

KPMG IN RUSSIA AND THE CIS

Doing Business in Russia

Your Roadmap to Successful Investments

2015

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Tax and Legal





SAINT PETERSBURG

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Foreword

Dear Reader,

This brochure has been prepared to provide an economic overview of Russia as well as to introduce the tax and legal issues that are important for those planning to do business in Russia. In particular, there is a brief discussion of the benefits of investing in the special economic zones, which include Skolkovo, the new “Russian Silicon Valley”, which is situated near Moscow.

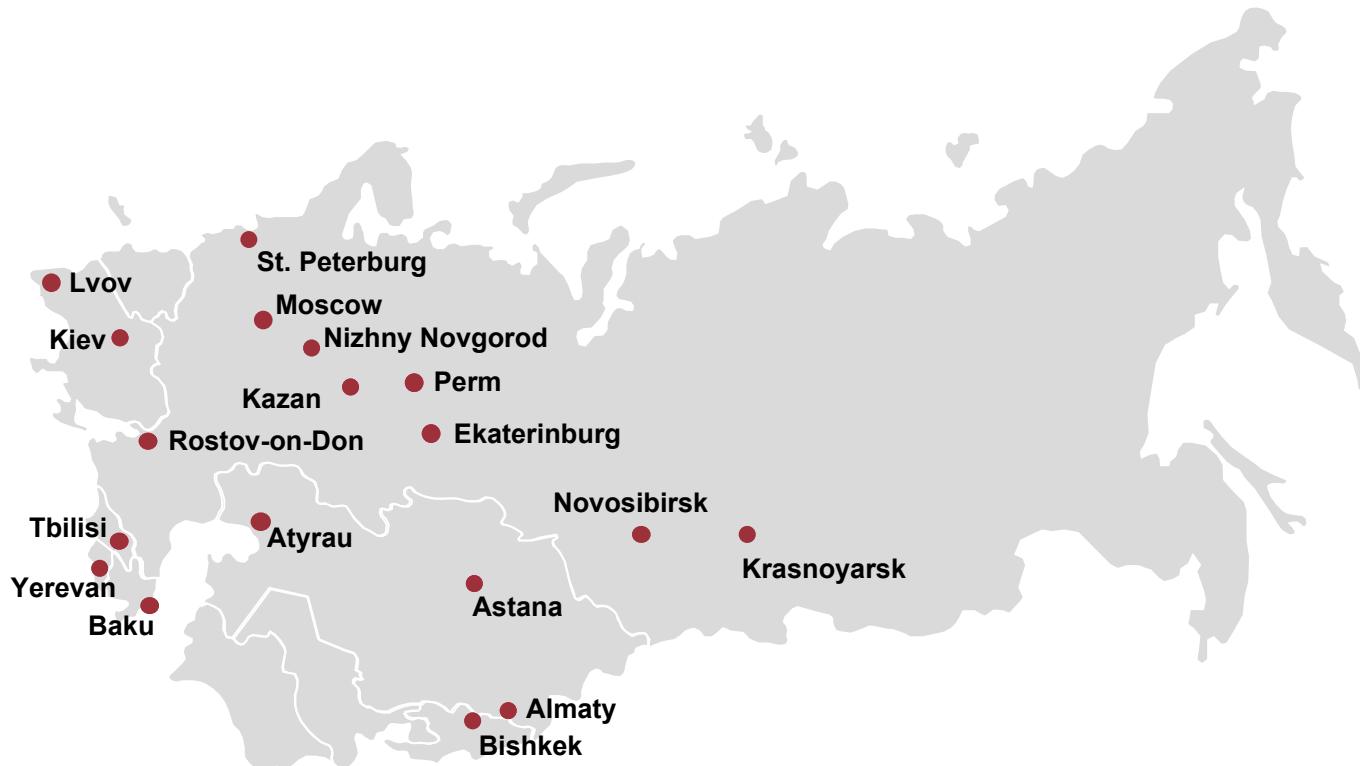
Russian tax and civil legislation is constantly developing, meaning that sometimes there is no clear answer to what might be considered a simple question. In such circumstances, court cases and rulings are important sources for interpreting legislation.

All information is correct as of 1 March 2015. 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 of doing business in Russia before undertaking any business ventures themselves.

About KPMG

KPMG is one of the world's biggest advisory, audit, and tax and legal firms, one of the global 'Big Four' companies. Comprising a global network of professional firms providing audit, tax and advisory services, KPMG employs over 162,000 outstanding professionals who work together to deliver value in 155 countries worldwide. KPMG has been working for more than 25 years in Russia and has more than 4,000 professionals working at 18 offices spread across seven CIS countries.

In recent years, KPMG in Russia and the CIS has been one of the fastest growing KPMG practices in the world. KPMG has been consistently rated the No. 1 audit firm in Russia from 2009–2013 by Expert RA and was named Tax Firm of the Year from 2012–2013 in Russia by the International Tax Review magazine.





Introduction to Russia

Country Facts

COUNTRY SNAPSHOT

Capital:	Moscow
Area:	17 mln sq km
Population (2014):	> 146 mln (Rosstat)
Cities with over 1 million citizens:	15
Number of regions:	83
President:	Vladimir Putin
Prime Minister:	Dmitry Medvedev
Currency:	Rouble (RUB)
Nominal GDP (2014):	RUB70,976 bln (Rosstat)
Real GDP growth (2014):	+ 0.6 % (Rosstat)
GDP PPP (2013):	USD3,460 bln (World Bank)
GDP per capita in PPP (2013):	USD24,114 (World Bank)
FDI (2013):	USD94.1 billion
Inflation (2014):	11.4% (Rosstat)
Foreign Reserves (06.02.2015):	USD374.7 bln (Russian Central Bank)

- According to UNCTAD (the United Nations Conference on Trade and Development), FDI into Russia rose 83% in 2013 to \$94 billion, putting Russia in third place globally after the US and China.
- GDP in 2014 grew by 0.6 percent
- Russia is the 6th largest country by GDP PPP
- Industrial output in 2014 was up 1.7 percent year-on-year
- Unemployment was 5.2 percent at the end of 2014. Russia has the largest labour force in Europe
- Russia is the largest country in Europe in terms of internet usage

Investment climate

The Russian economy is currently seeking to develop in quite an adverse foreign political and economic environment. Despite this, Russia has continued to undertake various measures aimed at improving its investment attractiveness. In particular, as announced at the 2014 Saint Petersburg International Economic Forum, Russia is seeking to maintain economic relations with the West, but actively develop and grow its economic relations with the East.

According to the 2015 'Doing Business' ratings, which measure how easy it is to conduct business operations in different countries, Russia was ranked at number 62¹ (having improved 30 positions compared with the previous year²). In particular, Russia was quite highly ranked (34th and 12th position, respectively) when measuring how easy it is to start a business or register property.

Revision and simplification of administrative procedures have significantly increased the attractiveness of investing in Russia.

It should be noted that continual improvement of the attractiveness of investment in Russia remains one of the government's key strategies. In particular, on 27 January 2015, the Russian Government issued a decree on high-priority measures to assure stable economic development and social stability in 2015³. Among the key points in the Government's actions were moves to increase the possibility of attracting renewable investment resources of significant value to the most important sectors of the economy.

As part of increasing the investment attractiveness of the Russian economy, Russia has developed a tax incentive system (both at the federal and regional level) aimed at making the investment process more effective.

The range of measures taken is quite extensive and includes developing special economic zones, creating 'advanced development' territories, and improving local tax incentive systems (diversifying the investment amounts needed to receive incentives, varying incentive types, etc.).

In addition, various measures are currently being taken to improve infrastructure in Russia.

Building on trends that started in previous years, there are an extensive combination of measures being implemented to improve Russia's investment attractiveness, which as of today have led to positive results. The current difficult foreign economic and political environment has not halted this process but rather accelerated it, encouraging flexibility and proactive change, all aimed at achieving the set goals.

Encouraging innovation and modernisation in the economy

Over the past few years, Russia has taken significant strides towards founding economic development on innovation. Both the President and government have voiced their support and are allocating substantial budget funds towards these goals.

Russia is striving to progressively develop in order to compete globally and overcome the failings experienced in the 1990s. At the same time, Russia is seeking to take advantage of international best practice.

The Russian President has already signalled that Russia's goal is to gradually transition away from an economy based on oil and raw material extraction to an economy focused on technology. To reach this goal, Russia is seeking to increase the hi-tech sector's share of GDP, grow the proportion of innovative products in

total production output, increase R&D spending, and make Russia's innovative products highly globally competitive. Many are sceptical about Russia's chances of success; nevertheless, the goal has been set.

The Russian business community is currently actively discussing Russia's innovation strategy, which runs until 2020 and forms the basis on which state policy can be consistently made. A conservative reading of the innovation strategy finds it covering economic development, supporting and motivating the domestic talent pool, protecting intellectual property, and establishing and supporting the necessary infrastructure. The strategy also covers improving the legislative framework, reducing administrative (tax/customs) barriers, providing tax incentives, and creating the prerequisites to support demand for innovative products.

Russia has already adopted and implemented a number of measures to support the development of an innovative economy. A number of state-controlled institutions now exist to invest in "innovative" companies. For example, the Russian Corporation of Nanotechnologies (Rusnano) supports projects in the field of nanotechnology, while the Russian Venture Corporation allocates funds to support venture capital based projects.

Russia additionally provides an extensive list of tax concessions to companies with a high degree of intellectual capital. For example, IT companies have had their social security contributions reduced from 30 percent to 14 percent until 2017, while their intangible assets are now amortised over 2 years instead of 10. A zero-percent profit tax rate has been introduced on income from the disposal of shares in Russian hi-tech companies (providing certain conditions are met), and legislation is being developed to improve the accounting of R&D expenses for profits tax purposes.

¹ <http://www.doingbusiness.org/rankings>

² <http://www.forbes.ru/news/272003-rossiya-podnyalas-v-reitinge-doing-business-na-62-mesto>

³ <http://www.rg.ru/2015/02/02/plan-doc.html>

Significant tax and customs concessions are also being granted to residents of special economic zones (set up to promote innovation and technological development). These concessions include decreases in major taxes (profits tax/social security contributions) through to full tax exemptions (property tax, land tax and transportation tax).

Some of the measures adopted for participants in the Russian flagship 'Skolkovo' project are internationally unique. The purpose of Skolkovo is to create the conditions necessary for successful innovation at every stage of development, including commercialisation of the end-results. Skolkovo provides all of the infrastructure needed to concentrate intellectual capital and generate innovative solutions in the priority industries of nuclear technology, energy efficiency, aerospace technology, IT and pharmaceuticals.

