi Motors, all automotive manufacturers, initiated car and truck assembly projects in these “industrial parks”. Pharmaceutical companies, like Berlin-Chemie and Novo Nordisk, have also invested in the region. In Vladimir oblast, due to tax concessions and the development of specialized industrial zones, foreign investors (Dow Chemical, Kraft Foods and others) have also initiated a number of manufacturing projects.

Data for the 1st half of 2011 shows that 81 percent of foreign investment was concentrated in only 5 regions.

Governors of most regions appear highly committed to increasing FDI and demonstrate a proactive and supportive approach to cooperating with foreign investors. However, at the lower level of regional government the support for FDI is notably less, and, without micro-management from the top, the governors’ good intentions are not realized.

Our 2010 study “Increasing FDI in the Russian regions” and the 2012 update are available at our web site www.kpmg.ru.

Russia’s regions have diverse income levels and industrial structures; therefore, attitudes towards foreign investments vary significantly across the country.

Developments in innovation and modernization of the economy

Over the past few years Russia has made significant strides on the path of innovation-based development. The Russian president and government have indicated their support and are allocating substantial budget funds for these goals.

Russia is striving to progressively develop and overcome the failings of the 1990s, to compete globally and at the same time to take advantage of international best practices.

An opportunity beckons. ***The Russian President has already declared that Russia's goal is to gradually change from an oil-oriented economy to a technology-oriented one.***

To reach this goal, Russia will increase the hi-technology sector's input into GDP, increase the proportion of innovative products out of total production output, enlarge R&D spending and promote commercialization of Russian innovative products. Many are skeptic about Russia's chances for success; however, the goal is set.

Currently the Russian business community is actively involved in discussing Russia's innovation strategy which is set up to 2020 and is considered as a basis for consistent state policy, at the very least, in the following areas: nurture, support and stimulation of the talent pool; protection of intellectual property; establishment and support of the required infrastructure; improvement in the legislative framework; reduction in administrative (tax/customs) barriers; provision of tax incentives; creation of the prerequisites and demand for innovative products.

Russia has already managed to adapt and implement a number of measures to support the development of an innovative economy. A number of state controlled institutions already exist, which invest in 'innovative' companies. For example, the Russian Corporation of Nanotechnologies supports projects in the nanotechnologies field, and Russian Venture Corporation allocates funds to support venture based projects.

Furthermore, Russia provides an extensive list of tax concessions for companies with a high degree of intellectual capital (for example, reduction of IT companies' social contributions from 30 percent to 14 percent until the year 2017 inclusive; introduction of intangible assets amortization for over 2 years instead of 10 years; adoption of a 0 percent profits tax rate for income received from disposal of shares in Russian hi-tech companies if certain conditions are met; development of legislation aimed at improving accounting of R&D expenses for profits tax purposes). Moreover, significant tax and customs concessions are granted to residents of the special economic zones aimed at innovation and technological development, namely decreases in major taxes (profits tax/social contributions) up to full exemptions (property tax, land tax and transportation tax).

Some of the measures, for example, the framework for participants of the Russian flagship Skolkovo project, are unique in international practice. In general, the purpose of the Skolkovo project is to create favorable conditions (at all stages of innovative project development including commercialization of the results) with all the infrastructure needed to concentrate intellectual capital and generate innovative solutions for priority industries – nuclear technologies, energy efficiency, airspace technology, IT and pharmaceutical. Regarding taxes, legislation stipulates exemptions for the Skolkovo residents from VAT, profits tax and property tax and a reduction in the rate of social contributions down to 14 percent for a period of up to 10 years. Furthermore, the regime stipulates a reimbursement of customs duties paid for imported qualifying equipment if certain conditions are met as well as simplified procedures for attracting foreign labor.

It is announced that basic infrastructure in Skolkovo will be completed soon, although currently companies that want to become project participants can be physically located elsewhere while enjoying all of the project's benefits including tax and customs concessions. According to current legislation companies can apply this privilege up to the year 2014.

Recognized global leaders in hi-technology like Intel, Nokia, Cisco, Microsoft, Siemens and Boeing already signed memorandums of understanding with Skolkovo Foundation (project's managing body). Some of them announced that significant investments will be made into the Skolkovo projects (billions of US dollars).

If the Skolkovo project is successfully combined with the introduction of other state supported measures to encourage innovations, Russia should have an opportunity to take its place among countries with a developed, innovation-based economy. The key issue now is to make the most of this opportunity in a competent and professional manner, so that everyone, including Russian citizens and foreign partners, believe in the success of the innovations concept and actively participate in the implementation of 'innovation-based' plans.

Living and working in Russia: Useful tips

Learn Russian. It is not only useful for everyday communications (many street vendors, waiters and shop assistants do not speak English) but also for business. Even if you conduct your meetings using English or an interpreter, it can be useful to know how you are being translated and to understand what is left un-translated.

Develop personal relationships. They are quite important in Russian business (and in your social life as well). Rewards do not always come in cash (and there is a law against bribing in Russia), but it always pays to be a nice, reliable guy.

Personal safety is not a problem. Moscow is as safe as or safer in terms of street violence than other major Western cities; although walking around the suburbs late in the evening or on days when there are football matches is not recommended.

Beware of traffic. Expats should select drivers for themselves and their children carefully and make sure they are competent and extremely patient; expats who drive or walk should be especially cautious because cars can make illegal and unexpected maneuvers at any time.

Qualified medical services are available. While there are many qualified doctors in Russia, expats often prefer doctors who speak English or their native language. There are several western medical clinics in Moscow and St. Petersburg that have many foreign, foreign-trained and/or foreign language-speaking doctors.

Good food. There are a lot of quality restaurants in Moscow and St. Petersburg (and elsewhere).

There can be some ethnic intolerance. It should be noted that there continue to be reported incidences of racist behavior in Russia. Those who do not look like native Russians should take special care (not be alone) in certain situations, including while using public transportation.

If you are coming to stay:

- An exemption from customs duties is available for bringing household goods into Russia within certain limits stated in the agreements of the Customs Union.
- Qualified (probably even English-speaking) household help can be found easily through the other expats.

- There are English, German, French, Japanese and other foreign language schools catering to expat children in Moscow and St. Petersburg (as well as some other cities), although there may be a less diverse choice of schools and curricula than in your home country.

Routine issues:

- As an expat (except those with a 'highly qualified' visa status), you must register and unregister each time you travel abroad or outside of your place of residence in Russia.
- To pay some bills, you must physically go to a certain bank and pay cash; however, cash machines are readily available.
- Registering your car can take 1-2 days of your or, hopefully, your driver's time (but your driver can only register your car for you if you have spent the time and money to grant the driver a power of attorney over your car. The power of attorney must be updated 2-3 times annually).

While the above does not cover all of the aspects of living in Russia, it is enough to suggest that expats can and do live safely, successfully and happily in Russia, even for long periods.





Starting a Business in Russia

Legal structures for starting a business in Russia

Investors often face problems when choosing between legal structures for their business in Russia. Below we comment on the following options:

- direct sales;
- distributorship contract;
- representative office or branch;
- Russian subsidiary

Direct sales

A foreign legal entity (FLE) that sells goods to customers located in the Customs Union (in particular, in Russia) directly from abroad would not be subject to Russian taxes and not required to establish a presence in Russia via any corporate structures. Russian customers would be responsible for clearing imported goods through customs and paying customs duties and taxes (import VAT, excise) as well as customs processing fees.

Import duty rates are established in the Unified Customs Tariff (UCT) of the Customs Union of Russia, Belarus and Kazakhstan. Generally, these import duty rates vary from 5 percent to 20 percent and apply to goods imported from countries that enjoy most favored nation status with Russia. If goods are imported from developing countries with most favored nation status, customs rates may be reduced. If goods are imported from a country that does not have most favored nation status, customs duties are imposed at twice the normal rate. Import VAT is payable on imported goods' customs value, which is increased by the import customs duty.

Technological equipment that is not manufactured in Russia can be exempted from import VAT upon import into Russia. Technological equipment imported into the Customs Union may be exempted from import customs duties provided certain requirements are met.

Generally, some goods imported into the Customs Union are subject to non-tariff regulations (e.g. certification, licensing, quotation, etc.). Currently,

legislation on non-tariff regulations is under development both in the Customs Union and Russia.

Customs duty rates for customs clearance are established depending on the cost of services rendered by the customs authorities but cannot exceed RUB100,000 (USD3,125).

Effective 1 January 2012 Belarus, Kazakhstan, and Russia form a single economic zone. Now, these countries' economies are more tightly integrated than under the Customs Union, and freedom of movement of goods, services, capital, labor, and equal treatment of legal entities is ensured.

On 16 December 2011 WTO ministers adopted Russia's WTO terms of entry at the 8th Ministerial Conference in Geneva. Russia will have to ratify the agreement within the next 220 days. Within 30 days of notifying the WTO of ratification, Russia will become a fully-fledged WTO member. As part of joining the WTO, Russia is obligated to decrease import duties on a wide range of goods.

Distributorship contract

An FLE may conclude a distributorship contract with a Russian company to sell goods in Russia. In this case the foreign legal entity would not be taxed in Russia. The Russian distributor would be responsible for clearing imported goods through customs and paying customs duties and import VAT. Distributorship contracts are seen as "vertical agreements" from an antitrust law perspective and must comply with antitrust regulations.

Representative office or branch

An FLE may choose to establish a presence in Russia through a representative office (RO) or branch. An RO or a branch is not a Russian legal entity but is a legal part of the FLE, and, therefore, the head office bears full responsibility for the obligations and actions of the

RO or branch. An RO is authorized to conduct certain "preparatory and auxiliary" activities for the head office. A branch, on the other hand, is able to conduct all activities that the head office itself could perform, including the execution of sales contracts. However, the Russian customs authorities often try to identify the ultimate Russian buyers of the imported goods and question the right of the branches of foreign legal entities to declare goods for customs clearance; therefore, it may be difficult for a Russian branch to clear goods through customs.

An appropriate state authority must accredit FLEs' ROs and branches; typically the State Chamber of Registration is the appropriate authority. However, the appropriate authority will depend on the FLE's activities – the Central Bank of the Russian Federation accredits foreign banks' representative offices, and the Federal Aviation Service accredits foreign aviation companies' representative offices. The maximum period of accreditation for an RO is three years and for a branch - five years. The accreditation period may be extended. Once accreditation is obtained, an RO or branch should register with other state bodies – the Federal State Statistics Services, the tax authorities and state non-budgetary funds. Setting up an RO or branch takes approximately 3-6 weeks after all necessary documents have been submitted to the registration authorities. The accreditation process requires the preparation, approval, and, in many cases, notarization and apostillation (legalization) of a large amount of documentation. The total time required may exceed the registration period stipulated by law.

An RO is authorized to conduct certain "preparatory and auxiliary" activities for its head office. A branch, on the other hand, is able to conduct all activities that the head office itself could perform, including the execution of sales contracts. Depending on the exact scope and nature of activities, both ROs and branches may create a taxable presence in Russia for their headquarter company.

Russian subsidiary

An FLE may choose to establish a presence in Russia through a Russian subsidiary. The most common business structures in Russia are Limited Liability Companies (LLC) and Joint Stock Companies (JSC). In an LLC (Russian abbreviation – OOO) the participation units attributable to shareholders (participants) are not considered securities under Russian securities legislation. Shares in a JSC are considered to be securities and are subject to registration with the Federal Financial Markets Services. A JSC may be either ‘open’ (OJSC), meaning publicly held (Russian abbreviation – OAO), or ‘closed’ (CJSC), meaning privately held (Russian abbreviation – ZAO).

Foreign companies often use LLCs to conduct wholly-owned businesses in Russia. The LLC law provides for many similar provisions to those in the JSC Law. However, there are certain distinctions.

Generally, one participant (individual or legal entity), may establish an LLC or JSC. However, another solely owned legal entity cannot establish an LLC or JSC as a one-man company (i.e. 100 percent owned).

Joint stock companies

A JSC is a legal entity that issues shares to generate capital for its activities. A shareholder is not generally liable for the JSC’s obligations, and a shareholder’s losses are limited to the value of their shares.

Different classes of shares are permitted; dividends and voting rights are equal for each share in a class.

Both forms of joint stock companies, OAO (OJSC) and ZAO (CJSC), may issue common or preferred shares and bonds. Both forms are subject to statutory reporting requirements and regulatory restrictions, but the requirements for public disclosure are less rigorous for CJSCs.

Recent changes to Russian corporate law allow for shareholder agreements in which participants may, among other things, determine voting obligations at general shareholder meetings, coordinate voting options with other

shareholders, determine the price at which shares can be sold and coordinate other actions related to the JSC’s management, activities, reorganization and liquidation.

The governing bodies of JSCs are the general shareholders meeting, board of directors and the executive body (sole or collegial).

The executive body manages the JSC’s day-to-day affairs and reports to the general shareholders meeting.

The shareholders meeting, upon proposal from the board of directors or at its own discretion, may delegate the powers of the executive body to an external commercial company or to an individual manager.

Limited liability company

The LLC law’s provisions are similar to those in the JSC Law.

LLC participants are not liable for the LLC’s obligations, and participants’ losses are limited by the value of their respective participation units.

LLC charters may restrict the transfer of participation units to third parties by LLC participants. If such restriction is stipulated, a participant may withdraw from an LLC at any time and require that the LLC (or remaining participants) provide a portion of the LLC’s net assets. The provided portion would be proportionate to the participant’s participation unit.

A participant, with the exception of a sole participant, may also withdraw upon its own request if this option is provided for in the charter.

LLC charters may limit the transfer of participation units or require obtaining other participants’ approvals for transferring units.

Economic partnership

A recently passed law introduces a new legal form for commercial legal entities — economic partnerships². This legal form is designed for companies involved in innovative activities (including providing venture capital).

The constitutive document of an economic partnership is the Articles of Association.

A partnership can be created by two or more persons (both individuals and legal entities can participate in a partnership).

An economic partnership is governed in accordance with a special partnership management agreement concluded by the partners. This agreement is certified and kept by the notary. The maximum number of participants in an economic partnership is 50 persons. If the number of participants in an economic partnership exceeds 50, it must be re-organized as a JSC within a year.

Share capital of the economic partnership is divided into shares. Contributions to share capital may be made in money, securities, property rights or other rights with a monetary value.

The partners have the right to participate in managing the partnership and in allocation of profits and expenses. The allocation of profits and expenses can be disproportionate to number of shares owned.

All shareholders by unanimous decision elect the governing bodies of the economic partnership. The partnership must maintain a register of participants, indicating the size of their stakes in the partnership capital and the stakes that belong to the partnership.

If the economic partnership is technically insolvent and the intellectual property owned by it may be seized and sold, some or all of the partnership’s participants can fulfill its obligations.

Taking into consideration that the new law is effective 1 July 2012, there is currently no practice related to establishing (including registering) economic partnerships in Russia. Therefore, certain practical aspects of commercial activities and managing economic partnerships are unclear. Thus, it could be advisable to establish a Russian subsidiary in one of the more common legal forms — LLC or JSC.

The most common forms of corporate structure in Russia are Limited Liability Companies (LLC) and Joint Stock Companies (JSC). Foreign companies often use LLCs for their wholly-owned businesses in Russia.

¹ Federal Law N 380-FZ “On economic partnerships” of 3 December 2011, effective from 1 July 2012.

Foreign investment law

Foreign investors are guaranteed certain property rights to their investments in the Russian Federation and to profits earned in Russia.

Foreign investments are regulated both on a federal and regional level. According to the federal law on foreign investments, the rights of foreign investors to conduct business activities in Russia and their rights to dispose of profits gained in Russia cannot be less favorable than national investors'. Certain limitations can be placed on foreign investors but only if these limitations are required for to protect constitutional guarantees; the health, rights and lawful interests of citizens; or state defense and security measures.

Foreign investors are generally subject to the same treatment as Russian investors. Restrictions on business activities – licensing, notifications and permission requirements – apply to both Russian and foreign legal entities.

Foreign investors are guaranteed the full and unconditional protection of their rights and interests. A foreign investor is entitled to recover losses caused by an unlawful action or omission by the federal or regional state authorities in accordance with Russian civil legislation.

The property of a foreign investor or company with foreign participation cannot be seized by way of nationalization or requisition except in cases stipulated by Russian federal laws or international laws.

In case of requisition, the worth of the seized property must be reimbursed to the foreign investor or company with foreign participation. In case of nationalization, the worth of the nationalized property and incurred losses must be reimbursed.

The law also offers foreign investors protection from unfavorable changes in Russian legislation if the foreign investor holds more than 25 percent of a Russian company's share capital. The law also offers foreign investors engaged in a priority investment project protection regardless of the foreign investor's stake in the project's share capital. Foreign investors are protected against:

- newly adopted laws altering customs duties, federal tax rates and contributions to state non-budgetary funds (subject to certain restrictions);
- amendments to current laws resulting in an increase of the investor's tax burden;
- any introduced bans and limitations on foreign investments in Russia.

Foreign investors have this protection during the first seven years of an investment project's pay-back period, starting from the date that the foreign investor began funding the project.

Russian legislation limits the activities of non-Russian investors participating in companies that are of strategic value to Russia ('strategic companies') that carry out certain activities, including:

- exploration of subsoil and extraction of mineral resources on land plots of federal significance;
- aerospace activities;
- certain services provided by a natural monopoly or a company with a dominant position on the Russian market;

- harvest of live aquatic resources;
- activities controlling hydro-meteorological and geothermal processes and events;
- certain activities related to the use of nuclear and radiation-emitting materials;
- certain activities related to the use of encrypting facilities and bugging equipment;
- military-technical activities.

Thus, non-Russian state companies are prohibited from performing transactions that would allow them to control strategic companies (e.g., from purchasing more than 50 percent of the voting shares (participation units) of a strategic company, participating in the regulatory body of a strategic company, etc.).

Non-Russian state companies may perform some transactions after obtaining approval from state authorities (i.e. purchase of more than 5 percent of voting shares (participation units) of a strategic company (different thresholds are set for different types of strategic companies)).

Other non-Russian investors (non-Russian private companies; non-Russian individuals; or Russian companies controlled by non-Russian companies or individual(s)) are permitted to carry out transactions that would result in their obtaining control over a strategic company. However, such transactions, among others, must be approved by the state authorities.

Russian legislation limits the ability of non-Russian investors to participate in companies that are of strategic value to Russia.

Russian regions and special economic zones

Most Russian regions have adopted regulations that establish tax concessions for investors. Currently, the majority of investment tax concessions relate to profits tax and property tax. Investment tax concessions are normally granted for a period not exceeding the investment project payback period, and the amount of the tax saving gained cannot exceed the amount of initial investment under the project. Regional authorities can establish additional conditions for granting concessions (employing individuals residing in the region, developing infrastructure, etc.).

A Special Economic Zone (SEZ) is a limited state territory where business is carried out under a special regime that grants certain tax, customs and other concessions to its residents. SEZ residents are legal entities or individual entrepreneurs operating on the SEZ territory. They have concluded an agreement on carrying out activities within the SEZ and are registered with the SEZ's authorities.

The establishment and operation of SEZs in the Russian Federation is regulated by an agreement concluded between the governments of Russia, Belarus and Kazakhstan³, by Federal Law № 116-FZ⁴ and by federal laws regulating particular SEZs.

Issues related to the establishment, operation and abolishment of the free economic zones are referred to in the national legislation, i.e. law № 116-FZ, that provides for four types of SEZs:

- technological implementation SEZ;
- industrial and development SEZ;
- tourist and recreational SEZ;
- port SEZ.

SEZs are established for 20 years, except for port SEZs, which are established for 9 years.

According to law № 116-FZ, a resident of an SEZ may only engage in activities prescribed for the respective type of SEZ. Law № 116-FZ contains an exhaustive list of the types of activities that may be carried out in each type of SEZ.

Apart from the above SEZs, there are complex SEZs in the Kaliningrad region (effective until 2031) and the Magadan region (effective until 2014). In these SEZs residents, due to a special legal regime, may conduct various types of activities.

Currently 27 SEZs operate in the Russian Federation. Three more SEZs are under development.

To obtain resident status, applicants should comply with the requirements of the desired SEZ.

The main requirements for candidates to obtain SEZ status are the following:

- The candidate should be registered on the specified territory.
- The business plan and the investment project should provide for a certain volume of investment to be made within a specified period (actual investments are not necessary on the date of the application's submission).
- The candidate is prohibited from registering branches or representative offices outside of the SEZ unless the SEZ is in the Kaliningrad or Magadan regions. However, even in these regions, the candidate's main activities must be performed on the territory of the SEZ.

Current legislation contains neither restrictions regarding the business reputation or credit history of the applicants nor limitations on sources of capital (i.e. companies with both Russian and foreign capital may become SEZ residents).

Residents of all SEZs established in the Russian Federation enjoy customs incentives based on a free customs zone customs procedure. Application for this procedure is regulated by the Customs Union agreement on SEZs and provides that goods imported into the SEZ are exempt from import customs duties and import VAT provided certain requirements are met.

SEZ residents could also enjoy the following tax concessions:

- profits tax rate reduction and favorable treatment of certain expenses for profits tax purposes;
- property tax and land tax exemptions during the concession period.

Law № 116-FZ contains a 'grandfather clause' under which the state guarantees that should tax legislation be amended so that it would have a negative effect on taxpayers' positions, such amendments will not be applied to residents of SEZs established in accordance with law № 116-FZ. Generally, this guarantee is granted during the effective period of the Customs Union agreement on SEZs.

Most Russian regions have adopted regulations establishing tax concessions for certain investment activities.

³ "On issues related to free (special) economic zones on the customs territory of the Customs Union and the customs procedure on the free customs zone" of 18 June 2010

⁴ Federal Law № 116-FZ "On special economic zones in the Russian Federation" of 22 July 2005

Other business issues

Licensing requirements

Certain types of business activities can only be carried out in Russia with a special license issued by authorized licensing bodies. Among others, the following activities are subject to licensing:

- surveying;
- pharmaceutical activities and production of medicines;
- development, production, repair, sale and trade of weapons and military equipment;
- overseas and inland waterway passenger and freight transportation;
- use of highly explosive and hazardous objects for production;
- production, storage, usage and distribution of explosive materials for an industrial assignment;
- activities related to the exchange of narcotic and psychoactive drugs.

Licensing is carried out on a federal and regional level.

To obtain a license, an application must be submitted to the licensing authorities.

The licensing requirements for most activities are similar.

The decision to grant or deny a license is generally made within forty-five days after the authorities receive the application and all accompanying documents. Regulations on the licensing of certain activities may stipulate shorter processing periods.

A license's terms of validity depends on the licensed activity but, in general, may not be less than five years.

Licenses are issued separately for each type of activity. It is prohibited to transfer a license to another legal entity or individual. A license becomes invalid when an organization is liquidated or terminates activities as a result of reorganization (unless it is reorganized via transformation) and when a sole proprietor's state registration certificate expires.

In accordance with the procedure established by the Administrative Code of the Russian Federation, authorized licensing bodies are entitled to suspend a license if the licensee is violating the licensing requirements and conditions. If a regulated activity is undertaken without the appropriate license, the competent government agency may request the court's permission to liquidate the company and confiscate all income derived from the unlicensed activity.

Performing a regulated activity without the appropriate license may cause significant penalties and other consequences. The penalties and consequences depend on specific circumstances.

For certain business activities, instead of receiving a license, companies are required to be members in professional self-regulated organizations that set their own membership criteria (e.g. applies to engineering, construction, and valuation services).

Certain types of business activities can be conducted only on the basis of a special license issued by an authorized licensing agency.

Land ownership

Pursuant to the Russian Federation's constitution, land and other natural resources may be owned privately. They can also be owned by state or municipal authorities or held under other ownership conditions.

Through legislation adopted at the regional level, the Russian Land Code regulates the purchase of land. In practice, it is still rather difficult to acquire land in Russia from state or municipal authorities. Owners of buildings, however, according to federal law have the exclusive right to purchase or the rent land plots underlying and surrounding their buildings.



Typically, land is available under lease (sometimes with a right of first refusal to purchase) for a maximum term of 49 years. Renting or acquiring state property (apart from execution of the abovementioned exclusive right) may require winning a tender/auction. If property is rented or obtained through other means, the transaction could be invalidated. Certain other restrictions also apply to owning land, e.g. foreign individuals or legal entities may not own land adjacent to a border.

Special laws regulate transactions involving farm land and relevant limitations. According to these laws, foreign individuals, legal entities and stateless persons, as well as Russian legal entities in which more than 50 percent of the share capital is owned by foreign individuals, legal entities or stateless persons can only lease (not own) farm land.

In practice, it is still rather difficult to acquire land in Russia. Both federal and local regulations should be considered.

Transfer pricing

A transfer price should be viewed as a price that is subject to monitoring by the tax authorities. The tax authorities monitor prices to ensure that they are established for commercial purposes and not for to reduce the tax burden.

On 18 July 2011 the President of Russia signed a law on transfer pricing. This law comes into force on 1 January 2012. Substantial changes were made to Russia's transfer pricing rules:

- The list of legal entities that are considered related parties is considerably extended.
- Prices will no longer be permitted to deviate up to 20 percent from market prices. Thus, it is becomes more difficult to conduct tax planning. Instead, the concept of an arm's length range will be introduced.
- The transactions that could be subject to transfer pricing control (controlled transactions) are more clearly specified.

Russian transfer pricing legislation is now more detailed and developed. As a result, the tax authorities could be more successful in challenging transfer prices in court.

Thus, in accordance with the law, the following transactions should be subject to transfer pricing regulation:

- Transactions between related parties where:
 - cross-border transactions occur;
 - the amount of income and expenses under the transaction exceeds RUB1 billion (USD31.25 million) (in 2012 – RUB3 billion (USD93.75 million), in 2013 – RUB2 billion (USD62.5 million) unless this transaction is between companies registered in the same region of the Russian Federation, provided that these companies (a) do not pay CIT in another region of the Russian Federation, (b) do not have tax losses and (c) do not have separate divisions in other Russian regions or outside the Russian Federation;
 - one of the parties to the transaction is a taxpayer using the unified tax on imputed income system, or unified agricultural tax system, or is a resident of the innovation center Skolkovo and applies a 0 percent CIT rate provided that the amount of income and expenses under the transaction exceeds RUB60 million (USD1.875 million);
 - one of the parties to the transaction is a resident of a SEZ in Russia provided that the amount of income and expenses under the transaction exceeds RUB100 million (USD3.125 million);
 - one of the parties is subject to the mineral extraction tax (with a rate stipulated as a percentage) provided that the amount of income and expenses under the transaction exceeds RUB60 million (USD1.875 million).

- Cross-border transactions involving oil and oil products, ferrous and non-ferrous metals, precious metals and precious stones (i.e. goods traded on international stock exchanges) if proceeds from transactions with the same counterparty exceed RUB60 million (USD1.875 million) for one calendar year.

- Transactions where one of the parties is a tax resident in a country included in the Russian Federation Ministry of Finance's blacklist) if proceeds from transaction with the same counterparty exceed RUB60 million (USD1.875 million) in one calendar year.

Taxpayers are required to keep transfer pricing documentation as evidence that the prices used are within an arm's length price range. Keeping transfer pricing documentation and submitting information about controlled transactions to the tax authorities are required for all controlled transactions.

If transactions that are subject to control take place in 2012, the taxpayer will be obligated to:

- notify the tax authorities of controlled transactions carried out within the calendar year – before 20 May 2013;
- prepare documentation justifying the market level of the prices in the controlled transactions – before 1 June 2013.

For taxpayers who qualify for major taxpayer status (in accordance with the criteria stipulated by the tax code), the new law introduces the possibility of concluding advance pricing agreements with the tax authorities (i.e. the taxpayers and the tax authorities agree in advance to apply a specific methodology to calculate the arm's length price range).

Substantial changes were made to Russia's rules governing transfer pricing.

Company and Labor Law

Company law

Parent liabilities

In general, a shareholder's liability is limited to the amount of capital that the shareholder invested in the company, including unpaid amounts. However, in the event of bankruptcy, a company's creditors may hold the 'parent' liable if the parent's actions caused the company's insolvency.

A 'parent' is broadly defined, and its definition includes control not only by ownership but by contractual or other relationships that allow a person, including a parent, to make a company's decisions.

Registration

Registration of a legal entity takes at least 3-5 weeks, including 1-2 weeks for application processing by the registration (tax) authorities. Registration of a JSC requires 4 additional weeks for registration of issued shares with the Federal Financial Markets Services. Foreign investors will be required to have certain documents legalized, translated or notarized, which can significantly lengthen the registration period.

'Express' company creation services are advertised, but caution is advised in using such services. Companies are often registered without having performed all of the necessary steps. These missing steps often become apparent only when a change to the

constituent documents is required, and the change is rejected by the tax authorities due to an earlier failure in the registration process. Resolving such issues can be more time consuming and costly than standard company registration.

'Off the shelf' companies are available, although it is inadvisable to purchase one. There are inherent risks, including potential liabilities (e.g. tax liabilities) involved in acquiring a company that may have been used for undisclosed purposes. Furthermore, in some cases, the change in ownership of a company, involving more than 25 percent of voting shares in a JSC and 1/3 of participation interests in an LLC requires prior approval from the Federal Antimonopoly Service. In all cases, a change in ownership must be registered, which can take as long as forming a new company.