Legislation provides VAT, profits tax and property tax exemptions for Skolkovo residents, along with a further reduction in the rate of social security contributions down to 14 percent for a period of up to 10 years. Customs duties on imported equipment that meets specific requirements can also be reimbursed, while simplified visa procedures can be adopted to bring in foreign specialists.

It was announced that Skolkovo's basic infrastructure will soon be completed, though companies that expressed interest in participating in the project before its completion have been able to be physically located elsewhere while still enjoying all of the project's benefits, including tax and customs concessions. Current legislation applied these privileges up until 2014.

Many recognised global hi-tech leaders, such as Intel, Cisco, Microsoft, Siemens and Boeing have already signed memorandums of understanding with the Skolkovo Foundation (the project's managing body). Some of them have announced significant investments (billions of US dollars) to be made in the Skolkovo project.

This flagship project is currently still at the implementation stage and the business community is awaiting the initial results.

If the Skolkovo project is successfully combined with other state-supported measures to encourage innovation, Russia is very likely to have the opportunity of taking its place among those countries in the world which have developed, innovation-based economies. The key is to make the most of this opportunity in a competent and professional manner, so that everyone, including Russia's citizens and foreign partners, believe in the concept of the innovation economy and actively support implementation of 'innovation-based' plans by the government.

Living and working in Russia: Useful tips

Learn Russian. This will not only help you in everyday communication (many street vendors, waiters and shop assistants do not speak English) but also when doing business. Even if you hold meetings in English or use an interpreter, it can still be useful to know how things are being translated and understand what has been missed out.

Develop personal relationships. Relationships are quite important in Russian business. You may not always be rewarded in cash (there are laws against bribery in Russia), but it always pays to be a sociable, reliable individual.

Personal safety is not a problem. Moscow is as safe as, or safer than (in terms of street violence), many other major Western cities. Though like in other major Western cities, it is still unadvisable for people to walk around the suburbs late at night, and advisable to avoid large crowds of football supporters.

Beware of traffic. Expats who hire a local driver for themselves and their children should choose carefully, selecting individuals who are competent and patient. Expats who drive themselves, or who walk,

should exercise extreme caution as many drivers – sometimes apparently randomly and at all times of the day – perform illegal and unexpected manoeuvres.

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 many quality restaurants in Moscow and St. Petersburg (and elsewhere).

There can be some ethnic intolerance. It should be noted that incidents of racism continue to be reported in Russia. People who physically do not look like native Russians should take special care (avoid being alone) in certain situations, including while using public transport.

If you are coming to stay:

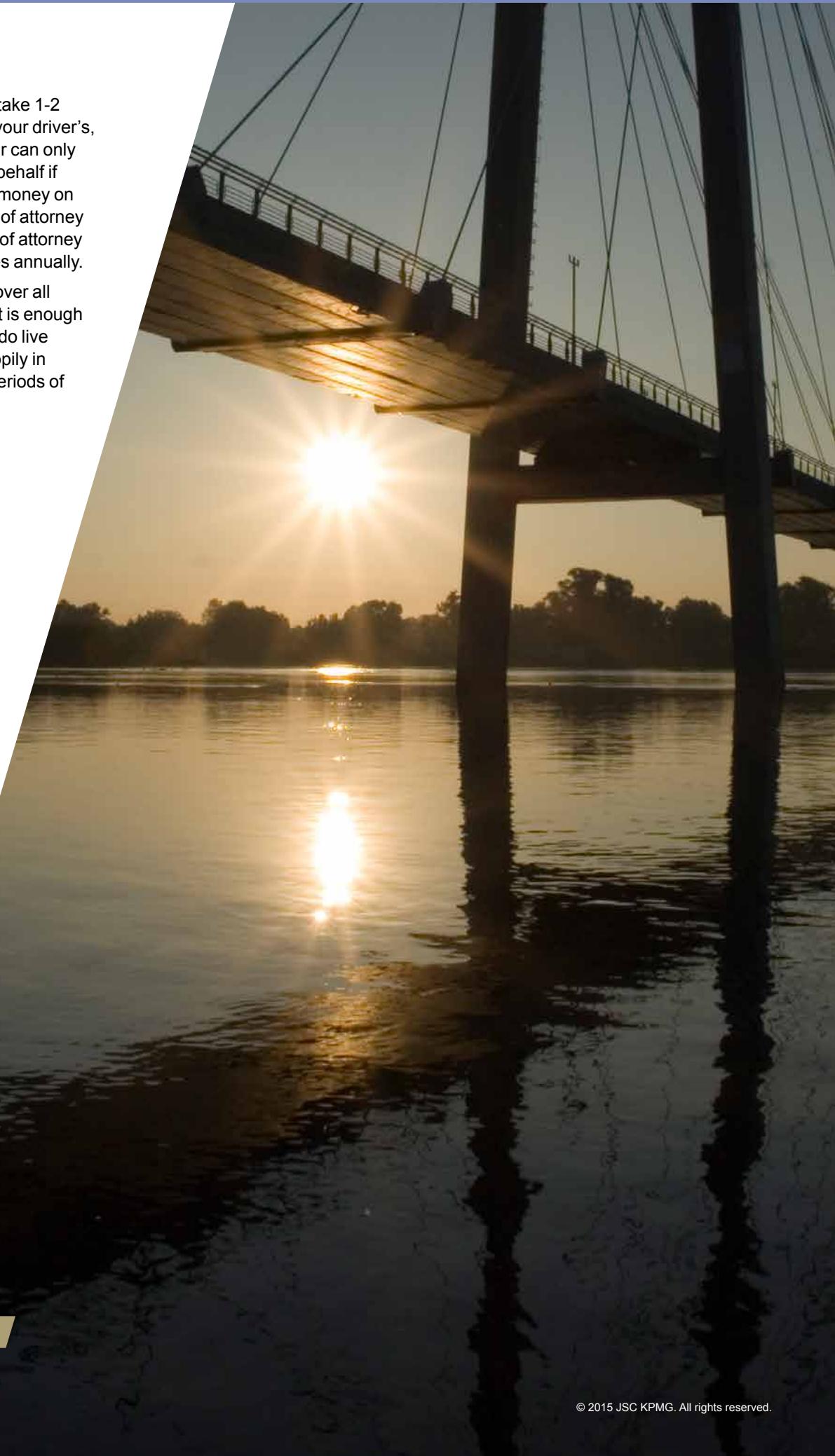
- An exemption from customs duties is available for bringing household goods into Russia within certain limits stated in the agreements of the Customs Union.
- Qualified (and English-speaking) household staff can be found easily through other expats.
- There are English, German, French, Japanese and other foreign language schools catering to expat children in Moscow and St. Petersburg (as well as in some other cities), although the choice of school and curricula is likely to be less diverse than in your home country.

Routine issues:

- As an expat (except those with 'highly qualified' visa status), you must register and deregister each time you travel abroad or away from your place of residence in Russia.
- Some bills require that you must physically go to a certain bank and pay cash. Fortunately, cash machines are readily available.

- Registering your car can take 1-2 days of your, or perhaps your driver's, time. However, your driver can only register your car on your behalf if you have spent time and money on granting the driver power of attorney over your car. The power of attorney must be updated 2-3 times annually.

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



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Starting a Business in Russia

Legal structures for starting a business in Russia

Investors often face the problem of deciding which legal structure they should choose for their business in Russia. Below you can find guidance on establishing the following options:

- Conducting direct sales
- Distributorship contracts
- Representative offices or branches
- Russian subsidiaries

Direct sales

A foreign legal entity (FLE) that sells goods directly from abroad to customers located in the Customs Union (in particular, in Russia) would not be subject to Russian taxes and would not be required to establish a presence in Russia via any corporate structures.

The Russian customers are responsible for clearing the imported goods through customs and for paying customs duties and taxes (import VAT, excise), as well as customs processing fees.

Import duty rates are set 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 favoured nation' status with Russia. If goods are imported from developing countries with most favoured nation status, then the customs rates can be reduced. Import VAT is payable on the customs value of the imported goods, and 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 is also likely to be exempted from import customs duties, provided certain requirements are met.

Some goods imported into the Customs Union are subject to non-tariff regulations (e.g. certification, licensing, quotas, etc.). Currently, legislation on

non-tariff regulations is being developed in both the Customs Union and Russia.

Customs clearance fees depend on the cost of the services rendered by the customs authorities, but cannot exceed RUB30,000 (USD490).

A 'disposal charge' is also payable on imported vehicles. The rates of this charge can vary depending on the engine power, vehicle weight and seating capacity.

Since 2012, Belarus, Kazakhstan, and Russia have formed a single economic zone. These countries' economies are now more tightly integrated than they were under the Customs Union, and freedom of movement for goods, services, capital and labour is ensured, along with guaranteed equal treatment for legal entities.

In 2012, Russia ratified the protocol on joining the World Trade Organisation (WTO) and became a full member. As part of joining the WTO, Russia now has certain commitments related to various sectors of the economy and international trade:

- Import duties on certain products have been lowered, while import duties on computers, components for manufacturing computers and hardware components must be removed within three years;
- Foreign insurance companies will be permitted to open branches in Russia after the transition period;
- Technical regulations will be simplified and developed based on international standards;
- A transition period is provided that will allow investors in the Kaliningrad and Magadan special economic zones to continue to receive tax breaks;
- There will be a transition period lasting until 1 July 2018, during which current industrial assembly regulations will be in force;
- Russia will guarantee a certain level of transparency concerning foreign-trade legislation;

- State subsidies to the agricultural sector will be USD9 billion per year in 2012. Subsequently, state subsidies will decrease yearly.

Distributorship contract

A FLE has the right to conclude a distributorship contract with a Russian company, allowing the Russian company to sell the FLE's goods in Russia. If one of these agreements is signed, then the foreign legal entity shall not be taxed in Russia. The Russian distributor shall be responsible for clearing the 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

A FLE can choose to establish a presence in Russia through a representative office (RO) or branch. A RO or branch is not a Russian legal entity, but is part of the FLE, and, therefore, the head office bears full responsibility for the obligations and actions of the RO or branch. A RO is only authorised 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 can perform, including the signing of sales contracts. However, the Russian customs authorities often try to identify the final Russian buyers of the goods being imported, and can question the right an FLE's branch has to declare goods for customs clearance. As a result, it can be difficult for a Russian branch to clear goods through customs.

ROs and branches are registered via accreditation from the Federal Tax Service of Russia, which has been acting as the accreditation agency since 1 January 2015. The Federal Tax Service accredits ROs and the branches of all foreign companies, except for foreign banks and foreign civil aviation companies (for these entities, their

ROs are respectively accredited by the Central Bank of Russia and the Federal Aviation Service).