Number of shareholders or participants

Generally, one participant (individual or legal entity) may establish LLCs and JSCs. However, LLCs and JSCs cannot be established by another solely-owned legal entity.

The maximum number of participants in an LLC or CJSC is limited to 50 persons. If the number of participants in an LLC exceeds 50, the LLC must be reorganized as an OJSC or a producing cooperative within one year. A CJSC with over 50 shareholders must be reorganized as an OJSC.

Minimum capital and contributions

For an OJSC, the statutory minimum charter capital is RUB100,000 (USD3,125) and RUB10,000 (USD312.50) for a CJSC.

The minimum charter capital for an LLC is RUB10,000 (USD312.5).

Payment of capital

For an LLC, 50 percent of the charter capital must be paid by the date of its state registration, and the balance must be paid in full within a year after completing state registration.

For a JSC, 50 percent of the charter capital must be paid within three months of state registration, and the balance must be paid in full within a year after completing state registration.

Charter capital contributions can be made in monetary form or in-kind. In-kind contributions require an independent appraisal.

Bank accounts

Ruble and foreign currency accounts can be opened after registration. Prior to registration a so-called 'accumulative' account is opened to hold the charter capital for establishing an LLC. Certain government requirements and bank requirements must be met.

Establishment costs (LLC, CJSC)

A shareholder (participant) of an LLC or JSC will pay a state registration duty of RUB4,000 (USD125). In addition there are fees for translating and notarizing documents. Professional fees for document collection, the preparation of the organization's documents and document submission range from EUR10,000 to EUR16,000.

Net assets position

Information on a JSC's net assets position is submitted to the authorities and recorded in the Unified State Register of Legal Entities.



If an LLC's or JSC's net assets on its balance-sheet fall below its share capital as of the end of the FY (except for the first 2 years), a reduction in stated capital to net asset value is required.

If, for two consecutive years, an LLC or JSC has net assets worth less than the minimum charter capital required by law, the company is subject to liquidation. In the event that voluntary liquidation is not undertaken by the shareholders or participants, government authorities may petition a court for liquidation, and creditors may demand early termination or the fulfillment of obligations and compensation for losses. In practice, forced liquidation is rare if a company fulfills its obligations (including taxes).

If, for two consecutive years, an LLC or JSC has net assets less than the minimum charter capital required by law, the company is subject to liquidation. Practically speaking, a low/negative net asset position can be cured through capital injection in the form of gratuitous financing or contributed assets (available only for an LLC). An increase in charter capital (even with a premium) is generally prohibited in such a situation except for a debt to equity conversion.

Debt to equity conversion

In Russian corporate law, conversion of debt into equity is a new option that is available to both LLCs and JSCs excluding credit organizations (banks).

An LLC's debt can be converted into equity in two cases. In the first, an LLC owes debt to a participant. The participant exchanges the debt for additional charter capital. In the second, the LLC is indebted to a third party. The third party can exchange the debt for a share equal to the amount owed.

Shareholders are permitted to set-off their monetary claims against a company by purchasing additional shares of a JSC only if shares are distributed by closed subscription.

Liquidation

A company may be liquidated by:

- a decision made at a general shareholders/participants meeting;
- a court decision if the company has become insolvent or bankrupt;
- a court decision if the company has grossly violated certain laws;
- expiration of the term or achievement of the goal for which the company was established (if provided for by the charter).

Liquidation procedures include the establishment of a liquidation commission and deregistration with the tax authorities. Tax deregistration can cause significant delays in completing the procedures as a tax audit is often performed before tax deregistration is permitted.

Once a liquidation commission has been appointed, all rights to manage the company are transferred to the commission.

If the liquidated company does not have sufficient assets for discharging its liabilities, insolvency procedures are applied.

Insolvency

Bankruptcy law provides for the protection of creditors of an enterprise and outlines the procedures to be followed in the event of bankruptcy. Bankruptcy is understood to be the inability to satisfy all pecuniary claims made by creditors or the inability to meet and execute pecuniary obligations as recognized by a court. A legal entity is considered insolvent and consequently can be declared bankrupt by a court if it fails to meet pecuniary obligations for three months after the date on which such obligations were due.

Bankruptcy legal proceedings can be initiated if the debt owed is more than RUB100,000 (USD3,125) to a legal entity or RUB10,000 (USD312.5) to an individual.

An RLE is considered insolvent and can consequently be declared bankrupt by a court if it fails to meet financial obligations (in the amount of approximately USD3,125) for three months following the date on which such obligations were due.

Reorganization

Mergers, consolidations, split-ups, spin-offs and transformations are permitted under the Civil Code, JSC Law and LLC Law.

Such reorganization entails a number of steps, e.g. a tax audit of the company by the Russian tax authorities, written notification saying that creditors are entitled to request that the company's obligations be prematurely terminated or accelerated, etc. In individual circumstances, this can mean that the completion of reorganization will require considerable time and effort.

Labour law

Labour regulations

Relations between employers and employees are primarily regulated by the Labor Code of the Russian Federation (Labor Code).

Employment relations are subject to the Labor Code, other legal acts of the Russian Federation containing labor regulations (including local acts adopted by the employer), the employer's collective agreement (if any) and direct employment contracts with the employee.

Employees shall enjoy the rights and benefits stipulated by Russian labor legislation. Russian labor legislation also governs the types of employment contracts and conditions of their conclusion, amendment and termination.

The Labor Code establishes an important provision ensuring employee rights, according to which employment contracts may not worsen the position of employees as compared to labor legislation.

The Labor Code is the main document regulating labor relations between employees and employers.

Social partnership

Under the Labor Code, "social partnership" is defined as the system of relations between employees, employers, state and local authorities aimed at regulating and balancing the interests of employees and employers in the area of labour relations. The following areas of interest, among others, are regulated:

- negotiation of collective agreements;
- mutual consultation on employment issues;

- participation of employees in the management of the company;
- participation of parties in pre-court negotiations.

Collective agreement

A collective agreement may be concluded between an employer and employees. The law does not require a collective agreement if neither party requests it. Trade unions normally represent employees when such an agreement is concluded. The employer is represented by the general director or his/her authorized representative(s).

The law allows the parties to define the content of a collective agreement independently; however, they may not be less favorable than those of the Labor Code. The collective agreement is subject to registration with the appropriate State Labor Office.

Role of trade unions

According to the Labor Code, the employer should consider the opinion of the trade union(s) on certain matters (if such union exists). Trade unions in Russia are more typically formed at a company level rather than on an industry-wide level.

Employment conditions

Employee guarantees

Russian labor legislation provides certain guarantees for employees, in particular:

- Standard working hours are not to exceed 40 hours per week.
- Overtime is permitted for certain categories of employees in certain circumstances, but generally should not exceed four hours in two successive days and 120 hours per year. Overtime is payable at the following rates: 1.5 times normal salary per hour for the first two hours

and, 2 times for subsequent hours and for work on weekends and non-working days. Also, employees may demand additional days-off as compensation for overtime.

- An employer may not require an employee to perform functions beyond those set out in his/her employment contract unless business circumstances require that this is done, in which case the employer has the right to transfer the employee to a position in a different line of work for a period not exceeding one month. An employee may be assigned to a job which requires lower qualifications subject to the employee's written consent. Performance of additional functions if required from an employee by the employer is subject to the employee's written consent and relevant paperwork should be prepared.
- Employees are entitled to 12 paid public holidays and an annual leave of at least 28 calendar days. For some categories of employees, the minimum annual leave established by legislation may exceed 28 calendar days.
- Employees are entitled to sick leave allowance paid by the employer and Social Insurance Fund based on an employee's wages and vary between 60 percent to 100 percent of the wage amount, depending on the length of service but may not exceed RUB1,203 per day of sickness (USD37.6).
- Wages for time spent away from work, for the performance of the functions of a trade union officer, appearing in court, going to vote, and fulfilling other state or social responsibilities.
- Severance pay in certain situations.
- Certain social benefits: maternity leave, paid holidays and vacation time.
- Overtime is permitted for certain workers, subject to certain conditions.



- Women are entitled to maternity leave for 70 calendar days (84 days for multiple births) prior to childbirth and 70 calendar days (86 days in the case of birth complications, and 110 for multiple births) after childbirth. Maternity leave is granted together with social insurance benefit paid out in the amount established by statutory legislation. Regardless of the employment period with a specific company, a woman is entitled to annual paid vacation which may be taken either before or immediately after maternity leave, as well as leave up until the child's third birthday. During the period of maternity leave until the child reaches one and a half years of age, the woman is paid a social insurance allowance. Fathers, grandparents and other relatives are entitled to baby care leave under certain circumstances.
- Employees may organize trade unions and participate in the management of the company. The primary trade union represents the interests of employees in dealings with the employer, ensures that the terms of the collective agreement are being complied with and participates in the resolution of labor disputes in accordance with statutory legislation.

Labor legislation establishes a number of guarantees for employees such as social benefits and compensation, severance and overtime payments, etc.

Employment contracts

The Labor Code states that an employment contract should contain "essential" conditions (e.g., place of work, starting date, position, working hours, salary and benefits, other) and "additional" conditions (e.g., trial period, confidentiality, other).

Employment contracts may be concluded for:

- an indefinite term; or
- a fixed term, but not exceeding five years.

Contracts with a fixed term are only allowed when employment relationships cannot be established for an indefinite term and specific conditions are satisfied. In particular, fixed term contracts are permitted with the following employees:

- directors, deputy directors, chief accountants;
- employees working in companies created for a specific project;
- part-time workers (having more than one job);
- if the work is temporary in nature.

Employers are required to conclude an individual written employment contract with each employee. After the contract is signed, a respective order for the employee's admission to work should be issued by the general director.

The grounds for terminating employment under Russian employment legislation include, inter alia:

- agreement of the parties;
- expiry of the term of the employment contract;
- cancellation of the employment contract at the initiative of the employer (as discussed below) or employee;
- refusal of the employee to continue working due to a change in owner or subordination of the employer, or its reorganization;
- refusal of the employee to continue work owing to relocation of the employer.

In general, an employee may terminate a contract by giving two-weeks advance written notice to the company, unless an earlier termination is mutually agreed. A fixed term employment contract may be terminated by an employee if he/she is injured or disabled and unable to perform the required work, management violates employment legislation, the collective agreement or employment contract, or if the employee has other good grounds for doing so. In some limited instances, the employee may terminate an employment contract without prior notice.

An employer may terminate a contract in a limited number of cases which include:

- an employee submitted false documents when hired;
- an employee fails to discharge work duties on a regular basis for no good cause – is absent for no good cause, is inebriated at work – or discloses state, commercial information or internal confidential information of the employer, steals from the employer, fails to comply with labor protection requirements, resulting in significant damage;
- the director of a company or company branch commits a single violation of employment responsibilities;
- an employee with financial responsibilities commits an act in breach of the trust of the company.

Russian law stipulates that employment contracts cannot be terminated at the initiative of the employer, inter alia, with the following employees:

- pregnant women or women with children under the age of three;
- single women with children under 14 or disabled children under 16.

Where employees are under 18 years of age, an employment contract may be terminated with the approval of the State Labor Inspectorate and Commission on Minors.

It may prove difficult to terminate an employment contract on the grounds that the employee is not suitable for the position unless there are clear job requirements with demonstrable failings by the employee. Courts generally rule in favor of the employee when considering cases of alleged wrongful dismissal. In practice, companies seek where possible to secure the employee's voluntary resignation.

The Labor Code prohibits the termination of labor contracts with certain categories of employees at the initiative of the employer.

Work book

Russian labor legislation requires that a work book be kept for each employee who has worked for at least five days at a company, if this work is the employee's main employment. This is the basic document in which is recorded the employment history of each individual over his/her lifetime. This book indicates the grounds for termination of employment contract and records of rewards for achievements at work, work performed by the employee, transfers to another permanent work, etc.

Every entry to the work book is attested by the signature of the authorized representative of the employer and by the employer's stamp.

Trial period for an employee

Trial periods (typically up to a maximum of three months) are permitted to assess the suitability of employees for a position. Certain categories of employees are not subject to a trial period (e.g. pregnant women, minors, transferees). The trial period may be established for six months for directors, deputy directors, chief accountants, deputy chief accountants and directors of branches, representative offices or other divisions.

The trial period for an employee typically lasts for 3 months.

Salary

The Labor Code safeguards the interests of employees related to timely salary payments as follows.

The employer should pay salaries at least twice a month. If salary payment is delayed by more than 15 days, the employee has the right to notify the employer and to stop working. In such cases, the employer may be obligated by a court to reimburse the employee for each idle day in the amount of two-thirds of the average salary (calculated based on actual salary accrued and the actual working time for the past 12 months).

The employer must pay interest for each day of salary payment delay in the amount of no less than 1/300 of the refinancing rate of the Bank of Russia.

Administrative fines can be levied on employing organizations and their responsible officials for delayed salary payments – RUB30,000-50,000 (USD937.5-1562.5) and RUB1,000-5,000 (USD31.3-156.3), respectively. In some cases, the employer's activities may be suspended for up to 90 calendar days.

If the responsible official has already been penalized for delayed salary payments, then they may be prohibited from holding executive positions for 1 to 3 years.

If salary payments are delayed for more than two months (three months in case of partial delay of salary payments), the criminal liability may apply.

Under the Criminal Code, if it is proved that the delay was due to the general director's unethical actions or other vested interest of the general director, the general director can be liable to pay a fine of up to RUB120,000 (USD3,750), or a fine in an amount equal to his/her wages or income from another source for a period of up to one year. In addition, the general director may be deprived of the right to occupy certain posts or to be engaged in a certain activity for a period of up to five years, or the deprivation of freedom for a term of up to two years could be imposed.

If the salary payments are fully delayed for more than two months or salary paid is below federal minimum salary level (RUB4,611) during that period, the Criminal Code stipulates a fine of RUB100,000-500,000 (USD3,125-15,625) or a fine equal to the salary or wages or earnings from another income source of the convicted person for a period of one to three years. In addition, the right to occupy certain posts or to be engaged in a certain activities could be relinquished for a period of up to three years with or without deprivation of freedom for a term of three to seven years.

Minimum statutory monthly wage

Minimum statutory monthly wage is used to regulate wages, compensation and other payments made under labor legislation, and also to calculate taxes, levies, penalties and other payments.

As of 1 June 2011, the federal minimum statutory monthly wage amounts to RUB4,611 (USD144). This minimum

statutory monthly wage in the amount stated above is used only to calculate labor remuneration and allowances for temporary inability to work.

Different level of minimum wages may be established by subjects of Russia, but no lower than RUB 4,611. Minimum wage for Moscow is established at the level RUB11,100 as of 1 July 2011.

For other purposes, such as the calculation of taxes, levies, penalties, liabilities under civil transactions, etc., a minimum statutory monthly wage in the amount of RUB100 (USD3.1) is applied.

Minimum statutory monthly wage is used to regulate wages and other salary related payments and to calculate taxes, levies and fines.

Currency form of salary pay

Direct salary payment to employees in Russia in foreign currency is prohibited.

In Russia salaries are normally paid in rubles. However, in accordance with collective agreements or employment contracts upon an employee's written request, labor may be remunerated in other forms as long as they do not contradict Russian legislation or international treaties to which Russia is party. The percentage of remuneration made in non-monetary form may not exceed 20 percent of an employee's total salary.

Severance payments

The Labor Code requires severance pay equal to at least two week's average earnings where an employment contract is terminated due to:

- drafting or enlisting of an employee into military or alternative civil service;
- refusal of an employee to be transferred to work in another location together with the enterprise, institution or organization upon its relocation;
- inability to work pursuant to a medical certificate issued in accordance with the legislation;
- refusal to continue work due to a unilateral change of the labor agreement conditions made by the employer (such a change is only possible in exceptional cases);

- reinstatement of an employee who previously performed the work;
- refusal of an employee to change work as prescribed by relevant medical authorities or if the employer is not able to offer relevant work.

In the event of the dissolution of an enterprise, institution, or organization, or staffing cuts, a one-off payment of monthly average earnings is required. Additional payments are required if the dismissed employee is unable to find work but no more than two months of payments (three months subject to specific conditions).

Work permits for foreign nationals

As a general rule, foreign citizens working on the territory of Russia are required to have a work permit. There are a few exceptions to this rule, mainly related to certain CIS nationals and other foreign nationals who possess residency permits. Work permits may also not be required for the employees of supplier or manufacturer of imported equipment entering Russia for the purpose of installation, supervision of installation or servicing of this equipment.

The standard work permit application process is quite a lengthy and burdensome procedure consisting of several stages. Each stage involves the submission of applications together with an extensive list of documents. The stages include:

- registration with the local employment authorities;
- submission of notification on vacancies available in the company to the Employment Service for subsequent conclusion of the authorities on the expediency of the engagement of foreign citizens for such vacancies (Conclusion);
- application for a corporate Permit for engagement of foreign labor at the Federal Migration Service of the Russian Federation (FMS) or the Department of the Federal Migration Service of the Russian Federation (Corporate Permit);
- application to the FMS for each expatriate's individual Work Permit (Individual Permit).

Typically it takes more than four months to obtain an individual work permit from start to finish.

The individual permit is issued for the period up to one year.

Separately, based on the work permit, a work visa must be obtained. Its obtaining also involves several stages where certain set of documents should be submitted to the immigration authorities.

Further, with respect to the regular category of work permit, each year by May 1 companies must report the number of foreign employees they anticipate engaging in the next calendar year. This procedure effectively constitutes a quota application. If the employer does not comply with this and does not receive notification of the approval of a quota, the employer will have work permit applications rejected. Alternatively, a company that failed to file a quota application or whose application was denied or partially approved may use a list of quota-exempt positions when applying for work permit only if the application meets all the quota-exempt requirements.

Work permit application for Highly-qualified Specialists (HQS)

Started from 1 July 2010, simplified procedure of obtaining the work permits for HQS came into force. HQS is a highly-skilled professional who is a foreign employee and has work experience and skills or achievements in a certain area and whose annual salary generally exceeds RUB2,000,000 (about USD62,500). It should be also noted that Representative offices of foreign legal entities can not apply for employing HQS. Obtaining work permits for foreign national as for HQS has the following benefits:

- obtaining an employment permit for the Russian employer is not required;
- the quota system is not applied to HQS;
- the work permit period can be issued for the term of up to three years;
- HQS may obtain multiple work visa for the term of up to three years;
- the procedure of obtaining work permit for HQS takes about fourteen business days from the moment of submission of such application;
- reduced income tax rate of 13 percent applies to salary paid locally to HQS non-tax residents irrespective of their tax residence status;
- extended length of business trips outside the region/regions for which the HQS work permit was obtained as compared with the standard work permit (30 calendar days in total during a calendar year or without limitation for HQS with travelling nature of work).

Migration registration procedure

Migration registration is the process of notifying the immigration authorities of a foreign citizen's whereabouts (international travel, as well as internal trips within Russia). It is the hosting party which is responsible for such registrations. The hosting party for this purpose is either the hotel or the employer (visa sponsor) or a landlord, if the foreign national is not staying in the hotel. ***Upon arrival in Russia, each foreign national must be registered in Russia in his host location.*** This process should be completed within seven business days of arrival every time a foreign national arrives in Russia or travels to another region (changes location) within Russia for more than seven business days.

HQS and his family members are exempt from registration procedures, if they arrive and stay in Russia for the period not exceeding 90 days and 30 days if they travel in Russia to another region. If HQS and his family members stay in Russia for more than 90 days (or 30 days traveling in another region), they are required to be registered within seven business days.



Business and Personal Taxation

Tax system overview

Russian tax legislation consists of the Tax Code of the Russian Federation (hereinafter, the Tax Code) and laws adopted in accordance with it.

Taxes and levies are imposed in Russia on the federal, regional and local levels.

Federal taxes and levies are those established by the Tax Code and by Federal Law and are paid throughout the Russian Federation.

As of 1 January 2012, the following federal taxes and levies are effective:

- Value-Added Tax (VAT);
- excise tax;
- Personal Income Tax (PIT);
- profits tax;
- mineral extraction tax;
- water tax;
- levies for natural and biological resources consumption;
- state duty.

Regional taxes and levies are those established by the Tax Code and by tax laws of the regions of the Russian Federation and are paid in the appropriate regions. Regional taxes include property tax, gambling tax and transport tax.

Local taxes and levies are those introduced by the Tax Code and by municipal authorities' regulations and are paid in the appropriate municipal areas. Local taxes are represented by land tax and personal property tax.

Local (or regional) legislation may only introduce those types of taxes and levies stipulated by the Tax Code. When doing so, the local (regional) authorities are allowed to establish the following elements of taxation:

- tax concessions;
- tax rates within the limits established by the Tax Code;
- procedures and deadlines for tax payments.

The above tax system results in different levels of tax burden for taxpayers registered in different regions.

Tax registration requirements

There is no separate tax registration for VAT purposes – a taxpayer obtains a single tax ID number for all taxes. However taxpayers have to obtain supplementary tax registration ID numbers ('KPP') with the tax authorities where their separate subdivisions are located.

A separate subdivision is a subdivision separately located from the head office (e.g. other city). A separate subdivision implies the creation of stationary working places for periods longer than one month. FLEs have to obtain tax registration with the local tax authorities within 30 calendar days from the day that activities begin in that location.

Business taxation

Profits tax

Tax base

Taxable profit is calculated as income minus expenses as per tax accounts.

Income is generally determined on an accrual basis. The application of a cash basis is allowed only if average sales proceeds for four consecutive quarters are less than RUB1,000,000, excluding VAT per quarter (USD35,112).

Expenses are deductible if they are incurred to generate income, are economically justifiable and are properly documented. Certain expenses specifically referred to in the Tax Code are treated as non-deductible.

Since 1 January 2012 consolidated profits tax reporting is allowed only if the parent company has a 90 percent or higher share in subsidiaries and the total annual amount of VAT, excise taxes, profits tax and mineral extraction tax is RUB10 billion or more (USD312.5 million). Also, total sales of the group must equal RUB100 billion or more (USD3.13 billion.), and total assets must be RUB300 billion or more (USD9.38 billion). Consequently only a few major Russian companies are able to use consolidated profits tax reporting.

Tax rates

The maximum profits tax rate is 20 percent, including 2 percent paid to the federal budget and 18 percent to the regional budget. The regional profits tax rate can be reduced to 13.5 percent at the discretion of the regional authorities.

Certain types of income are taxed via withholding mechanism at flat rates stipulated by the Tax Code (see section Withholding income tax, p. 26).

Tax concessions

The gratuitous receipt of assets from a parent company, a subsidiary or an individual does not result in taxable income if:

- the recipient's or transferor's ownership in the other party's share capital amounts to more than 50 percent;

- the individual owns more than 50 percent of the recipient company;
- the property received (except for money) is not disposed of within one year from the date of receipt.

Receipt of property, property rights or non-property rights to increase net assets from a shareholder, as well as the forgiveness of debt by a shareholder and reinvestment of dividends payable to (but not received by) a shareholder does not result in taxable income, regardless of the percentage of shares owned by the contributing shareholder.

Current profits tax legislation does not stipulate other profits tax concessions.

Tax losses can be carried forward for 10 years.

Tax accounting

The Tax Code requires taxpayers (including permanent establishments) to maintain separate accounts for profits tax purposes. Tax accounting rules may differ from Russian statutory accounting principles (e.g. with regard to depreciation, recognition of interest expenses, etc.).

The methodology applied for profits tax purposes should be clearly explained in the taxpayer's tax accounting policy. Once chosen, the tax accounting policy may not be changed during the financial year, except for changes of legislation.

Taxation of FLEs

FLEs whose activities in the Russian Federation give rise to a permanent establishment (PE) for tax purposes are subject to profits tax on income minus expenses attributable to the Russian PE.

Under the Russian tax legislation, the activities of a FLE give rise to a PE:

1. If an FLE has a place of business in Russia (branch, office, bureau or other independent subdivision); and the FLE conducts business activities here on a regular basis. In particular, a construction site

located in Russia under certain circumstances could be considered the PE of the FLE performing construction activities.

2. If an FLE acts in Russia through a dependent agent. A dependent agent is understood in Russian legislation as well as under the applicable double tax treaty (if any) as a company or individual which, on the basis of contractual relations with a principal, has and habitually exercises the right to conclude contracts and negotiate essential terms of contracts in the name of the principal or to bind the principal's participation in a business activity (except for activities of auxiliary or preparatory nature).

Generally, the approach to profits tax calculation for PEs of FLEs is similar to those established for RLEs, with certain exceptions, in particular, resulting from the applicable provisions of double tax treaties (e.g. allocation of management costs).

FLEs having no PE in Russia are subject to withholding tax on Russian source income (for details see the section *Withholding income tax* below, p. 26).

Filing and payment

Taxpayers (except PEs and certain other taxpayers) are allowed to file profits tax returns either monthly or quarterly. PEs should file profits tax returns quarterly. An annual return is due by 28 March of the year following the reporting year.

Taxpayers (except PEs) pay monthly advance payments on profits tax. PEs pay quarterly advance payments. Final payments are due 28 March of the year following the reporting year.

Withholding income tax

An FLE receiving Russian source income which is not attributable to its Russian PE (e.g., rent, royalties, interest and dividends, freight income, etc.) is subject to withholding income tax at the source.

Income derived from the business activities of the FLE in Russia (e.g., nonrecurring consultancy services), which do not give rise to a PE, are exempt from withholding income tax.

There is no withholding tax on the repatriation of profits from a local Russian RO or branch of a FLE to the head office. However liquidation proceeds are subject to taxation at source.

Tax rates

Withholding income tax rates vary depending on the type of taxable income.

Tax rates for dividend income are:

- 0 percent – dividends payable to an RLE if this RLE owns at least 50 percent of shares in the dividend payer for 365 consecutive days provided that the dividend payer is not a resident of an off-shore country (e.g., BVI, Guernsey, Jersey, Cyprus, or any other state indicated in the list established by the RF Ministry of Finance).
- 9 percent – for dividends received by an RLE from an RLE or FLE.
- 15 percent – for dividends payable to an FLE by an RLE.

Generally, FLEs having no PE in Russia are subject to a 20 percent withholding income tax on most Russian source income such as interest, royalties, income from leasing and rental operations, etc. Freight income is taxed at 10 percent.

Withholding income tax rates may be reduced down to 0 percent in accordance with double tax treaties concluded between the Russian Federation and the country of the factual beneficiary's residence.

For a list of double tax treaties and the withholding tax rates applicable under these treaties to dividends, interest and royalties, see Appendix 1. *Chart of Withholding tax rates*, p.55.

An FLE should confirm its residency in a country party to a double tax treaty with the Russian Federation to enjoy the reduced withholding income tax rates. This confirmation is documented by a certificate issued by the relevant foreign authorities.

In the absence of the proper certificate, tax should be withheld and remitted to the budget. If tax is withheld even though treaty relief is available, a refund claim can be filed by the foreign recipient.

Filing and payment

Withholding income tax should be withheld from income payable to the FLE and remitted to the budget on the date when the payment is made to the FLE.

An RLE (or FLE with a PE in Russia) should also file a withholding income tax calculation.

Value added tax

Value Added Tax (VAT) is an indirect tax, the burden of which is borne by the end-customer but should be accounted for by the supplier.

Taxable supplies

Generally VAT should be charged by the taxpayers (companies, individual entrepreneurs, importers of records) on the following transactions:

- sale of goods (works, services) provided that such supplies are performed on the territory of the Russian Federation and Russian continental shelf (including those supplied free-of-charge);
- transfer of property rights;
- transfer of goods, works and services for the taxpayer's own consumption and the incurred expenses are non-deductible for profits tax purposes;
- construction and installation works carried out for internal consumption;
- import of goods into Russia and other territories under Russian jurisdiction.

Place of supply rules

The Tax Code stipulates specific 'place of supply' rules that are applied to determine whether goods, works or services are supplied in Russia and thus are subject to Russian VAT.

It is important to understand where the goods are located at the moment of sale; whether or not the goods have been transported; and where the goods originated from.

Sale of goods, works, services (including those supplied free-of-charge or transferred for the company's own consumption), transfer of property rights, construction conducted by and for the company itself and import of goods into Russia are subject to Russian VAT.

Works (services) are generally deemed to be supplied in Russia if the supplier of such works (services) has a place of business in Russia. However there are specific 'place of supply' rules in the Tax Code for a number of works (services) (for instance, for services related to movable or immovable property, for intangible services like consulting, marketing, engineering, for transportation and freight forwarding services, for works (services) rendered on the Russian continental shelf, etc.).

Taxable base

VAT should be accounted for in prepayments when they are made and/or on the total transaction price at the moment of the goods' shipment, when works are performed, services rendered or property rights transferred. If more than one of these actions is undertaken, VAT should be accounted for when the first occurs.

VAT accounted for on prepayments may subsequently be offset against the full amount of VAT due after disposal.

Effective 1 October 2011, when the value of goods (works, services) has been changed (change in the price of the goods (works, services) or their quantity), an adjusted VAT invoice should be issued and respective amendments to VAT obligations should be performed.