Any FLE intending to open an RO or branch in Russia must pay a state fee of RUB120,000 (USD1,959). Once accredited, the RO's or branch's term is unlimited. The Federal Tax Service reviews the application for accreditation within 25 business days, and once certified (via the issuing of a certificate on accreditation by the Federal Tax Service), the FLE should file an application for tax registration with the local tax authorities, and register its RO or branch with the Federal State Statistics Service and social security funds.

Bank accounts can be opened after the RO or branch has been accredited with the accreditation authority and registered with the tax authorities and the Federal State Statistics Service.

In total it takes approximately 6-9 weeks to set up an RO or branch after all the necessary documents have been submitted to the registration authorities. As the setting up process requires the preparation, approval, and, in many cases, notarisation and apostillation (legalisation) of a large number of documents, the total time required is likely to exceed the period mentioned above.

An RO is authorised to conduct certain “preparatory and auxiliary” activities for its head office. A branch, on the other hand, is able to conduct all of the activities that the head office itself performs, including the signing of sales contracts. Depending on the exact scope and nature of activities, both ROs and branches can be used to create a taxable presence in Russia for their company.

Russian subsidiary

An FLE can choose to establish a presence in Russia via establishment of 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 as securities under Russian securities legislation. Shares in a JSC, on the other hand, are considered to be securities and are subject to registration with the Bank of Russia's department governing admittance to financial markets. A JSC can be either public (its shares are publicly traded) or non-public.

Foreign companies often use LLCs to conduct their wholly-owned business in Russia. LLC law has many provisions similar to those in JSC Law; however, there are certain distinctions.

Generally, only one participant (individual or legal entity) has the right to establish an LLC or JSC. However, a solely-owned legal entity cannot establish another LLC or JSC as a subsidiary (i.e. one that would be 100-percent owned by the legal entity).

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. For each share in one particular class, the dividends and voting rights are equal.

Both forms of joint stock company – public and non-public – have the right to 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 non-public companies.

Recent changes to Russian corporate law allow shareholder agreements in which participants can, 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, reorganisation and liquidation.

The governing bodies of a JSC are the general shareholders meeting, the board of directors and the executive body (a sole individual or a group).

The executive body manages the JSC's day-to-day affairs and reports to the board of directors and the general shareholders meeting.

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

Limited Liability Company

The provisions in LLC law are similar to those in JSC law.

An LLC's participants are not liable for the LLC's obligations, and any losses the participants may experience are limited to the value of their respective participation units.

LLC charters are likely to restrict participants in an LLC from transferring participation units to third parties. If this is indeed the case, a participant has the right to withdraw from an LLC at any time and require that the LLC (or the remaining participants) give the withdrawing participant a portion of the LLC's net assets commensurate with the proportion of participation units the participant owned.

LLC charters can limit the transfer of participation units or require that the other participants' or the LLC's approval is gained first before transferring the units.



Economic partnership

A recently passed law introduces a new legal form for commercial legal entities — economic partnerships⁴. This legal form is designed for companies involved in innovative activities (including the provision of venture capital). A partnership can be created by two or more persons (both individuals and legal entities can participate in a partnership). The maximum number of participants in an economic partnership is 50. If the number of participants in an economic partnership exceeds 50, it must be re-organised as a JSC within a year.

The constitutive document of an economic partnership is the Articles of Association. In addition, when establishing an economic partnership, its participants should conclude a special partnership management agreement to govern the rights and obligations of the participants, management of the partnership, its activities, etc. This agreement is certified and kept

by a notary. The share capital of the economic partnership is divided into shares. Contributions to the share capital can be made in the form of money, securities, property rights or other rights with a monetary value.

The partners have the right to participate in managing the partnership and also to allocate profits and expenses. The allocation of profits and expenses can be disproportionate to the 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 and indicate the size of their stakes in the partnership capital, as well as list equity stakes belonging to the partnership itself.

If the economic partnership is technically insolvent and the intellectual property it owns is seized and sold, the participants in the partnership are liable for the partnership's obligations. These can

be met by one participant acting independently, a group of participants, or all of them together.

The law that gives effect to economic partnerships was passed on 1 July 2012. Since then, only a few economic partnerships have been established (registered) in Russia. Therefore, some of the practical aspects of conducting commercial activities and managing economic partnerships remain unclear. It is thus advisable to establish a Russian subsidiary in one of the more common legal forms — as either an LLC or JSC.

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

⁴ Federal Law N 380-FZ "On economic partnerships" of 3 December 2011, effective 1 July 2012

Foreign investment law

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

Foreign investments are regulated both on a Federal and regional level. According to Federal law on foreign investments, the rights of foreign investors to conduct business activities in Russia, and their rights to take the profits gained in Russia must be the same as those of native Russian investors. Certain limitations can be placed on foreign investors, but only if these limitations are required to protect constitutional guarantees such as those protecting the health, rights and lawful interests of citizens, or state defence and security measures.

Foreign investors are generally subject to the same treatment as Russian investors. Licensing, notification and permission requirements that may restrict business activities 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 of a company with foreign participation cannot be seized in order to be requisitioned or nationalised, unless stipulated by Russian Federal or international laws.

If requisition occurs, the value of the seized property must be reimbursed to the foreign investor or company with foreign participation. If nationalisation takes place, the value of the nationalised property and incurred losses must be reimbursed.

The law also offers foreign investors protection from unfavourable changes in Russian legislation if the foreign investor holds more than 25 percent of a Russian company's share capital, and this protection also covers priority investment projects, 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 in 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') and in companies that carry out some other activities, such as:

- Exploring subsoils and extracting mineral resources on land plots of Federal significance;
- Aerospace activities;
- Certain services provided by natural monopolies or companies with a dominant position on the Russian market;
- Harvesting 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-technology activities.

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

Non-Russian state companies can engage in some transactions, though only after obtaining approval from Russian state authorities (i.e. they can purchase more than 5 percent of the voting shares (participation units) in 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 allowed to carry out transactions that would result in them obtaining control over a strategic company. However, these transactions must be approved by Russia's 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 laws that allow tax concessions to be given to investors. Currently, the majority of investment tax concessions relate to profits tax and property tax. Investment tax concessions are normally granted only for the investment project's payback period, and the amount of the tax saving gained cannot exceed the amount initially invested in the project. Regional authorities can establish additional conditions for granting concessions (i.e. employing individuals residing in the region, assisting in the development of infrastructure, etc.).

A Special Economic Zone (SEZ) is a clearly defined and limited piece of territory within a particular region of Russia, in which business is carried out under special circumstances granting certain tax, customs and other concessions to the residents of the SEZ. The residents in a SEZ can be legal entities or individual entrepreneurs, though they must conclude an agreement to carry out their activities and operate within the territory of the SEZ, and be registered with the SEZ's authorities.

The establishment and operation of SEZs in the Russian Federation is regulated by an agreement between the governments of Russia, Belarus and Kazakhstan⁵, by Federal Law No. 116-FZ⁶ and by specific Federal laws that regulate particular SEZs (if any).

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

- A technological implementation SEZ;
- An industrial and innovation SEZ;
- A tourism and recreation SEZ;
- A Ports and Logistics SEZ.

SEZs are established with intended lifespans of 49 years.

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

Apart from the abovementioned SEZs, there are some combined SEZs in the Kaliningrad region (effective until 1 April 2031) and the Magadan region (effective until 31 December 2025). The residents of these SEZs have been allowed by special laws to conduct various types of activities.

There are currently 17 SEZs operating in the Russian Federation.

To become a resident of a SEZ, applicants should comply with the requirements laid down by their desired SEZ.

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

- The candidate should be registered on the specified territory of the SEZ.
- The business plan and the investment project should provide for a certain volume of investment to be made within a specified period (the actual investment amounts are not necessary on the date an application is submitted).

- 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 does not contain restrictions regarding the business reputation or credit history of the applicants, or 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 deriving from customs rules that designate SEZs as 'free customs zones'. This is regulated by an agreement that requires all activities to be performed within the SEZ and guarantees that the goods imported into the SEZ are exempt from import customs duties and import VAT, providing that certain requirements are met.

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⁵ "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

⁶ Federal Law No. 116-FZ "On special economic zones in the Russian Federation" of 22 July 2005

SEZ residents also enjoy the following tax concessions:

- Profits tax rate reductions and favourable treatment of certain expenses for profits tax purposes;
- Property tax and land tax exemptions during the concession period.

Law No. 116-FZ contains a 'grandfather clause' under which the state guarantees that, should tax legislation be amended so that it has a negative effect on the taxpayers' positions, the amendments will not be applied to the residents of SEZs who took up residence in accordance with law No. 116-FZ. In general this guarantee applies for the period that an agreement to carry out activities within a SEZ is in force.

Most Russian regions have adopted laws that provide tax concessions for certain investment activities.

Other business issues

Licensing requirements

Certain types of business activities can only be carried out in Russia with a special licence issued by an authorised licensing body. The following activities (among others) are subject to licensing:

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

Licensing is carried out at both the Federal and regional level.