Input VAT

Generally Russian taxpayers are entitled to claim for recovery input VAT related to purchased goods (works, services) and property rights provided that:

- Goods, works, services and property rights are acquired for the purpose of carrying out VAT-able transactions.
- Goods, works, services and property rights are booked in accounts.
- VAT invoices duly prepared in accordance with the invoice requirements provided by the Tax Code (customs declarations for customs VAT) are received by the taxpayer.

In respect of VAT paid at customs upon import and VAT withheld by tax agents, VAT should be paid to the customs authorities/to the Russian budget upon the import of goods / when the payment to an unregistered foreign supplier is made.

Under certain conditions it is also possible for the taxpayers who made advance payments to the suppliers to recover the amount of VAT included in advance payments.

When both VATable and non-VATable supplies are performed or supplies are subject to different VAT rates, taxpayers in most cases should account for supplies and respective input VAT separately. Recovery of VAT in these cases may be subject to specific rules (proportional recovery, collecting supporting documents, etc.).

VAT invoice

VAT invoice is a specific document serving VAT recovery and is distinct from a commercial invoice. A VAT invoice can be issued either in hardcopy or in electronic format.

Tax rates

Generally, the sales of goods (works, services) are taxable at the standard VAT rate of 18 percent.

A reduced VAT rate of 10 percent applies to certain types of medical goods, books and periodicals, foods and children's goods (according to the list established by the RF Government).

The Tax Code stipulates a list of goods (works, services) that are supplied at a 0 percent VAT rate. This list includes, inter alia: export sales; international transportation services and related freight forwarding services; transport and certain related services for oil, oil products, natural gas and electrical power transmission; services provided at river and sea ports; and services provided by Russian railway carriers. To apply the 0 percent VAT rate, the supplier should collect specific supporting documents within the established term and submit a VAT return with these supporting documents to the tax authorities.

Generally, the sales of goods (works, services) are taxable at a standard VAT rate of 18 percent.

Exemptions

The Tax Code lists certain types of activities that are exempt from VAT, in particular:

- leasing premises located in Russia to foreign individuals and foreign representative offices accredited in Russia;
- selling residential real estate, certain medical goods, medical services, foods produced by students or school cafeterias, public conveyance services, ritual services, educational services rendered by licensed nonprofit educational institutions, cultural services, art services, etc.;
- banking and insurance services; sales of financial instruments in conditional transactions;
- licensing or assigning certain intellectual property rights.

Importation of specific types of goods into Russia may also be VAT exempt.

The Tax Code provides for certain types of VAT exemptions, primarily related to financial and social welfare services.

Reverse charge mechanism

If foreign companies that are not registered with the Russian tax authorities supply goods (works, services) in Russia, and these supplies are deemed to be made in Russia in accordance with the 'place of supply' rules, the tax-registered buyer of such supplies is required to withhold VAT from the income payable to the foreign supplier and remit that tax to the budget.

Having withheld and paid the VAT to the budget, the buyer can then offset this VAT against its output VAT under the general rules for offsetting input VAT.

Customs Union

Starting from 1 July 2010 the Customs Union between Russia, Belarus and Kazakhstan came into effect. Russian tax legislation provides for special rules that are applied to transactions between member states of the Customs Union.

Goods exported from one member state of the Customs Union that are destined for another are subject to a 0 percent VAT rate. The application of a 0 percent VAT rate should be confirmed by a specific list of documents.

Goods imported from one of the member states are subject to the same VAT rates that are applied to domestic transactions within the importing member state.

VAT payable to the Russian budget

VAT payable to the budget is determined as the difference between the VAT accounted for on supplies subject to VAT and the VAT incurred on purchases subject to VAT (plus the amount due to the budget under specific cases).

An excess of input VAT over output VAT should be refunded to the taxpayer from the budget. Generally VAT refunds may be made after the tax authorities have performed a 'desk audit' and confirm the legitimacy of the input VAT claimed. Starting in 2010, taxpayers are also entitled to refund the VAT through the accelerated VAT refund procedure, which generally allows them to receive the cash tax refund prior to completion of a desk tax audit. For example, the taxpayer may apply for this accelerated VAT refund procedure if a bank guarantee is obtained from a bank approved by the Ministry of Finance.

VAT payment and filing

VAT returns should be submitted quarterly no later than the twentieth date of the month following the quarter that has ended. The Russian Tax Code provides for VAT payment deferral. VAT may be paid by one third of the amount due by the twentieth day of each of the three consecutive months following the reporting quarter.

Taxpayers submit VAT returns on a quarterly basis and have the right to pay the VAT in three equal installments.

Social security contributions

Social security contributions are payable in Russia in form of mandatory insurance contributions to the Russian Pension Fund, Social Insurance Fund, and Medical Insurance Funds on behalf of each employee (personified contributions) as well as contributions for mandatory social insurance against occupational accidents and diseases.

Insurance contributions are levied on companies, individual entrepreneurs and individuals making payments to individuals in the frames of employment relations and under civil contracts for the provision of services or the performance of work and other specific types of contracts, as well as on self-employed individuals, including individual entrepreneurs, notaries and advocates. No contributions are payable by employees.

Payments subject to insurance contributions

Insurance contributions are payable on remuneration and other payments to individuals under employment and civil contracts. Certain compensation is exempt from insurance contributions, including business trip expenses, temporary disability allowances, employee dismissal expenses (excluding compensation for unused paid vacation days), professional development expenses and some others.

With regard to foreign nationals, contributions are paid in full on remuneration of foreign nationals residing in Russia based on a permanent or temporary residence permit; contributions are paid in part on remuneration of foreign nationals temporarily staying in Russia on a visa basis.

Insurance contributions are not paid on the remuneration of foreign employees temporarily staying in Russia – employees who come to Russia based on a visa and do not have residency or temporary residency permits - if they work under a fixed-term labour contract for less than 6 month or are employed under the highly qualified specialist regime.

Insurance contributions rates

For 2012, personal contributions equal 30 percent of an employee's salary if the salary is below RUB512,000 (about USD16,000) and 10 percent of higher salary payments. The threshold is subject to annual revision by the Russian government.

Type of insurance contribution	Charge rate
Pension Fund	26%
Social Insurance Fund	2.9%
Federal Mandatory Medical Insurance Fund	3.1%
Territorial Mandatory Medical Insurance Fund	2%

Employers of foreign nationals temporarily staying in Russia must pay personal contributions only to the Pension Fund.

Mandatory social insurance against occupational accidents and diseases

Apart from insurance contributions, employers are required to pay contributions for mandatory social insurance against occupational accidents and diseases. These contributions are payable on total payroll at a flat rate that varies depending on the risk category that the employing company belongs to according to the Russian Social Insurance Fund – minimum rate, 0.2 percent of payroll; maximum, 8.5 percent. Generally, office activity is subject to contributions for insurance against injuries and professional illness at 0.2 percent.

Insurance contributions concessions

During 2012-2014, reduced rates of insurance contributions will apply to agricultural producers, residents of technical-innovative special economic zones, taxpayers applying the simplified tax regime (for certain types of activity), legal entities employing disabled individuals (provided that certain conditions are met), IT companies and others.

Filing and payment

Insurance contributions are payable to the Pension Fund, the Social Insurance Fund and the Medical Insurance Funds.

Insurance contributions are paid monthly no later than the 15th of the following month.

Payers should file insurance contribution calculations on a quarterly basis. Quarterly calculations are filed with the Pension Fund and Medical Insurance Fund by the 15th day of the second month following the reporting quarter. Quarterly calculations should be filed with the Social Insurance Fund by the 15th of the month following the reporting quarter.

In addition to the above, insurance contribution payers are required to file individual data on insured individuals with the Pension Fund on a quarterly basis.

Property tax

Property tax is levied on those properties listed on a taxpayer's balance sheet as fixed assets (except for land plots).

Tax base

The tax base is the average annual fixed assets net book value per Russian statutory accounting.

FLEs having no PE in Russia are subject to property tax only on immovable property located in Russia.

Tax rate

The maximum tax rate is 2.2 percent. The regional authorities can reduce the property tax rate to 0 percent.

Tax concessions

The Tax Code stipulates a number of property tax concessions. In particular, companies are exempt from property tax on assets classified as public railways, federal highways intended for public use, trunk pipelines, power lines, and on assets constituting an integral, technical component of the above. The list of such assets is established by the RF Government.

Property tax paid by an RLE on property located outside of Russia could be offset when paying property tax in Russia. To carry out related offsetting, the taxpayer should submit a document confirming payment of property tax abroad.

Filing and payment

The regional authorities establish the terms for advance and final property tax payments.

Property tax calculations are filed quarterly. An annual property tax return should be filed by 30 March of the year following the reporting year.

Other taxes

Transport tax

Transport tax is payable by FLEs and RLEs owning registered transport vehicles. Taxable vehicles include automobiles, motorcycles, scooters, buses, airplanes, helicopters, motor vessels, yachts, sail boats, boats, snowmobiles, etc. The tax base is the engine capacity, gross tonnage or unit of a vehicle.

The tax rates are established by the Tax Code at RUB2.5 to RUB200 (USD0.078-6.25) per unit of horse power and can increase or decrease up to ten times, depending on the region.

The regional authorities are allowed to establish tax incentives and allowances for certain taxpayer categories.

The terms for the submission of transport tax payments and the filing of advance calculations are established by the authorities of the region where the vehicle is registered. However, the final annual payment and the annual tax return are due no earlier than 1 February of the following year.

Land tax

Land tax is calculated based on the cadastral value of land plots according to the RF legislation applicable to the region where the land plot is located.

Under the Tax Code the land tax rate for lands intended for agricultural purposes and housing facilities must not be higher than 0.3 percent and not higher than 1.5 percent of the cadastral value of a land plot for other purposes. The regional authorities can decrease this rate to 0 percent. The regional authorities can also stipulate tax incentives or allowances for certain taxpayer categories.

Advance payments are due quarterly, and the final tax payment is due no later than 1 February of the following year.

Water tax

Water tax is payable by companies consuming water for special and/or specific, indicated business purposes.

Tax rates differ for various types of water consumption and are set in rubles per 1 thousand cubic meters of water consumed.

Water tax returns are filed, and payments are made quarterly.



Special tax regimes

The Tax Code also provides special tax regimes under which a taxpayer is entitled to pay a single tax rather than a number of taxes. This regime may be applied if certain requirements are satisfied. Special tax regimes include the simplified tax, unified agricultural tax, tax on imputed income and special rules on production sharing agreements.

Unified tax on imputed income

The local tax authorities may allow certain taxpayers to apply unified tax on imputed income if the taxpayers are engaged in:

- consumer domestic services;
- veterinary services;
- vehicle maintenance, repair and washing;
- lease of car parking places and car parking services;
- passenger and cargo transportation services (certain restrictions apply);
- retail trade and catering (certain restrictions apply);
- certain kinds of advertising;
- services related to providing accommodations (certain restrictions apply).

The unified imputed income tax is applicable if the taxpayer satisfies the following criteria:

- average annual staff headcount is equal to or lower than 100;
- other legal entities' contribute less than 25 percent to the taxpayer's share capital.

The unified imputed income tax is not applied together with the simplified taxation or a unified agricultural tax.

Unified imputed income tax taxpayers are exempt from the following taxes (with regards to those operations subject to this tax):

- profits tax (for legal entities) or income tax (for individual entrepreneurs);
- VAT (except for VAT payable on imports);
- property tax.

Unified imputed income tax is levied on a taxpayer's imputed income. Imputed income is determined as the base return rate of activity for the period multiplied by physical indicators (area, number of vehicles or headcount) and adjusting factors. Imputed income tax is paid at a rate of 15 percent.

Payable unified imputed income tax could be reduced (to 50 percent of the initial tax accrual) by deducting insurance contributions for mandatory pension insurance, medical insurance and social insurance for temporary disability or maternity leave.

Tax returns and payments are due quarterly.

Simplified taxation system

The simplified tax system replaces profits tax, VAT (except for VAT payable on imports) and property tax.

As of 1 January 2010 through 30 September 2012, a company may apply the simplified tax system if it satisfies the following criteria in the first nine months of the year preceding the planned adoption of the simplified tax system:

- the company's revenue does not exceed RUB45,000,000 (USD1,406,250);
- the net book value of fixed assets and intangible assets does not exceed RUB100,000,000 (USD3,125,000);
- the average annual headcount does not exceed 100.

The following entities may not apply the simplified tax system:

- RLEs with branches;
- FLEs and ROs (branches) of FLEs;
- banks, insurance companies, pension funds, investment funds, parties of production sharing agreements, taxpayers of unified agricultural tax, etc.;
- entities in which other legal entities have participation shares exceeding 25 percent.

The simplified tax rate could be:

- 6 percent on revenues; or
- 15 percent on profits (revenues minus deductible expenses). However, the regional authorities could reduce the 15 percent tax rate to 5 percent depending on the taxpayer category.

Taxpayers are subject to quarterly advance payments, whereas the annual final payment is due by 31 March of the following calendar year. Advance tax estimates and annual tax returns are due during the same terms as the corresponding payments.

Unified agricultural tax

Agricultural producers are allowed to apply the unified agricultural tax. This tax replaces profits tax, VAT (except for VAT payable on imports) and property tax.

The unified agricultural tax is levied on income minus deductible expenses.

Income is calculated in accordance with general profits tax rules. Expenses are deductible if they are referred to in the established list, economically justifiable and properly documented.

The unified agricultural tax rate is 6 percent.

Advance payment is due after the first six months, and final payment, as well as the tax return, is due by 31 March of the following year.





Personal taxation

Personal income tax

Personal income tax in Russia depends on the taxpayer's tax residency status. An individual is considered a Russian tax resident if he/she is physically present in Russia for a period of 183 days or more during 12 consecutive months. Short-term travel (less than 6 months) outside Russia's borders for medical treatment or educational activities does not interrupt the individual's presence in Russia.

The clarifications of the Russian Ministry of Finance state that both days of arrival and of departure should be counted when calculating days of presence in Russia for the purpose of determining an individual's tax residency status.

Clarifications also state that if a company makes a payment locally in Russia, it should determine the individual's tax residency status on each date of payment in order to apply the appropriate withholding tax rate. Residency is determined on the basis of a 183-day period within the 12-month period immediately preceding the date of income payment. Consequently, the tax withheld may not be final.

Final tax liabilities are determined based on the individual's tax residency status for the reporting calendar year. This status is determined based on a 183-day period in the reporting calendar year.

Tax residents are subject to PIT on worldwide income, whereas non-residents are subject to PIT only on Russian-source income.

Residents are subject to PIT on worldwide income, while non-residents are liable only with regard to Russian source income.

Tax base

Taxable income includes income received in cash, in kind, and in a form of deemed income. Income in kind is assessed based on the market price of the goods received or services consumed.

Deemed income results when:

- interest payments on loans from organizations and sole proprietors when the payments are benchmarked to a rate of 2/3 the refinancing rate of the Bank of Russia on loans in Russian rubles, or to 9 percent per annum on loans in other currencies. The use of credit cards issued by non-Russian banks may also trigger deemed taxable income for the card holder.
- Favorable prices are paid by an individual for goods or services purchased from related parties.
- Securities and financial instruments are acquired at a price below market level.

Tax rates

13 percent PIT applies to all types of income, with the following exceptions:

- 9 percent on dividend income received by tax residents (both from RLEs and FLEs), and also to interest income on specific debt securities;
- 13 percent on the Russian employment income of tax non-residents who are foreign employees having the status of highly-qualified specialists;

- 13 percent on Russian employment income of tax non-residents who are foreign nationals staying in Russia on a visa-free basis and who are individuals engaged based on a special license to work for personal, home and similar needs;
- 35 percent on certain types of non-employment income (e.g., deemed income resulting from favorable interest for the use of loans);
- 15 percent on dividend income received by tax non-residents from Russian companies;
- 30 percent on the Russian-source income of tax non-residents (except for dividend income from RLEs, Russian employment income of highly-qualified specialists and income tax payable on license by foreign nationals staying in Russia on a visa-free basis).

Generally, tax residents pay PIT on the majority of income types at a 13 percent flat rate.

Tax deductions

Standard tax deductions

Standard monthly tax deductions of RUB3,000 (USD93.75) and RUB500 (USD15.60) could be granted to certain categories of individual taxpayers (such as disabled war veterans, handicapped persons etc.). If a taxpayer is eligible for multiple tax deductions, the higher deduction should apply.

In addition, a standard tax deduction of RUB1,400 (USD43.75) per month could be granted to a parent for each of two children and RUB3,000 (USD93.75) for subsequent amounts of children up to age 18 or for each child - daytime undergraduate between the ages of 18 and 24. The tax deduction may be doubled for one of the parents if the other parent applies to refuse the deduction or if there is only one parent.

These tax deductions are granted until the parent's cumulative annual income exceeds RUB280,000 (USD8,750).

Social tax deductions

Social tax deductions are available in the amount of qualified charity expenses, but no more than 25 percent of income received in the tax period.

Social deductions are also available with regard to:

- expense on educating the taxpayer and each of his/her children;
- expenses on medical treatment and medicines for the taxpayer and his/her spouse, parents, children;
- contributions for voluntary medical insurance for the taxpayer and his/her spouse, parents and children;
- contributions to a private pension fund for the benefit of the taxpayer, his/her spouse, parents and disabled children;
- additional insurance contributions to the cumulative part of state pension.

In aggregate the above five deductions should not exceed RUB120,000 (USD3,750) in one calendar year per each taxpayer (except expenses on some kinds of expensive medical treatment within the list approved by the Russian Government deductible in amounts of actual expenses and expenses for expenditures for education of taxpayer's children deductible within the limit of RUB50,000 (USD1,563) per child).

Property-related tax deduction

Property deductions could be granted on expenses on purchasing (construction) dwellings and land plots used to construct a dwelling (or along with a dwelling) in Russia (up to RUB2,000,000 (USD62,500)). Interest on loans used to pay for purchase/construction and expenses from selling a dwelling and land plot (up to RUB1,000,000 (USD31,250) or in the amount of documented actual expenses) and from selling other property (up to RUB250,000 (USD7,813) or in the amount of documented actual expenses) that has been owned for less than 3 years are also deductible.

Income from the sale of property that has been owned by the seller for three years or more is tax-exempted provided that the seller is a Russian tax resident in the year of sale.

Professional tax deductions

Professional tax deductions could be granted to individuals conducting registered entrepreneurial activity. These deductions apply to documented business related expenses. If business related expenses are undocumented, the sole proprietor could apply

professional tax deductions up to 20 percent of income derived from business activities.

Professional deductions could also be granted to individuals who receive income under a civil-law service or work agreement. The deductions are based on documented expenditures related to performing services under these agreements.

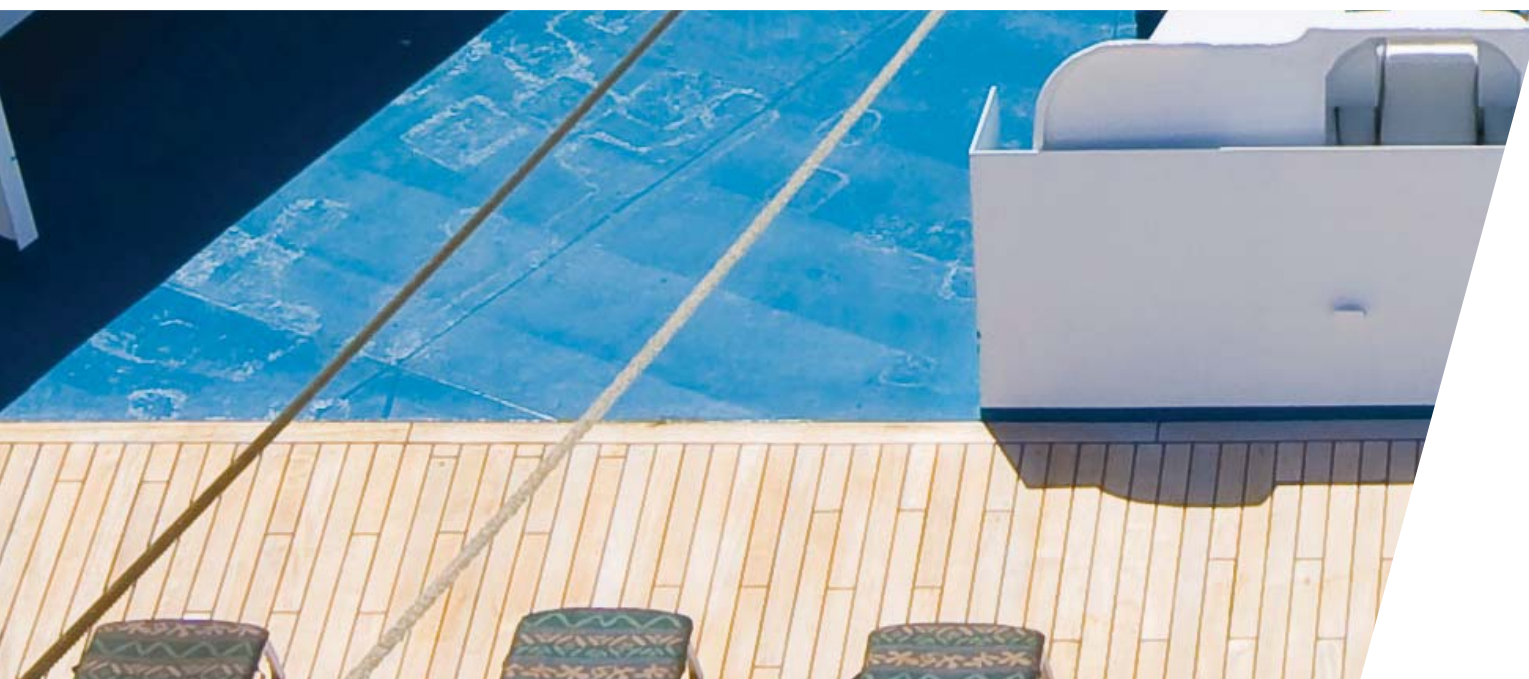
Individuals who receive author's fees or fees for the creation, execution or other use of specific intellectual property could apply for professional tax deductions that amount to their documented expenses or in a fixed amount if the documents supporting the expenses are unavailable (from 20 to 40 percent depending on the type of intellectual property).

Tax residents could benefit from claiming standard, social, property and professional deductions.

Filing and payment

Individual entrepreneurs, RLEs, ROs and Branches of FLEs registered in Russia which pay remuneration to individuals are considered tax agents, and they are required to withhold PIT from income payable to such individuals and remit it to the Russian financial authorities.

If PIT was not withheld by a tax agent, individuals should file a PIT declaration and pay PIT with regard to taxable income. Generally, the PIT declaration should be filed no later than 30 April of the year following the reporting year.





Tax refund

PIT declaration should also be required if individuals want to claim tax deductions or refund PIT which was excessively withheld by the tax agent in certain cases.

Other taxes payable by individuals

Personal property tax

Houses, apartments, cottages, garages and other buildings, premises and constructions owned by individuals are subject to personal property tax.

Tax rates differ – from 0.1 percent to 2 percent – depending on the inventory value of the property.

Certain categories of taxpayers are exempt from personal property tax (e.g. pensioners).

Individual property tax is assessed by the tax authorities annually and should be paid by taxpayers based on a tax assessment not later than 1 November of the subsequent calendar year.

Individuals who possess immovable property are subject to personal property tax.

Transport tax

Individuals owning transport vehicles and/or possessing a vehicle based on a power of attorney are subject to transport tax.

Taxable vehicles include automobiles, motorcycles, scooters, autobuses, airplanes, helicopters, motor vessels, yachts, sailing boats, boats, snowmobiles, etc.

Transport tax is determined based on the vehicle's engine power/capacity and the respective tax rates established by regional laws.

Individuals possessing transport vehicles are subject to transport tax.

Financial Reporting

Russian accounting principles

Russian accounting is regulated by a system of legal acts which consists of four different levels.

The first level consists of the laws regulating the way accounting is set up and maintained by companies, including:

- The Federal Law on Accounting, which contains basic accounting and reporting requirements.
- On 6 December 2012 Federal Law № 402-FZ Law of Accounting was adopted by the Russian parliament. This law will replace outdated Federal Law on Accounting № 129-FZ of 21 November 1996 and become effective for 2013.
- The Civil Code of the Russian Federation, which consolidates many accounting issues. The Civil Code of the Russian Federation defines a legal entity as having its own balance sheet, establishes the obligatory approval of annual financial statements, provides definitions of subsidiary and associated companies

and determines procedures for reorganization and liquidation of different kinds of legal entities.

- The Federal Law on Governmental Support of Small Business in the Russian Federation, which provides for accounting and reporting compilation according to a simplified procedure.
- Federal Laws On Joint Stock Companies and On Limited Liability Companies, which establishes information disclosure and presentation requirements, stipulates the requirement for the data contained in the annual report to be confirmed by the internal auditor and determines the procedure by which the annual financial statements are approved as well as instances in which an audit opinion is required.

The second level consists of accounting regulations (standards), which regulate accounting policies, compilation and presentation of financial statements, accounting for fixed and intangible assets, inventory, loans, income, expenses, financial investments, profits tax, etc.

In content, many of these regulations are close to International Financial Reporting Standards (IFRS). Bringing the national accounting system into accord with IFRS is part of the accounting reforms that began in 1998.

New accounting regulations are intended to be issued in the future. The topics covered will be in accordance with the current list of IFRS standards. Russian accounting regulations currently have no standards on the leasing or impairment of assets, for example. Furthermore, the existing accounting regulations are revised on a regular basis to enhance their compliance with IFRS.

The third level comprises methodological instructions on accounting, including recommendations in which specific procedures for applying principles and regulations of accounting are set out for particular types of activities.

One of the most important documents at this level is the Chart of Accounts and related instructions.



The fourth level includes documents issued by the company itself, which determine its accounting policies in all systematic, technical and organizational aspects and are approved by the company's internal order on accounting policies. If there are any specific accounting methods that are not specified in relevant accounting standards, companies have the right to develop them independently and to adopt them by including them in the order on accounting policies.

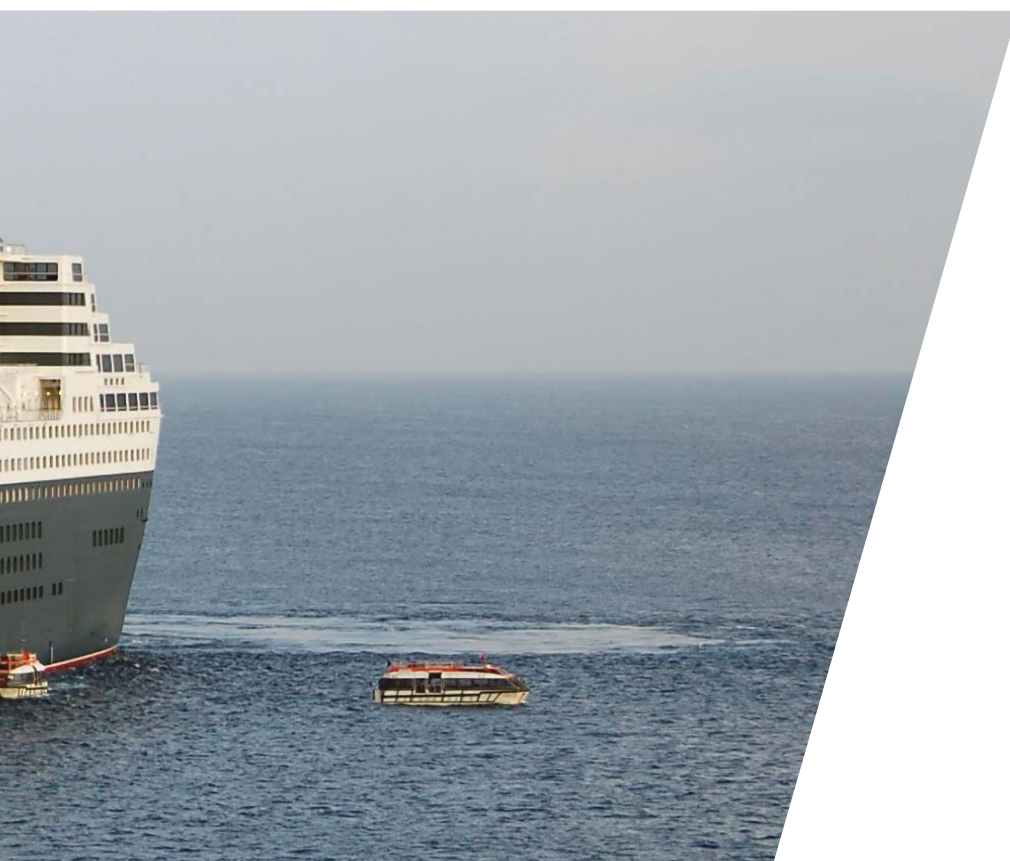
Branches and representative offices of foreign companies located in the Russian Federation are allowed to maintain their accounting on the basis of regulations established in the country in which the foreign company resides unless these regulations contradict IFRS. However, branches and ROs are required to submit annual activity reports to the tax authorities along with tax returns.