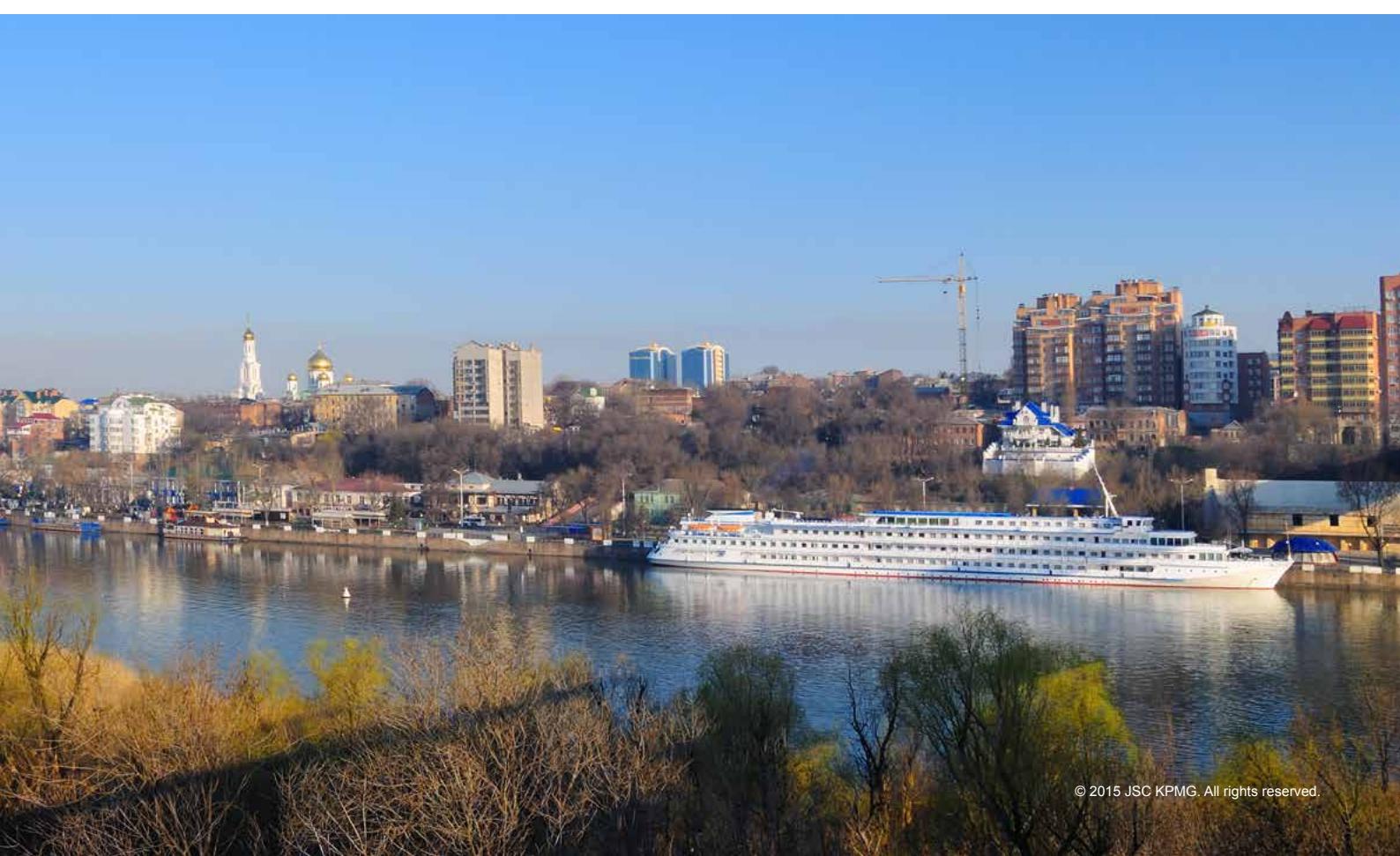
To obtain a licence, an application must be submitted to the licensing authorities.

The licensing requirements depend on the type of licensed activity.

The decision to grant or deny a licence is generally made within the forty-five days after the authorities receive the application and all of its accompanying documents. Regulations on the licensing of some other activities can allow for shorter processing periods.

Generally, licences are issued for indefinite terms.

Licences are issued separately for each type of activity. The transfer of a licence to another legal entity or individual is prohibited, except for in cases specifically provided for by law. A licence becomes invalid when an organisation is liquidated or terminates activities as a result of its reorganisation (unless it is reorganised via legal transformation into another form of company) or when a sole proprietor's state registration certificate expires.



In accordance with the procedure established by the Administrative Code of the Russian Federation, authorised licensing bodies are entitled to suspend a licence if the licensee violates the licensing requirements and conditions.

Performing a regulated activity without the appropriate licence is likely to lead to the imposition of significant penalties, with other consequences that could include a court order requiring enforced liquidation. The penalties and consequences depend on the specific circumstances.

For some business activities, instead of receiving a licence, a company is required to become a member of a professional self-regulated organisation that sets its own membership criteria (this for example applies to engineering, construction and valuation services).

Some business activities can be conducted only on the basis of a special licence issued by an authorised licensing agency.

Land ownership

Pursuant to the Constitution of the Russian Federation, land can be owned privately. Land can also be owned by state or municipal authorities or held under other ownership conditions.

The Russian Land Code regulates the purchase of land via regional-level legislation. In practice, it is still quite difficult to acquire land in Russia from state or municipal authorities. However, according to Federal Law, the owners of buildings have the exclusive right to purchase or rent the land plots underlying and surrounding their buildings.

Typically, land-lease contracts (sometimes with a right to purchase) run for a maximum term of 49 years. Renting or acquiring state property (apart from when executing the aforementioned exclusive right) is likely to require winning a tender/auction. If property is rented or obtained without conducting the obligatory tendering procedures, then the transaction can be invalidated.

Certain other restrictions also apply to owning land, e.g. foreign individuals or legal entities do not have the right to own land adjacent to the state border of the Russian Federation.

Special laws regulate transactions involving farmland. 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.

When acquiring land in Russia, both Federal and local regulations should be considered.

Transfer pricing

A transfer price should be viewed as a price subject to monitoring by the tax authorities. The tax authorities monitor prices to ensure that they reflect market realities and have not been fixed to reduce the tax burden.

Since 2012 the following changes have been made to Russia's transfer pricing rules:

- The list of legal entities that are considered related parties has been considerably extended;
- Prices will no longer be permitted to deviate up to 20 percent from market prices. It thus has become more difficult to set prices with a view to planning the tax amounts to be paid. Instead, the concept of an arm's length range has been introduced;
- Transactions subject to transfer pricing control (controlled transactions) have been defined and specified more clearly.

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

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 (with no limit on the annual aggregate turnover from all transactions between the parties);
 - The amount of income and expenses under the transaction for one calendar year exceeds RUB1 billion (approximately USD16.4 million at the rate of 61 roubles: 1 dollar), unless this transaction is performed between:
 - (1) The participants in a consolidated group of taxpayers, or
 - (2) Companies registered in the same region of the Russian Federation, provided that these companies (a) do not pay corporate income tax (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, or
 - (3) Companies conducting activities within the same hydrocarbon mine, engaging in transactions related to the extraction of hydrocarbon raw materials, or
 - (4) Taxpayers engaged in making interbank loans (deposits) which are limited in term to 7 calendar days, or
 - (5) Taxpayers engaged in transactions in the sphere of military and technical cooperation between the Russian Federation and other foreign countries (as regulated by the respective federal laws);
 - One of the parties to the transaction is a taxpayer using the unified tax on an imputed income system, or the unified agricultural tax system, while the other party does not use this tax regime; provided that the amount of income and expenses under the transaction exceeds RUB100 million (approximately USD1.6 million at the rate of 61 roubles: 1 dollar) for one calendar year;

- One of the parties to the transaction is a resident of the Skolkovo Innovation Center and applies a 0 percent CIT rate, or is free of taxpayer obligations, or is a resident of an SEZ in Russia, or is a participant in a free economic zone; while the other party is not utilising any such benefits, provided that the amount of income and expenses under the transaction exceeds RUB60 million (approximately USD0.98 million at the rate of 61 roubles:1 dollar) for one calendar year;
- One of the parties is subject to the mineral extraction tax (with a rate stipulated as a percentage), provided that the transaction concerns extracted minerals and that the amount of income and expenses in the transaction exceeds RUB60 million (approximately USD0.98 million at the rate of 61 roubles:1 dollar) for one calendar year;
- One of the parties to the transaction is a taxpayer holding a licence to extract hydrocarbon raw materials from a mine, while the second company is the operator of the mine, provided that the amount of income and expenses in the transaction exceeds RUB60 million (approximately USD0.98 million at the rate of 61 roubles:1 dollar) for one calendar year;
- One of the parties is a participant in a regional investment project that can apply preferential tax rates, if the amount of income and expenses in the transaction exceeds RUB60 million (approximately USD0.98 million at the rate of 61 roubles:1 dollar) for one calendar year.
- Cross-border transactions involving oil and oil products, ferrous and non-ferrous metals, mineral fertilisers, precious metals and precious stones (i.e. goods traded on international commodity exchanges), if the proceeds from these transactions with the same counterparty exceed RUB60 million (approximately

- USD0.98 million at the rate of 61 roubles:1 dollar) for one calendar year.
- Transactions, where one of the parties is a tax resident in a country included on the Russian Federation Ministry of Finance's blacklist, and if proceeds from the transactions with this counterparty exceed RUB60 million (approximately USD0.98 million at the rate of 61 roubles:1 dollar) in one calendar year.
- Taxpayers are obliged to notify the tax authorities of any controlled transactions carried out within the calendar year before 20 May of the year following the year in which the transactions took place. Notification of controlled transactions should be given in a strictly prescribed format. This discloses information about each operation performed within the controlled transaction (for instance, the operations performed within a buy-sell transaction would cover each delivery of each particular item of goods).
- Taxpayers could be subject to a penalty of RUB5000 if notification is provided after the deadline or errors/mistakes are detected in the notification by the tax authorities. Although the taxpayer may regard the penalty amount as insignificant, the presence of the penalty on the taxpayer's records will act as a sign that the tax authorities should include the company on their lists for further transfer pricing audits.
- In addition, in order to comply with Russian transfer pricing regulations, taxpayers – as per the request of the tax authorities – should justify the prices applied in controlled transactions by preparing supporting transfer pricing documentation. The taxpayer should submit the documentation with respect to the controlled transaction (or for a group of similar transactions) specified in the request from the Russian tax authorities. Transfer pricing documentation should contain the following information: a description of the main characteristics of the taxpayer's business, analysis of related parties or a description of the main characteristics of the group

of companies in which the taxpayer participates, information about the controlled transaction and functional analysis, selection of the transfer pricing method applied for tax purposes and the sources of information used, and calculation of the arm's length range.

The tax authorities may request the transfer pricing documentation on controlled transactions starting from 1 June of the year following the year in which the transactions took place. Accordingly, the taxpayer should provide the transfer pricing documentation 30 working days after receiving the request.

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).

Tax Monitoring

Federal law № 348-FZ dated 4 November 2014 introduced into the Russian Tax Code a new type of tax control called tax monitoring (amendments made in Part I of the Russian Federation's Tax Code, including *inter alia* a new Section V_2 "Tax control via tax monitoring", were adopted). Below we have provided the key information covering the underlying principles in these new forms of cooperation between taxpayers and the tax authorities as part of 'tax monitoring'.

- Taxpayers voluntarily participate in tax monitoring and can independently assess the practical value and usefulness of this form of tax control.

The participation criteria are as follows:

- 1) The total amount of federal taxes paid in the calendar year prior to the year an application is submitted by the potential participant exceeds RUB300 million;
- 2) The total income generated by the potential participant exceeded RUB3 billion during the period prior to the year the application was submitted;

3) According to accounting (financial) data, the total value of the applicant's assets exceeded RUB3 billion as at 31 December in the calendar year prior to the year the application was submitted.

The Law provides the members of a Consolidated Group of Taxpayers with the opportunity to participate in tax monitoring, but only from 1 January 2016.

- If a decision on participation is positive, a taxpayer must submit its application before 1 July of the year preceding the calendar year to be subject to tax monitoring.

The application should also include regulations on information cooperation (basic supervision agreements); information on direct/indirect participants with participation interests of over 25%; and the tax policy that took effect. The tax authority will make a decision on tax monitoring by 1 November of the year in which the application was submitted.