The key accounting principles in the Russian Federation are:

- **Separate entity principle:** in accordance with which assets and liabilities of the company are separate from assets and liabilities of the owner or assets provided to the entity by other persons.
- **Going concern principle:** in accordance with which it is assumed that the company will continue operating in the foreseeable future.
- **Principle of accounting policy consistency:** the accounting policy selected by the company is applied consistently from one reporting year to another, and a change in the accounting policy is only possible if there are changes in the legislation of the Russian Federation or in accounting regulations, new accounting methods developed by the company or significant changes in operating conditions.
- **A matching principle:** this states that business operations are recorded in the reporting period in which they occur regardless of when receipts or payments relating to these transactions are actually made.
- **Principle of timeliness and completeness of recording transactions:** the accountant should make records according to the set timelines and reflect all of the transactions made.
- **Prudence principle:** the accountant should record liabilities and expenses rather than assets and income and should not allow for any hidden reserves.
- **Substance-over-form principle:** transactions should be accounted for based on their economic substance and business circumstances rather than legal form.
- **Principle of non-contradiction:** analytical accounting data should be identical to synthetic accounting data on the last calendar day of each month.
- **Rationality principle:** application of a rational accounting method based on the company's size and business environment.
- **Materiality principle:** data on material assets, liabilities, income, expenses and transactions should be recorded separately if this information is essential for evaluation of the entity's financial position or financial results.

Companies use a working chart of accounts developed on the basis of the centrally established Chart of Accounts.

All business operations performed by companies should be supported by relevant source documents in Russian. These documents are the primary accounting documents underlying financial statements. Source documents prepared in other languages should be translated into Russian on a line-by-line basis.



Statutory reporting requirements

A company's financial statements must present the company's economic and financial position fully and reliably, any change in this position and the financial results of the company's activities.

According to Russian legislation, commercial legal entities prepare interim financial statements (for each month and as a cumulative total for each quarter, six months and nine months) and annual financial statements.

Annual financial statements include:

- balance sheet;
- income statement;
- appendices to the above two items containing additional information on changes in equity, cash flows, movement of borrowed funds, changes in accounts receivable and payable, etc.;
- notes;
- audit opinions (issued in cases stipulated by legislation);
- interim financial statements including the balance sheet and the income statement unless otherwise stipulated by the founders (shareholders).

Tax returns are not included in the financial statements.

The information in the financial statement for the reporting year and the previous year must be presented in comparable formats. A company's financial statements must include the results of the activities of the company's branches, representative offices and other structural subdivisions.

If the company has subsidiaries or associated companies, consolidated financial statements must be prepared in addition to the company's own financial statements. The consolidated financial statements must include figures from the reports of companies located both in the Russian Federation and abroad.

From 2012, credit, insurance and listed companies are obligated to prepare consolidated financial statements in accordance with the modified version of IFRS officially adopted and published by the RF Ministry of Finance.

A financial year for a Russian legal entity is a calendar year.

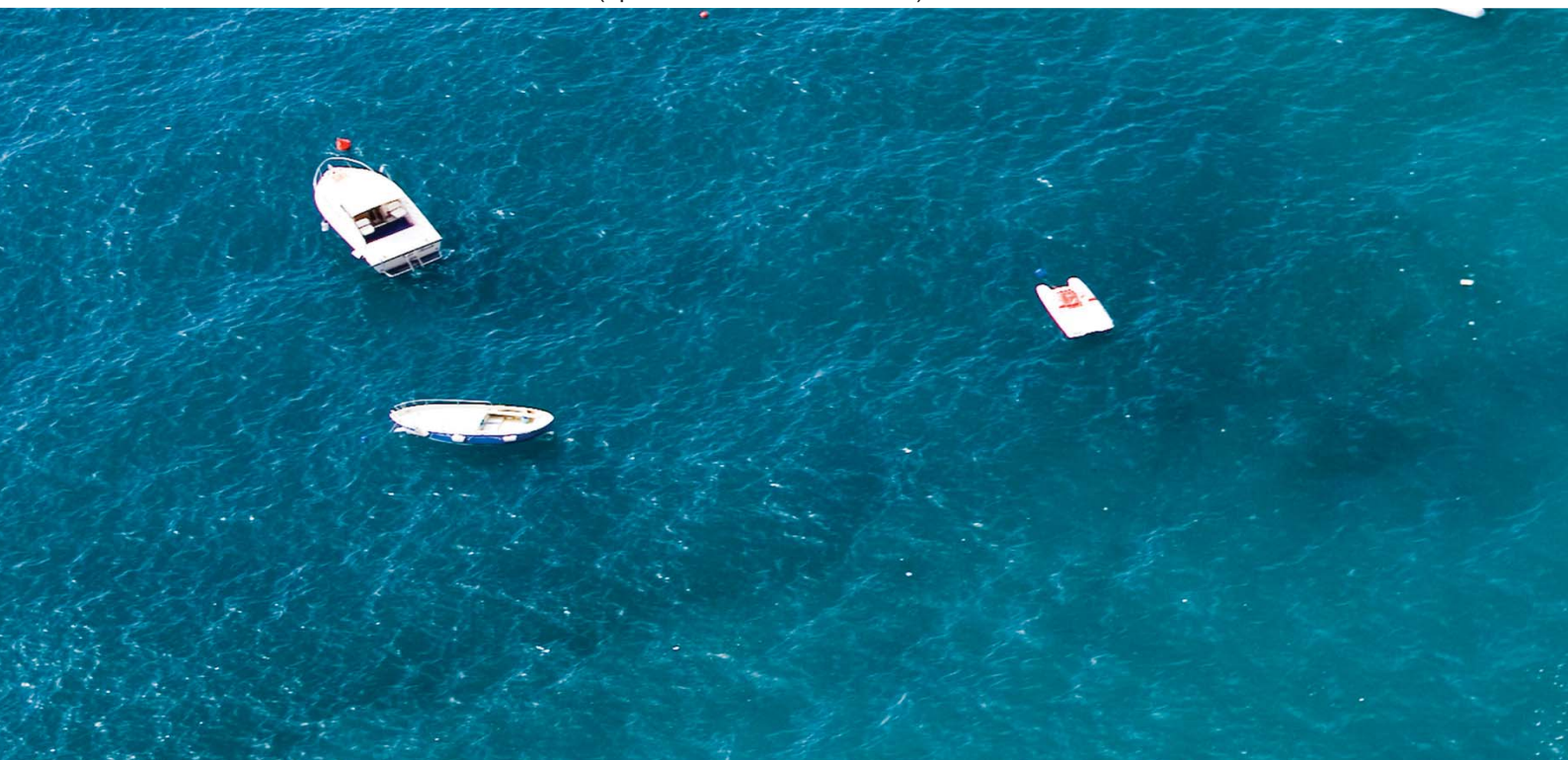
Companies submit annual financial statements to:

- shareholders;
- statistics authorities;
- tax authorities;
- other interested users (upon shareholders' decision).

Considering the fact that company's financial statements in Russia are prepared in accordance with statutory legislation that differs from IFRS, in order to present the financial statements to foreign founders or investors, the statutory financial statements are normally brought into compliance with IFRS. Presenting financial statements in accordance with IFRS and, consequently, increasing their transparency, will facilitate the inflow of foreign investment into the production sector of the economy and increase the possibility of obtaining credit.

Towards this end, the RF Ministry of Finance has elaborated on the Concept for the Development of Accounting and Reporting in the Russian Federation bringing Russian accounting principles in line with IFRS. New accounting standards are to be drafted and the old ones, amended to ensure broader integration of IFRS into Russian practice.

On 27 July 2010 Federal Law № 208-FZ Consolidated financial reporting was adopted by the Russian parliament. This law obliges credit, insurance and listed companies to consolidate financial reporting in accordance with a version of the IFRS, which has been officially adapted and published by RF Ministry of Finance.



Audit requirements

The Federal Law on Audit requires that the following entities have annual audits:

- open joint-stock companies;
- listed companies;
- companies participating professionally in the stock market;
- credit or insurance companies, clearing agencies, mutual insurance associations, currency, commodity and stock exchanges, incorporated investment funds, non-budgetary state funds, management companies of incorporated investment funds, unit investment funds or non-state pension funds (apart from non-budgetary state funds);
- companies (except for agricultural cooperatives and unions of such cooperatives) whose annual earnings from the sale of goods (performance of works, provision of services) for the year preceding the accounting year exceed RUB400,000,000 (USD12,500,00), or the value of assets on the balance sheet at the end of the year preceding the accounting year exceeds RUB60,000,000 (USD1,875,000);
- companies presenting and (or) publishing consolidated financial reports;
- companies for which audits are compulsory under other federal laws.

A compulsory audit shall be carried out every year.

Audit of listed companies, credit and insurance companies, non-state pension funds, companies that the state owns more than 25 percent of, state corporations, state companies and consolidated financial reporting shall only be carried out by audit organizations. Because audit activities are subject to self-regulation, to provide audit services in the Russian Federation, an audit organization should be a member of an appropriate self-regulatory organization.

Appendix 1.

Chart of Withholding Tax Rates

Country	Dividends percent	Interest percent	Royalties percent
Armenia	5; 10*	0	0
Australia	5; 15*	10	10
Austria	5; 15*	0	0
Azerbaijan	10	0; 10*	10
Belarus	15	0; 10*	10
Belgium	10	0; 10*	0
Brazil	10; 15*	0; 15*	15
Bulgaria	15	0; 15*	15
Canada	10; 15*	0; 10*	0; 10*
China	10	0; 10*	10
Croatia	5; 10*	10	10
Cyprus	5; 10*	0	0
Czech Republic	10	0	10
Denmark	10	0	0
Finland	5; 12*	0	0
France	5; 10; 15*	0	0
Germany	5; 15*	0	0
India	10	0; 10*	10
Indonesia	15	0; 15*	15
Ireland	10	0	0
Italy	5; 10*	10	0
Japan/USSR	15	0; 10*	0; 10*
Kazakhstan	10	0; 10*	10
Kyrgyzstan	10	0; 10*	10
Luxembourg	10; 15* / (5*)	0	0
Mexico	10	0; 10*	10
Netherlands	5; 15*	0	0
Portugal	10; 15*	0; 10*	10
Singapore	5; 10*	0; 7.5*	7.5
Slovak Republic	10	0	10
Slovenia	10	10	10
South Africa	10; 15*	0; 10*	0
Spain	5; 10; 15*	0; 5*	5
Sweden	5; 15*	0	0
Switzerland	5; 15*	0; 5; 10* / (0*)	0
Tajikistan	5; 10*	0; 10*	0
Turkey	10	0; 10*	10
Turkmenistan	10	5	5
UK	10*	0	0
Ukraine	5; 15*	0; 10*	10
USA	5; 10*	0	0

***Armenia:** 5 percent on dividends — this rate applies if the holding value is at least USD40,000; otherwise, 10 percent.

***Australia:** 5 percent on dividends — this rate applies to dividends paid out of profits that have borne the normal tax rate if the dividends are paid to an Australian company (not a partnership) that directly holds at least 10 percent of the capital of the Russian company. Also, the Australian company's holding must be worth at least AUD700,000, and the dividends must be exempt from tax in Australia; in all other cases, 15 percent.

***Austria:** 5 percent on dividends — this rate applies if the recipient company (not a partnership) directly owns at least 10 percent of the capital in the Russian company, and the holding value exceeds USD100,000; otherwise, 15 percent.

***Azerbaijan:** 0 percent on interest applies, inter alia, to interest paid to public bodies; otherwise, 10 percent.

***Belarus:** 0 percent on interest applies, inter alia, to interest paid to the government or the national bank; otherwise, 10 percent.

***Brazil:** 10 percent on dividends — this rate applies if the recipient directly owns at least 20 percent of the capital in the Russian company; otherwise, 15 percent.

***Brazil:** 0 percent on interest applies, inter alia, to interest paid to public bodies; otherwise, 15 percent.

***Bulgaria:** 0 percent on interest applies, inter alia, to interest paid to the government or the Bank of Bulgaria; otherwise, 15 percent.

***Canada:** 10 percent on dividends — this rate applies if the recipient company owns at least 10 percent of the capital or has voting power over the Russian company; otherwise, 15 percent.

***Canada:** 0 percent on interest applies, inter alia, to interest paid to the central bank; otherwise, 10 percent.

***Canada:** 0 percent on royalties — the rate applies, inter alia, to computer software, patents and know-how; otherwise, 10 percent.

***China:** 0 percent on interest applies, inter alia, to interest paid to public bodies, the central bank, or the government; otherwise, 10 percent.

***Croatia:** 5 percent on dividends — this rate applies if the recipient company owns at least 25 percent of the capital of the Russian company, and the holding value is at least USD100,000; otherwise, 10 percent.

***Cyprus:** 5 percent on dividends — this rate applies if the holding value is at least USD100,000 (under a new protocol to the Cyprus-Russia double tax treaty — EUR100,000; however, the protocol to the treaty is signed but not ratified yet); otherwise, 10 percent.

***Finland:** 5 percent on dividends — this rate applies if the recipient company (other than a partnership) directly owns at least 30 percent of the capital in the Russian company, and the holding value is at least USD100,000; otherwise, 12 percent.

***France:** 5 percent on dividends — this rate applies if the French company (i) has directly invested at least EUR76,225 in the Russian company and (ii) is taxed in France but is exempt with respect to dividends (i.e. participation exemption). A 10 percent rate applies if only one of the requirements is fulfilled; otherwise, 15 percent.

***Germany:** 5 percent on dividends — this rate applies if the German company owns at least 10 percent of the capital in the Russian company and the holding value is at least EUR80,000; otherwise, 15 percent.

***India:** 0 percent tax rate on interest applies, inter alia, to interest paid to public bodies; otherwise, 10 percent.

***Indonesia:** 0 percent tax rate on interest applies, inter alia, to interest paid to public bodies; otherwise, 15 percent.

***Italy:** 5 percent on dividends — this rate applies if the recipient company directly owns at least 10 percent of the capital in a Russian company and the holding value is at least USD100,000; otherwise, 10 percent.

***Japan:** 0 percent tax rate on interest applies, inter alia, to interest paid to public bodies and the central bank; otherwise, 10 percent.

***Japan:** 0 percent on royalties — this rate applies to copyright royalties; otherwise, 10 percent.

***Kazakhstan:** 0 percent tax rate on interest applies, inter alia, to interest paid to public bodies; otherwise, 10 percent.

***Kyrgyzstan:** 0 percent tax rate on interest applies, inter alia, to interest paid to public bodies and the central bank; otherwise, 10 percent.