- Tax monitoring covers all of the taxes and duties calculated for the period from 1 January to 31 December of the chosen calendar year.
- In contrast to traditional forms of tax control, in-house and field tax audits, tax monitoring provides extended cooperation in which the taxpayer should notify the tax authorities in advance about any uncertainties or risks related to its tax position and payments to the federal budget. The tax authority in turn should address uncertainties concerning the taxpayer's tax position following a request by the taxpayer as well as on its own initiative, resulting in the provision of a motivated opinion by the tax authority.
- If the Company agrees with the motivated opinion, it should send a notification to the tax authority stating that it agrees and stating the amendments it is making to comply with the motivated opinion (if any).

If the taxpayer disagrees with the motivated opinion, it can file an appeal with a higher tax authority within one month in order to initiate the mutual agreement procedure. During consideration of the appeal, one of two possible decisions may be issued: (1) a decision to change the motivated opinion, or (2) upholding of the original motivated opinion. Disagreement with an upheld motivated opinion may lead to the conducting of a field tax audit, the results of which may be appealed to a higher tax authority and in court.

- Positive cooperation via tax monitoring gives the taxpayer certainty and allows it to be in control of its tax position. It also allows for a better relationship with the tax administration, for less administrative burden, and for the taxpayer's exemption from in-house and field tax audits within the tax monitoring period (with some exceptions).



Tax manoeuvres in the Russian Oil & Gas industry

Late in 2014, the Russian President signed Federal law # 366-FZ of 24.11.2014 that introduced a new tax system, called “tax manoeuvres”, that significantly affects Russian Oil & Gas majors and refineries.

The key reason behind the shift to this new tax system was the intention to reduce the shortfall in government receipts as a result of oil supplies from Russia to Belarus and Kazakhstan taking place within the conditions of a common economic space, the Eurasian Economic Union (EEU). In accordance with a recent decision by the EEU, Russia needed to lower its export duties to the levels adopted by Kazakhstan in order for a single oil market to be completed by 2018. If not aligned with Kazakhstan, the differences would likely incentivise Russian oil companies to export crude oil through Kazakhstan and Belarus, causing losses to the oil-dependent Russian federal budget.

To resolve this issue, the ‘tax manoeuvre’ was introduced to gradually reduce export duties on oil 1.7 times and on petroleum products from 1.7 to 5 times over 2015–2017, while simultaneously raising the minerals extraction tax (MET) on oil 1.7 times and on gas condensate 6.5 times over this period. The ‘manoeuvre’ should in theory balance budgetary losses from export duties with new gains from the MET.

Another aim of these tax reforms is to modernise the oil refinery industry and to improve the refining quality, which is currently very low in comparison with Europe. In this vein, export duty for fuel oil will be gradually increased to 100% by 2017. The initial plan had export duties rising to this level in 2015, causing some experts to suggest that this could cause the immediate closure of many old refineries in Russia. To prevent this, the initial plan was amended to provide more time for refineries to complete full-scale modernisation.

The ‘tax manoeuvre’s’ key fiscal figures are presented in the table below:

Despite a decrease in export duties for light oil products, oil refineries are expected to face a serious drop in their profit margins due to their growing production costs, caused by higher domestic prices for crude oil, which were traditionally calculated as an export netback (i.e. the oil price in international markets minus export-related costs, such as transportation fees and export duty).

To avoid this negative fallout for refineries, changes to excise taxation were introduced which represent a decline in the excise tax rates for oil products and in the excise extra refund procedure (the so called “negative excise system”). This means that refineries meeting specific conditions are allowed to receive refunds on the excise they pay, multiplied by a refund coefficient that varies between 1.37 and 2.88 in 2015, 1.6 and 2.84 in 2016, and 1.94 and 3.4 from 2017, depending on the type of oil product.

	Tax rates / coefficients to change via implementation of the tax manoeuvre (from 2015 onwards), compared to the previous system			
	2014	2015	2016	2017 and subsequent years
MET per tonne, RUB	493	766	857	919
Marginal export duty coefficient for crude oil, %	59	42	36	30
Export duty rates on petrochemicals, % of oil export duty:				
Light and medium distillates	66	48	40	30
Gasoline	90	78	61	30
Naphtha	90	85	71	55
Fuel oil, bitumen etc.	66	76	82	100

Company and Labour Law

Company law

Liabilities

(i) Parent liabilities

In general, a shareholder's liability is limited to the amount of capital that the shareholder invested in the company, including as-yet unpaid amounts. However, in the event of bankruptcy, a company's creditors have the right to hold the "parent" liable for the debts of its bankrupt subsidiary if the actions of the parent caused the subsidiary company's insolvency.

The "parent" company is also liable for any deals by its subsidiary that were concluded on instructions issued by the parent company or with its approval.

(ii) Liabilities of controllers

The term "controller" is broadly defined, and its definition includes control not only via ownership, but also via contractual or other relationships that allow a person / entity, including a parent company, to take decisions on behalf of a company, or otherwise influence a company's activities.

Registration

Registration of a legal entity by the appropriate authorities takes five business days from the moment that documents are submitted.

Registration of a JSC requires up to an additional six weeks to register the issued shares with the Securities Market and Commodity Market Department at the Bank of Russia.

Foreign investors are required to have certain documents legalised, translated or notarised, which can significantly lengthen the registration period.

It is possible to find adverts for 'Express' company creation services, but caution is advised when using such services. Companies are often registered not in accordance with official procedures, with many steps in the process being missed out. These missing steps often become apparent only when a change to the company's constituent documents is required, and the change is rejected by the tax authorities due to the

authorities' discovery of earlier violations in the registration process. Resolving these issues at a later date can be more time consuming and costly than simply undertaking the standard company registration route.

"Off the shelf" companies are also available, although it is not advisable to purchase one. There are inherent risks, including potential liabilities (e.g. tax liabilities) involved in acquiring a company that could have been used for undisclosed purposes. Furthermore, in some cases, to successfully change the ownership of a company (involving more than 25 percent of voting shares in a JSC and more than 1/3 of participation interests in an LLC), prior approval from the Federal Antimonopoly Service is required.

In all cases, any change in ownership must be registered, and this can take as long as forming a new company.

Number of shareholders or participants

It only takes one participant (individual or legal entity) to establish an LLC and/or a JSC. However, LLCs and JSCs cannot be established by another solely owned legal entity.

The maximum number of participants in an LLC is limited to 50 people. If the number of participants in an LLC exceeds 50, then the LLC should be reorganised into a JSC or a production cooperative within one year. The number of shareholders in a JSC is not limited by law.

Managing directors

The company may appoint more than one managing director (i.e. CEO) capable of acting on behalf of the company jointly or individually. If this option is chosen, it must be stipulated in the charter of the company and all of the individuals selected must be registered in the state register of legal entities.

Minimum capital and contributions

For a public JSC, the statutory minimum charter capital is RUB100,000 (approximately USD1,630); and

for a non-public JSC, the statutory minimum is RUB10,000 (approximately USD163.00).

The statutory minimum charter capital for an LLC is RUB10,000 (approximately USD163.00).

Payment of capital

For an LLC, 100 percent of the charter capital should be paid within 4 months from the date of its registration with the state. Alternatively, at the discretion of the founder, the charter capital can be paid in full or partially before the LLC is state registered. If this option is chosen, a temporary account should be opened by the founder(s) in a Russian bank. Upon registration of the LLC, this account should be closed and the funds transferred to current accounts that have been opened.

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 the year following completion of state registration.

Charter capital contributions can be made in monetary form or in-kind. Monetary contributions should be made in amounts not less than the statutory minimum charter capital. In-kind contributions require independent appraisal (irrespective of their value).

Bank accounts

Rouble and foreign currency accounts can be opened after registration, though they must meet certain government and bank requirements.

Establishment costs (LLC, JSC)

A shareholder (participant) in an LLC or JSC must pay a state registration fee of RUB4,000 (approximately USD65.00), which is payable at the moment the registration documents are filed. In addition, if a JSC wants its share issue to be registered, there is a registration fee of up to RUB200,000 (approximately USD3,260).

There are additional fees for translating and notarising documents. Professional fees for document collection, the preparation of an organisation's documents, and document submission range from USD7,000 to USD10,000 for an LLC and from USD13,000 to USD16,000 for a JSC (to establish the entity in Moscow).

Net assets position

If an LLC's or JSC's net assets on its balance sheet fall below its charter capital as of the end of the financial year (with the exception of the first two financial years), the company must undertake one of the following actions:

- (1) Increase its net assets; or
- (2) Reduce its charter capital to an amount not exceeding its net assets (but not lower than the statutory minimum amount of charter capital).

If, for the same period as indicated above, an LLC or a 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, then the government authorities are likely to petition a court for liquidation, and creditors are likely to demand early termination or the fulfillment of obligations and compensation for losses. In practice, forced liquidation is rare if a company meets its obligations (including taxes).

If, for two consecutive years, an LLC or a 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 rectified through capital injection in the form of gratuitous financing or contributed assets (available only for an LLC). In practice, an increase in charter capital can also recover a low/negative net assets situation if it is done with an additional premium (including a debt-to-equity conversion).

Debt-to-equity conversion

According to Russian corporate law, converting debt into equity is an option available to both LLCs and JSCs, excluding credit organisations (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 participatory interest equal to the amount owed.

Shareholders are permitted to set-off their monetary claims against a company by purchasing additional shares in a JSC only if the shares are issued via a closed subscription.

Liquidation

A company can 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;
- A court decision if the goals, which the company was established to achieve, cannot be realised;
- Expiration of the term or achievement of the goal for which the company was established (if provided for by the charter).

The liquidation procedures include forming a liquidation commission, notifying creditors via issuing announcements on liquidation in mass media outlets, settling creditors' claims, distributing the remaining assets among the shareholders / participants, and deregistering the company with the state authorities that the company originally registered with. Tax deregistration can cause significant delays in completing the procedures, as a tax audit is 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 to discharge its liabilities, insolvency procedures are applied.

Insolvency

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

Bankruptcy legal proceedings can be initiated if the debt owed is not less than RUB300,000 (approximately USD4,900) to a legal entity or RUB10,000 (USD163.00) to an individual.

A Russian legal entity is considered insolvent and can consequently be declared bankrupt by a court if it fails to meet its financial obligations (of approximately USD5,000; or RUB10,000 (USD163.00) to an individual) for three consecutive months following the date on which the obligations were due.

Reorganisation

Mergers, consolidations, split-ups, spin-offs and transformations are permitted under the Civil Code, under JSC law and under LLC law. It is possible to reorganise an entity via a simultaneous combination of the above different forms of reorganisation.

Reorganisation entails a number of steps, e.g. a tax audit of the company by the Russian tax authorities; written notification to creditors, who are entitled to request that the company's obligations be prematurely terminated or accelerated; etc. This can mean that completion of a reorganisation can require considerable time and effort for an individual entity.

Labour law

Labour regulations

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

Employment relations in the Russian Federation are regulated by the Labour Code; other legal acts that contain regulations relating to labour (including internal policies, decrees and acts adopted by the employer); the employer's agreements with its staff (if any agreements exist); and direct employment contracts with actual employees.

Employees enjoy the rights and benefits provided for under Russian labour legislation. This same legislation also governs the types of employment contracts that can exist and the terms under which they can be concluded, amended and terminated.

Importantly, the Labour Code provides that no employment contract may stipulate conditions that are worse than the minimum provisions provided for under Russian labour legislation.

Social partnerships

The Labour Code establishes a set of principles providing for social partnership in labour relationships. Social partnership is defined as the system of relations between employees, employers, the state and the local authorities, aimed at regulating and balancing the interests of the employees and employers in their 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;
- Involvement of all parties in negotiations / disputes before things go to court.

Collective agreements

A collective agreement can be concluded between an employer

and its employees. The law does not require a collective agreement if neither party requests it. If a collective agreement is signed, then a trade union usually represents the employees. The employer is represented by the general director or his/her authorised representative(s).

The law allows the parties to define the content of any collective agreement independently; however, the contents must not make any conditions worse than the minimum standards provided for by the Labour Code. The collective agreement is subject to registration with the appropriate State Labour Office.

Role of trade unions

According to the Labour Code, an employer is obliged to consider the opinion of a trade union(s) (if such a union exists) on certain matters. In Russia, trade unions are more typically formed at company level rather than at industry level.

Employment conditions

Employee guarantees

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

- Standard working hours are not to exceed 40 hours per week.
- Overtime is permitted for some employee categories in specific circumstances, but generally should not exceed four hours in two successive days or 120 hours per year. Overtime is payable at the following rates: no less than 1.5 times the normal salary rate per hour for the first two hours, and no less than twice the normal rate for subsequent hours and for work on weekends and non-working days. Employees additionally have the right to demand additional days off as compensation for overtime.
- An employer does not have the right to require that an employee performs functions beyond those set out in his/her employment contract, unless business circumstances require otherwise, 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 can be assigned to a job requiring lower qualifications only subject to the employee's written consent. If the employer needs additional work performing by the employee, then the employee needs to provide his or her written consent and the relevant paperwork needs to be completed.
- Employees are entitled to 14 paid non-working days of public holidays and annual leave of at least 28 calendar days. For some categories of employee, the minimum annual paid leave established by legislation can exceed 28 calendar days.
- An employee is entitled to a sick leave allowance, paid by his/her employer and the Social Insurance Fund, based on the employee's salary, which is between 60 percent and 100 percent of salary, depending on length of service. However, in 2015, this cannot be more than RUB1,633 per day. Employers can pay temporary disability benefits at a higher rate from their own accounts.
- Legislation also provides wages covering time spent travelling on behalf of work, for performance of the functions of a trade union officer, for appearing in court, for going to vote, and for fulfilling other state or social duties.
- In certain situations, legislation provides severance pay.
- Overtime is permitted for some workers, subject to certain conditions being fulfilled.
- Women are entitled to maternity leave for 70 calendar days (84 days if this is not the first child) prior to childbirth and 70 calendar days (86 days if there were complications with the birth, and 110 for the birth of twins, triplets, etc) after childbirth. Maternity leave is granted along with social insurance benefits, which are paid in amounts defined by statutory legislation. Regardless of her period of employment with a specific company, a woman is also entitled to

annual paid vacation, which can be taken either before or immediately after maternity leave, as well as leave until the child's third birthday. During her maternity leave and 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 only under certain circumstances.

- Employees have the right to organise trade unions and participate in the management of the company. Generally, trade unions represent the interests of the employees in their dealings with the employer, ensure that the terms of collective agreements are being complied with, and participate in resolving labour disputes in accordance with statutory legislation.

Russian labour legislation provides a number of guarantees to employees, such as social security payments and benefits, severance pay, unused vacation pay, dismissal pay, overtime, etc.

Employment contracts

The Labour 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 can be concluded for:

- An indefinite term; or
- A fixed term 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 have been satisfied. In particular, fixed term contracts are permitted, *inter alia*, for the following types of employees:

- Directors, deputy directors, chief accountants;
- Employees working in companies created for a specific project;

- Part-time workers (having more than one job);
- Individuals in full-time education.

Employers are required to sign individual written employment contracts with each of their employees. After the contract is signed, a respective order admitting the employee into work within the company should be issued by the general director.

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

- Mutual agreement has been reached by both parties;
- Expiry of the term of the employment contract;
- Cancellation of the employment contract upon the initiative of the employer (as discussed below) or the employee;
- Refusal by the employee to continue working due to a change in the ownership / management or control of the employer, or due to the employer being reorganised;
- Refusal of the employee to continue working after the employer has relocated.

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

In a limited number of cases, an employer has the right to terminate a contract. These include:

- An employee submitted false documents when hired;

- An employee fails to fulfill their work duties on a regular basis without any good reason for why they cannot; is absent without any good explanation; is inebriated at work; discloses state, commercial or the employer's internal confidential information; steals from the employer; or fails to comply with labour protection requirements, resulting in significant damages;
- The director of a company or company branch commits a single violation of their employment responsibilities;
- An employee with financial responsibilities commits an act which breaches the trust of the company.

Russian law states that employment contracts cannot be terminated on the initiative of the employer, *inter alia*, with the following types of 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 less than 18 years of age, an employment contract can be terminated with the approval of the State Labour Inspectorate and Commission on Minors.

It can 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 favour of the employee when considering cases of alleged wrongful dismissal. In practice, companies seek, where possible, to secure the employee's voluntary resignation.

The Labour Code prohibits employers from initiating termination procedures against certain categories of employees.

Work book

Russian labour 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 a fundamental document in which the employment history of each individual is recorded over his/her lifetime. This work book indicates the grounds for termination of employment contracts and records rewards and achievements at work, the work performed by an employee, transfers to another place of permanent work, etc.

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

Employee Trial Periods

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 trial periods (e.g. pregnant women, minors, transferees). The trial period can be extended to 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 cannot exceed 3 months.

Salary

The Labour Code guarantees timely salary payments to employees 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 stop working. If this happens, the employer is likely to be obligated by a court to reimburse the employee for each idle day with two-thirds of the average salary (calculated based on the actual salary accrued and the actual working time for the past 12 months).

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

Administrative fines can be levied on employers (RUB30,000 to RUB50,000)

and their responsible officials (RUB1000 to RUB5000) for delayed salary payments. In some cases, the employer's activities can be suspended for up to 90 calendar days.

If the responsible official has already been penalised for delayed salary payments, then they can be prohibited from holding executive positions for a period of 1 to 3 years.

If salary payments are delayed for more than two months (three months in cases where partial delay of salary payment has occurred), criminal liability applies.

The Criminal Code provides that if it can be proven that employees were paid less than half of the salary payable to them due to the personal motives of the general director, or due to actions motivated by self-interest, then the general director can be fined up to RUB120,000, or fined by an amount equal to his/her wage or income from another source for a period of up to one year. The general director may also be disqualified from occupying certain positions or engaging in certain activities for a period of up to one year, or the general director may be subject to forced labour for a term of up to two years, or the general director may even be imprisoned for a term of up to one year.

More stringent criminal liability applies if the salary payments are delayed in full for more than two months, or if salary is paid at an amount below the Federal minimum salary level (in 2015, this was RUB5,964) for more than two months, or if the above mentioned violations caused severe consequences.

Minimum statutory monthly salary

The minimum statutory monthly salary is used to regulate wages, compensation and other payments made under labour legislation, and also to calculate taxes, levies, penalties and other payments.

As of 1 January 2015, the Federal minimum statutory monthly salary is RUB5,964. This minimum statutory monthly salary is used only to calculate labour remuneration and allowances covering temporary inability to work.

Different levels of minimum salary may be established by regional local authorities in Russia, but these levels cannot be lower than the Federal minimum level. The minimum salary level for Moscow in the period from 1 January 2015 to 31 March 2015 is RUB14,500.

For the purposes of calculating taxes, levies, penalties, liabilities under civil transactions, etc, a relevant minimum statutory monthly salary of RUB100 is applied.

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

Currency and form of salary payment

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

In Russia, salaries are normally paid in roubles. However, in accordance with collective agreements or employment contracts signed upon the written request of an employee, workers can 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 cannot exceed 20 percent of an employee's total salary.

Severance payments

The Labour Code requires severance pay to be equal to at least two-week's average earnings when an employment contract is terminated due to the following reasons:

- The drafting or enlisting of an employee into military or alternative civil service;
- The refusal of an employee to be transferred to work in another location should the enterprise, institution or organisation relocate;
- An employee is unable to work pursuant to a medical certificate issued in accordance with legislation;
- Refusal to continue work due to a unilateral change to the labour

- agreement conditions made by the employer (such changes are only possible in exceptional circumstances);
- An employee who previously performed the work is being reinstated after a period of leave (i.e. maternity leave comes to an end);
 - Refusal of an employee to find a new job should the relevant medical authorities prescribe this course of action for the employee, or if the employer is not able to offer relevant work.

If an enterprise, institution, or organisation is dissolved, or if there need to be staffing cuts, then 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' worth of payments (three months subject to specific conditions).

Work permits for foreign nationals

As a general rule, foreign nationals working in 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 are not always required for the employees of suppliers or manufacturers of equipment imported into Russia for the purpose of installing, supervising the installation of, or servicing the 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 a notification to the Employment Service stating that there are vacancies in the company for which only the employment of foreign citizens will satisfy. The Authorities must reach a conclusion that this is correct (Conclusion stage);

- Application for a corporate permit from the immigration authorities to engage foreign labour (Corporate Permit);
- Application to the immigration authorities for each expatriate's individual Work Permit (Individual Permit).

Typically it takes more than four months to obtain an individual work permit. The individual permit is issued for a period of up to one year.

In a separate process, but based on the work permit, a work visa must be obtained. Its procurement also involves several stages, in which a specified set of documents must be submitted to the immigration authorities.

It should be noted regarding work permits that each year, by 15 July, companies must report the number of foreign employees they anticipate to engage in the next calendar year. This procedure effectively constitutes a quota application system. If the employer does not comply with this and does not receive notification that they have an approved quota, the employer will have any work permit applications rejected. A company that fails to file a quota application or whose application was denied or partially approved has the right to use a list of quota-exempt positions when applying for a work permit, but only if the application meets all of the quota exemption requirements.