***Luxembourg:** 10 percent — this lower rate applies if the Luxembourg recipient owns at least 30 percent of the capital in the Russian company and the holding value is at least EUR75,000 or its equivalent in national currency; otherwise, 15 percent. Under a proposed protocol to the DTT between Luxembourg and Russia, which is not ratified yet, a 5 percent rate applies to dividends if the Luxembourg recipient owns at least 10 percent of the capital in the Russian company and the holding value is at least EUR80,000 or its equivalent in national currency.

***Mexico:** 0 percent on interest — this lower rate applies, inter alia, to interest paid by public bodies; in other cases, 10 percent.

***Netherlands:** 5 percent on dividends — this rate applies if a Netherlands company (other than a partnership) directly owns at least 25 percent of the capital in a Russian company and has invested in it at least EUR75,000 or its equivalent in national currency; otherwise, 15 percent.

***Portugal:** 10 percent on dividends — this rate applies if the Portuguese company has directly owned at least 25 percent of the capital in the Russian company for an uninterrupted period of at least 2 years prior to the payment; otherwise, 15 percent.

***Portugal:** 0 percent tax rate on interest applies, inter alia, to interest paid to public bodies; otherwise, 10 percent.

***Singapore:** 5 percent on dividends — this rate applies if the beneficial owner of the dividends is the government of the other contracting state or company holding at least 15 percent of the share capital in the company paying dividends and has invested in this company at least USD100,000 or its equivalent in another currency; otherwise, 10 percent.

***Singapore:** 0 percent tax rate on interest applies to interest paid to the government of the other contracting state; otherwise, 7.5 percent.

***South Africa:** 10 percent on dividends — this rate applies if the recipient company directly owns at least 30 percent of the capital in the Russian company and the holding value is at least USD100,000; otherwise, 15 percent.

***South Africa:** 0 percent tax rate on interest applies, inter alia, to interest paid by public bodies; otherwise, 10 percent.

***Spain:** 5 percent on dividends — this 5 percent rate applies if (i) the Spanish company has invested at least EUR100,000 in the Russian company and (ii) the dividends are exempt in Spain. A 10 percent rate applies if only one of the conditions is met; otherwise, 15 percent.

***Spain:** 0 percent on interest — this lower rate applies, inter alia, to long-term loans (minimum 7 years) granted by credit institutions residing in a contracting state; otherwise, 5 percent.

***Sweden:** 5 percent on dividends — this rate applies if a Swedish company (other than a partnership) owns 100 percent of the capital in a Russian company (or in the case of a joint venture, at least 30 percent of the capital in the joint venture) and foreign capital invested exceeds USD100,000; otherwise, 15 percent.

***Switzerland:** 5 percent on dividends — this rate applies if the Swiss company (other than a partnership) owns at least 20 percent of the capital in the Russian company and the holding value exceeds CHF200,000; otherwise, 15 percent.

***Switzerland:** 0 percent rate on interest applies, inter alia, to interest paid in connection with the sale on credit of any industrial, commercial or scientific equipment; 5 percent on interest — this rate applies to loans of any kind granted by a bank; otherwise, 10 percent. Under a protocol to the DTT between Switzerland and Russia, which is not ratified yet, a 0 percent rate applies to interest paid.

***Tajikistan:** 5 percent on dividends — this rate applies if the recipient company directly owns at least 25 percent of the capital in a Russian company; otherwise, 10 percent.

***Tajikistan:** 0 percent tax rate on interest applies, inter alia, to interest paid to public bodies; otherwise, 10 percent.

***Thailand:** 0 percent tax rate on interest applies, inter alia, to interest paid to public bodies; 10 percent rate applies, inter alia, to interest paid to financial institutions; in other cases, the domestic rate applies (there is no general reduction under the treaty).

***Turkey:** 0 percent tax rate on interest applies, inter alia, to interest paid to the government or the central bank; otherwise, 10 percent.

***UK:** 10 percent on dividends — applies if dividends are subject to tax in the hands of the recipient company.

***Ukraine:** 5 percent on dividends — this rate applies if the holding value is at least USD50,000; otherwise, 15 percent.

***Ukraine:** 0 percent tax rate on interest applies, inter alia, to interest paid to the government or the central bank; otherwise, 10 percent.

***USA:** 5 percent — this rate applies if the recipient company owns at least 10 percent of the capital or voting power in the Russian company; otherwise, 10 percent.

***Uzbekistan:** 0 percent tax rate on interest applies, inter alia, to interest paid to the government or the central bank; otherwise, 10 percent.

***Venezuela:** 10 percent on dividends — this rate applies if the recipient company (other than a partnership) directly owns at least 10 percent of the capital in the Russian company and the value of the capital investment is at least USD100,000; otherwise, 15 percent.

***Venezuela:** 0 percent tax rate on interest applies, inter alia, to interest paid to the government or the central bank; 5 percent tax rate applies to interest paid to a bank; otherwise, 10 percent.

***Venezuela:** 10 percent tax rate applies to fees for technical services; 15 percent tax rate applies in case of royalties.

***Vietnam:** 10 percent on dividends — this rate applies if the recipient company has invested in the capital of the Russian company at least USD10 million; otherwise, 15 percent.



Appendix 2.

Fines for Tax and Customs Violations

Fines based on the Tax Code

Type of infringement	Fine
Late registration with the tax authorities	RUB10,000 (approximately USD312.5) in case of missing registration deadlines If the activity is conducted without registration – 10 percent of the income received as a result of activity, but not less than RUB40,000 (approximately USD11,250)
Late submission of tax returns	5 percent of the amount due for each full or part month late, but not more than 30 percent and not less than RUB1,000 (approximately USD31.25)
Substantial violation of the rules for accounting for taxable income and expenses	RUB10,000 (approximately USD312.5) If committed in several tax periods – RUB30,000 (approximately USD938). If resulted in understatement of tax base - 20 percent of the amount of tax underpaid (if any), but not less than RUB40,000 (approximately USD1,250)
Default of payment or underpayment of taxes	20 percent of the tax underpaid as a result of the understatement of the taxable base or illegal actions. 40 percent of the tax underpaid if the tax underpayment was deliberate
Non-withholding and/or default of payment of taxes by a tax agent	20 percent of the tax not withheld and not paid by the tax agent

In the above cases, if a taxpayer corrects the errors themselves and pays additional taxes and fines payable, late payment interest for erroneous book-keeping and tax calculation should not be assessed.

Normally late payment interest is charged in the amount of 1/300 of the Central Bank of the Russian Federation refinancing rate (8 percent as of 26 December 2011) for each day of delay in tax payment. Currently interest would be 0.027 percent per day.

Fines based on the Administrative Code

Type of infringement	Fine
Violation of terms of registration with the tax authorities	RUB500 - 1,000 (from USD16 to USD31) for missing registration deadlines; RUB2,000 - 3,000 (from USD63 to USD94), if the activity is executed without registration
Violation of terms for submission of tax returns	RUB300 – 500 (from USD9 to USD16) or prevention
Non-submission of essential information for tax control purposes	For individuals – RUB100 - 300 (from 3 to 9), For company's executives – RUB300 - 500 (from 9 to 16) – non-submission of information, or submission of incomplete information necessary for tax control purposes

Fines based on the Criminal Code

The Criminal Code provides responsibility for tax evasion by an individual or a legal entity.

According to the Russian Criminal Code, officials of a company could be subject to criminal fines for underpayment of taxes by the company.

In particular, material tax evasion could result in confinement for a period of up to six years, prohibition on executing specific activities for three years and a fine in the amount of RUB200,000 - 500,000 (from USD6,250 to USD15,625) or in the amount of salary or other income of the offender for a period from one to three years.

Tax evasion is considered material if the amount of delinquent taxes over three years exceeds RUB10,000,000 (approximately USD312,500), and provided that the amount of delinquent taxes exceeds 20 percent of the total amount of taxes payable or exceeds RUB30,000,000 (approximately USD937,500).

Organization or individual is free of criminal liability on the condition that they have committed tax evasion for the first time and have paid to the budget, in full, all tax arrears, corresponding late payment interest, and fines.

Fines for customs violations

Type of violation	Fines
Unlawful transportation of goods and/or vehicles across the customs border of the Customs Union	Fine of 50 percent to 300 percent of the value of goods and/or vehicles with their possible seizure
Non-declaration of goods and/or vehicles under the established forms	Fine of 50 percent to 200 percent of the value of goods and/or vehicles with their possible seizure
Incorrect declaration (e.g. provision of incorrect information regarding name, description, classification code of goods, etc.) if such declaration caused underpayment of customs duties	Fine of 50 percent to 200 percent of the underpaid customs payments with possible seizure of goods/vehicles in question
Violations of the requirements of the customs procedure	Fine of 50 percent to 200 percent of the value of goods and/or vehicles with their possible seizure
Illegal acquisition, use, storage, or transportation of the goods and/or vehicles	Fine of 50 percent to 200 percent of the value of goods and/or vehicles with their possible seizure
Customs duties evasion	Fine of RUB100,000 - 500,000 (from USD3,125 to 15,625) or at the rate of 1-3 years salary or confinement for a period of up to two years In case of especially large scale customs duties evasion, fine of RUB300,000 - 500,000 (from USD9,375 to 15,625) or at the rate of 2-3 year's salary or confinement of up to 5 years with forfeit of right to hold some posts or carry out some activities for a period of up to 3 years, or without such forfeiture. The evasion of customs duties is considered large scale if the total sum of unpaid customs duties exceeds RUB2,000,000 (approximately USD62,500) and on an especially large scale if it exceeds RUB10,000,000 (approximately USD312,500)

Appendix 3. KPMG's Tax & Legal Department: Cutting Through Complexity

Why KPMG

In the Russian Federation, the tax and legal system is constantly changing. These changes occur rapidly, and tax payers are frequently unable to prepare for them. We, at Tax and Legal KPMG in Russia and the CIS, have specialists who are also members of the State Duma's Budget Committee, which gives us a competitive advantage. We understand what lawmakers have in mind when they are drawing up bills, and we are able to anticipate future changes in legislation.

We combine in-depth knowledge with the international experience of KPMG specialists in 150 different countries to offer progressive approaches to your tax and legal issues. With our help, company-clients are optimizing their business practices, and they are freeing up additional financial resources.

We are open to constructive dialogue and propose practical solutions to any and all issues.

Our team

KPMG in Russia and the CIS employs more than 400 tax and legal consultants, including both local and foreign specialists. They bring with them vast experience not only in advisory services but in the business world as well. With his own extensive knowledge of tax advisory services in the local market, Graham Povey heads Tax & Legal in Russia and the CIS, overseeing individual practice groups. As the head of a strong and cohesive team of professionals, Graham makes it his department's priority to be not only our clients' consultants who help solve urgent and sensitive issues quickly and efficiently but also their trusted partners.

Our approach to key issues:

- **Tax effectiveness.** To raise tax effectiveness, KPMG uses a combined approach that includes improving cash flow, centralizing funds, reallocating the group's management expenses, international planning, implementing appropriate ERP and tax management systems and fiscal management.
- **Transfer pricing.** We have completed more than 100 complex analyses of transfer prices for Russian and international clients across many different sectors.
- **International tax planning.** We will help you find the most effective way to build your international group structure. If you have subsidiaries located abroad, we will help you to structure their activities.
- **Mergers and acquisitions.** Our team provides a full range of services from financial, legal and tax due diligence to restructuring advice and legal advice on transaction agreements.
- **Tax dispute resolution.** Our litigation group provides support during tax disputes, which includes representing clients' interests in court, supporting clients during tax audits and throughout the pre-trial settlement process, preparing appeals of court decisions and appeals for tax authorities to take action or to remain uninvolved, and interpreting laws and practice for clients who are dealing with state authorities

Corporate tax services

KPMG has teams dedicated to addressing all of the tax issues that corporations may confront:

- indirect tax,
- transfer pricing,
- effective management of tax liabilities (and its outsourcing),
- development of problem-solving methods,
- tax considerations during restructuring,
- international tax planning,
- tax structuring for mergers and acquisitions, including support for after companies have been integrated.

Glossary of terms

Personal services

We provide services for individuals and company staff. These services include helping to ensure personal compliance with tax legislation, implementing relevant company-wide programs, pension planning and assisting with other personnel issues. Our specialists are also able to provide professional wealth management services. Personal services also tie into secondment structuring, both inbound and outbound, and related tax, legal and immigrations issues.

Legal advice

In addition to our standard corporate registration services, KPMG assists with mergers and acquisitions and provides legal support for companies and for individuals' own projects, in terms of legal due diligence and drafting of transaction documents.

Complex tax projects

The specialists at KPMG's Tax & Legal have experience supporting from a tax and legal perspective IT projects and projects requiring financial and strategic consulting; we analyze financial risks, develop progressive approaches and adapt systems to conform with Russian and international legislation. These projects have included introducing new software systems, overseeing commercial restructuring of holding companies, advising on money laundering issues and issues related to corporate intelligence and resolving commercial issues. Moreover, we actively participate in projects where we work to improve personnel management and support the improvement of operational efficiency within our clients' companies.

AUD	Australian dollar
BRIC	Brazil, Russia, India and China
BVI	British Virgin Islands
CHF	Swiss franc
CIS	Commonwealth of Independent States
CJSC	Closed joint stock companies
ERP	Enterprise Resource Planning
EUR	Euro
FCZ	Free customs zone
FDI	Foreign direct investment
FLE	Foreign legal entity
FMS	Federal Migration Service
FRF	French Franc
FZ	Federal law (Federalni Zakon)
GDP	Gross domestic product
HQS	Highly-qualified specialists
ID	Identification
IFRS	International Financial Reporting Standards
IT	Information and technology
JSC	Joint stock companies
Kg	Kilogram
LLC	Limited liability companies
OJSC	Open joint stock companies
PE	Permanent establishment
PIT	Personal income tax
R&D	Research and development
RA	Rating agency
RF	Russian Federation
RLE	Russian LinkExchange
RO	Representative office
RUB	Russian ruble
SEZ	Special economic zone
UCT	Unified Customs Tariff
UK	United Kingdom
US	United States
USD	United States dollars
USSR	Union of Soviet Socialist Republics
VAT	Value added tax
YoY	Year-on-year

Contact us:



Graham Povey
Head of Tax and Legal
in Russia and the CIS
Partner
T: + 7 (495) 937 44 77
F: + 7 (495) 937 44 99
E: gpovey@kpmg.ru



Alisa Melkonian
Head of Tax and Legal
KPMG North-West Regional Center
Partner
T: +7 (812) 313 73 00
F: +7 (812) 313 73 01
E: amelkonian@kpmg.ru

www.kpmg.ru

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

Legal services may not be offered to SEC registrant audit clients or where otherwise prohibited by law.

© 2011 ZAO KPMG, a company incorporated under the Laws of the Russian Federation, a subsidiary of KPMG Europe LLP, and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in Russia.

The KPMG name and logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International.