Work permit applications for Highly Qualified Specialists (HQS)

Since 1 July 2010, a simplified procedure for obtaining Individual Permits for HQS has been in force. A HQS is a highly-skilled professional who is a foreign employee and who has work experience and skills or achievements in a certain area and whose annual salary is generally not less than RUB2,000,000.

Obtaining Individual Permits for foreign nationals to work as HQS has the following benefits:

- The Russian employer does not need to obtain a Corporate Permit;

- The quota system does not apply to HQS professionals;
- The Individual Permit can be issued for a term of up to three years;
- A HQS professional has the right to obtain multiple work visas for a term of up to three years;
- The procedure to obtain an Individual Permit for HQS professionals takes about fourteen business days from the moment a complete package of documents is submitted;
- An income tax rate of 13 percent applies to the salary paid to an HQS under their relevant employment contract, irrespective of their tax residence status in Russia;
- Extended stays for business trips outside the region / regions for which the HQS Individual Permit was obtained are allowed, as compared to the standard Individual Permit.

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 carrying out registration. The hosting party is either the hotel or the employer (visa sponsor), or a landlord if the foreign national is not staying in a hotel. Upon arrival in Russia, each foreign national must be registered in Russia at their 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 professionals and their family members are exempt from registration procedures if they arrive and stay in Russia for a period not exceeding 90 days, and exempt for 30 days if they travel to another region in Russia. If HQS professionals and their family members stay in Russia for more than 90 days (or 30 days if traveling to another region), they are required to be registered with the immigration authorities.

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 at 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 2015, 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 on the consumption of natural and biological resources;
- State duties and registration fees.

Regional taxes and levies are those established by the Tax Code and by specific regional tax laws effective in the regions of the Russian Federation and which are only paid in that specific region. Regional taxes include property tax, gambling tax and transport tax.

Local taxes and levies are those introduced by the Tax Code and by the regulations of municipal authorities and which are paid only in the appropriate municipal areas. Local taxes consist of land tax and personal property tax.

Local (or regional) legislative bodies only have the right to introduce the taxes and levies delegated to their authority by the Tax Code. When deciding on tax rates, 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

No separate tax registration needs to take place in order to pay VAT – a taxpayer obtains a single tax ID number for all taxes. However, taxpayers have to obtain supplementary tax registration ID numbers ('KPP') from the tax authorities for the places where their separate subdivisions are located.

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



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Business taxation

Profits tax

Tax base

Taxable profit is calculated as income minus expenses as recorded in the 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 (USD16,320)⁷.

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.

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 (USD163 million)⁸. Additionally, the group's total sales must be RUB100 billion or more (USD1.63 billion)⁹, and total assets must be RUB300 billion or more (USD4.89 billion)¹⁰. 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 a withholding mechanism at flat rates stipulated by the Tax Code (*for details, see the withholding income tax section below, p.35*).

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 (with the exception of transferors which are incorporated in one of the countries (offshore zones) on a list issued by the Ministry of Finance);
- 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 from a shareholder in order to increase the net assets, as well as the forgiveness of debt by a shareholder and the reinvestment of payable dividends 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 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 cannot be changed during the financial year, except in response to changes in legislation.

Taxation of Foreign Legal Entities (FLEs)

For FLEs whose activities in the Russian Federation give rise to permanent establishment (PE), profits tax on income minus the expenses attributable to the Russian PE is due.

Under Russian tax legislation, the activities of an 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 in Russia on a regular basis. In particular, a construction site located in Russia, under certain circumstances, can be considered the PE of the FLE performing the 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 the essential terms of contracts in the name of the principal or to bind the principal's participation into a business activity (except for activities which are of an auxiliary or preparatory nature, such as marketing).

Generally, the approach to calculating profits tax for the permanent establishments of foreign legal entities is similar to the approaches established for Russian legal entities, with certain exceptions. In particular, these exceptions include those resulting from the applicable provisions of double tax treaties (e.g. the allocation of management costs).

FLEs having no PE in Russia are subject to withholding tax on income sourced in Russia (*for details, see the withholding income tax section below, p.35*).

Filing and payment

Taxpayers (except Permanent Establishments (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 on 28 March of the year following the reporting year.

Withholding income tax

A FLE in receipt of income sourced in Russia 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 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 representative office or from the branch of an FLE to the head office. However, the proceeds from liquidation 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 on dividends payable to a Russian legal entity (RLE) if this RLE has owned at least 50 percent of the shares in the dividend payer for 365 consecutive days, providing that the dividend payer is not resident in an off-shore country (e.g. the British Virgin Islands, Guernsey, Jersey, or any other state on a list compiled by the Ministry of Finance of the Russian Federation).
- 13 percent on dividends received by an RLE from an RLE or Foreign Legal Entity (except for FLEs incorporated in the countries on the Ministry of Finance's list).
- 15 percent on dividends payable to an FLE by an RLE.

Generally, Foreign Legal Entities having no Permanent Establishment in Russia are subject to 20 percent withholding income tax on most Russian-sourced income, such as interest, royalties, income from leasing and rental operations, etc. Freight income is taxed at 10 percent.

Withholding income tax rates can be reduced in accordance with double tax treaties concluded between the Russian Federation and the actual country of the beneficiary's residence.

For a list of double tax treaties and the withholding tax rates applicable under these treaties on dividends, interest and royalties, see *Appendix 1. Chart of Withholding tax rates, p.52*.

A Foreign Legal Entity should confirm that it is resident in a country that is party to a double tax treaty with the Russian Federation in order to enjoy the reduced withholding income tax rates. Confirmation must be documented in a certificate issued by the relevant foreign authorities. A FLE should also confirm that it is the actual beneficiary of the dividends.

In the absence of a proper certificate and confirmation of actual beneficiary status, tax should be withheld and remitted to the budget at the standard rate.

Filing and payment

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

A Russian Legal Entity (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 carried by the end-customer – but which should be accounted for by the supplier.

Taxable Supplies

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

- Sales of goods (work, services), provided that the sales take place on the territory of the Russian Federation

(including the free-of-charge supply of goods) and the transferal of property rights;

- Transfer of goods (work, services) for the taxpayer's own needs if the incurred expenses are non-deductible for profits tax purposes;
- Construction and installation work carried out to benefit only the taxpayer;
- The import of goods into Russia and to other territories under Russian jurisdiction.

Place of Supply Rules

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

Goods are deemed to be supplied on Russian territory for VAT purposes if:

- the goods at the beginning of their shipment or transportation are located in Russia or on other territories under Russian jurisdiction;
- the goods at the moment of their sale are located in Russia or on other territories under Russian jurisdiction, and are not in transit / being shipped through Russia.

Notably, the shipment or sale of hydrocarbons or hydrocarbon products from the territory of the Russian continental shelf is considered as supply on Russian territory.

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

Tax Agent Mechanism

If foreign companies that are not registered with the Russian tax authorities supply goods (work,

services) in Russia, and these supplies are deemed to have taken place in Russia in accordance with the 'place of supply' rules, then the buyer, who is tax-registered in Russia, is required to calculate the amount of Russian VAT, withhold this VAT from the amount of the fee payable to the foreign supplier, and remit that VAT to the Russian federal budget on behalf of the foreign company (the "tax agent" mechanism).

Having withheld and paid the VAT to the state budget, the buyer can then recover this VAT against its output VAT under general rules for the recovery of input VAT.

VAT Base

VAT should be calculated and paid upon receipt of prepayments and/or on the total transaction price at the moment the goods are shipped, when work is performed, services are rendered or property rights are transferred. If the moment payment occurs differs from the moment that shipping takes place, VAT should be accounted as at the earliest of the two dates. If the date the taxable base is calculated is the date of prepayment, then the taxpayer is obliged to calculate the taxable base again at the moment of shipment. VAT paid with respect to prepayments can subsequently be claimed for recovery after shipment.

When VAT is calculated by the tax agent, the obligation to withhold VAT by the tax agent occurs at the moment of payment and benefits the foreign seller (which is not registered with the Russian tax authorities).

When the value of goods (work, services) has been changed (in particular, when changes have taken place in the price of the goods (work, services) or their quantity), the seller should issue a corrective VAT invoice and the parties should correct their VAT obligations in the way prescribed by VAT law.

Recovery of VAT

Generally, Russian taxpayers are entitled to claim for recovery input VAT related to purchased goods (work, services) and property rights, VAT paid

under the reverse-charge mechanism, and VAT paid when importing goods into Russia, provided that:

- goods, work, services and property rights are acquired in order to carry out VAT-able transactions in Russia;
- goods, works, services and property rights are booked in the taxpayer's accounts and the taxpayer has the respective primary documents;
- the taxpayer has VAT invoices duly prepared in accordance with the requirements provided by the Tax Code (documents confirming payment of VAT for cases involving the recovery of import VAT and payment of VAT under the reverse charge-mechanism).

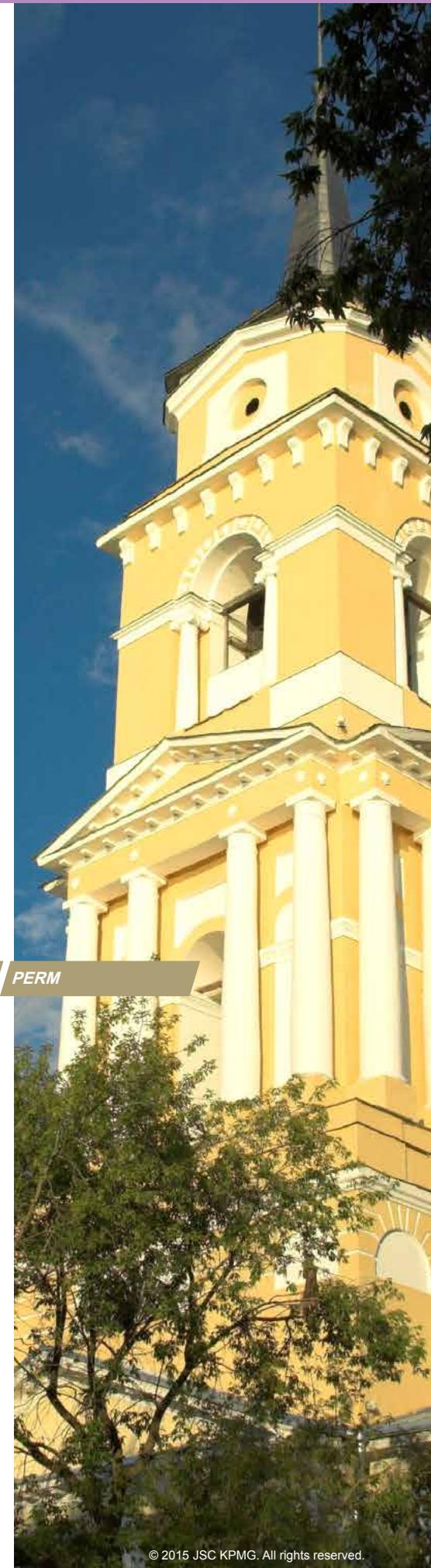
Under certain conditions, it is also possible for taxpayers who made prepayments to suppliers to recover the VAT amount included in the prepayment amount.

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

VAT Invoice

A VAT invoice is a special VAT document needed for VAT recovery. The structure of this document is established by the Russian Government. The VAT invoice differs from a commercial invoice and can be issued either in hardcopy or in electronic format (if electronic document interchange with the counterpart is agreed, it must be conducted in accordance with the specific requirements of the law).

In some cases, taxpayers are not required to issue VAT invoices, notably if they perform VAT exempt transactions. If supplies are provided to buyers who do not pay VAT or who are exempted from the obligation to pay VAT, it is permissible – upon the mutual consent of both parties – for VAT invoices to not be issued.



VAT Rates

Generally, the sale of goods (work, services) is taxable at a standard VAT rate of 18 percent.

A reduced VAT rate of 10 percent applies to the sale of certain types of medical goods, books and periodicals, foods and children's goods (in accordance with the list of goods established by the Government of the Russian Federation).

The sale of certain types of goods (work, services) is subject to a zero-percent VAT rate. The zero percent VAT rate applies, *inter alia* to: export sales; international transportation services and related freight forwarding services; transportation and rendering of certain services related to the transportation of oil, oil products, natural gas and electricity power outside Russia; certain types of air transportation; certain services rendered at river and sea ports; and certain services rendered by Russian railway carriers in relation to the international transportation of goods. To apply a zero-percent VAT rate, the supplier should collect the necessary supporting documents within the established time limit and submit a VAT return with the supporting documents to the Russian tax authorities.

Generally, the sale of goods (work, services) on the territory of Russia is taxable at a VAT rate of 18 percent. A VAT rate of 10 or 0 percent applies in certain cases.

Exemptions

Certain types of activities are subject to exemption from VAT, in particular:

- Leasing premises located in Russia to foreign individuals and foreign entities accredited in Russia (if there are reciprocity rules applying in the respective foreign jurisdiction);
- Selling residential real estate, certain medical goods, medical services, foods produced by school cafeterias, public conveyance services, religious and ceremonial services, educational services rendered by licensed nonprofit educational institutions,

certain services in the sphere of art and culture, etc.;

- Banking operations and insurance services; REPO operations;
- The transfer of certain types of intellectual property (IP) rights or the transfer of rights allowing for IP to be used on the basis of a licence agreement.

The import of certain types of goods into Russia can also be VAT-exempt.

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

Customs Union

The legislation of the Eurasian Customs Union between Russia, Belarus and Kazakhstan (the Customs Union) establishes special VAT rules with respect to transactions between citizens in the different member states of the Customs Union. The export of goods from one member state to another is subject to a zero-percent VAT rate. The zero-percent VAT rate should be supported by provision of the relevant documents, including documents showing the application to import the goods and that the import VAT has been paid. The documents should be stamped by the tax authority of the member state where the goods were exported.

The import of goods from one member state to another is subject to import VAT in the other member state. A taxpayer is obliged to submit a separate VAT return with respect to this import of goods.

VAT Payable to the Russian State Budget

VAT payable to the budget is generally determined as the difference between the amount of output VAT accounted for on supplies subject to VAT, and the amount of input VAT incurred on purchases (plus the amount due to be paid to the budget in special cases) in a respective tax period.

An excess of input VAT over output VAT could be refunded to the taxpayer from

the budget upon submission of a special application. Generally VAT refunds can only be made after the tax authorities have performed a 'desk tax audit' and confirmed the legitimacy of the input VAT claimed. Since 2010, taxpayers have also been entitled to VAT refunds through use of the accelerated VAT refund procedure, which generally allows them to receive a cash tax refund prior to completion of the desk tax audit. However, this procedure can apply only if the taxpayer has already paid a substantial sum of taxes, or if the taxpayers provide a bank guarantee, or if they are residents of a territory classified as being of "advanced social and economic development".

VAT Payment and Filing

VAT returns should be submitted quarterly in electronic form by no later than the twenty-fifth day of the month following the quarter that has ended. Generally, the VAT should be paid by one third of the amount due by the twenty-fifth day of each of the three consecutive months following the reporting quarter.

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



Social Security Contributions

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

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

Payments subject to personified contributions and rates

Insurance contributions are payable on remuneration and other payments to individuals under employment and civil contracts. Some forms of compensation are 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.

For 2015, personified contributions are payable at the rates provided in the table below subject to an annual remuneration threshold established for contributions to the Pension Fund and the Social Insurance Fund. The threshold is subject to annual revision by the Russian government.

A foreign national's contributions are paid in full on the remuneration they earn in Russia based on their permanent or temporary residence permit.

An employer of foreign nationals who are staying temporarily in Russia on a visa must pay personal contributions to the Pension Fund and to the Social Insurance Fund (unless the employee is a HQS).

No personified contributions are payable for HQS.

Personal contribution concessions

Reduced insurance contribution rates apply to agricultural producers, businesses in technology and innovation special economic zones, taxpayers applying the simplified tax regime (for certain activity types), legal entities employing disabled individuals (provided that certain conditions are met), and IT companies, among others.

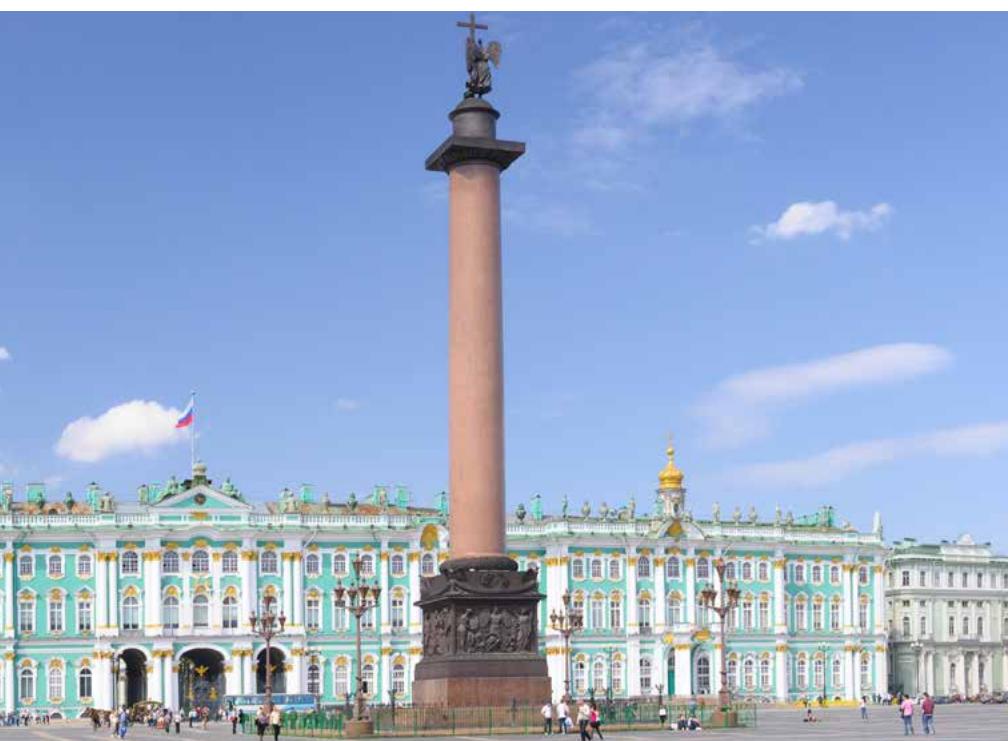
Mandatory social insurance against occupational accidents and diseases

Apart from the aforementioned personified contributions, employers are required to pay mandatory social insurance contributions against occupational accidents and diseases. These contributions are payable on the 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. The minimum rate is 0.2 percent of payroll; the maximum rate is 8.5 percent. Generally, office activity is subject to insurance contributions against injuries and professional illness at a rate of 0.2 percent.

Filing and payment

Insurance contributions are payable on a monthly basis.

Generally, those making payments should file various reports with the Pension Fund and the Social Insurance 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

Generally the tax base is the net book value of the average annual fixed assets according to Russian statutory accounting. For a number of property types (administrative and business centres; nonresidential premises aimed to be used / actually used as offices or for trading and catering; a FLE's immovable property that does not have PE status in Russia, or is not being used in the PE's operations in Russia; residential premises not accounted for as a fixed asset on the balance sheet), the tax base is the cadastral value of the specific facility.

Movable property that has been booked as a fixed asset since 1 January 2013 is exempt from tax, except for facilities booked as a result of reorganisation or the liquidation of a legal entity, or as a result of a transfer between related parties.

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.

Lower tax rates are established for assets classified as public railways, pipelines and power lines, and on assets constituting an integral, technical component of the above. The list of these types of assets was compiled by the Government of the Russian Federation. The rates for these assets are one percent in 2015, 1.3 percent in 2016, 1.6 percent in 2017, and 1.9 percent in 2018.

The regional authorities can reduce the property tax rate to zero percent.

With respect to immovable property, for which the tax base is the cadastral value, the tax rate (in Moscow) cannot exceed 1.7% in 2015, and 2% from 2016. For other Russian regions, the rate in 2015 should not exceed 1.5%, and 2% from 2016.

Tax concessions

The Tax Code stipulates a number of property tax concessions. In particular, companies are exempt from property tax on assets classified as Federal highways intended for public use and on assets constituting an integral, technical component of such highways. The list of these assets has been compiled by the Government of the Russian Federation.

Property tax paid by a Russian legal entity on property located outside of Russia can be offset when paying property tax in Russia. To carry out this offsetting, the taxpayer should submit a document confirming the payment of property tax abroad.

Filing and payment

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

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

Other taxes

Transport tax

Foreign legal entities and Russian legal entities should both pay transport tax if they own registered transport vehicles. Taxable vehicles include automobiles, motorcycles, scooters, buses, airplanes, helicopters, merchant vessels, yachts, sailing boats, boats, snowmobiles, etc. The tax base is calculated based on the engine volume, gross tonnage or type of vehicle.

The tax rates are established by the Tax Code and range from RUB1 to RUB200 (USD0.02–3.26) per unit of horse power and can increase or decrease by up to ten times, depending on the region.

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

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 annual tax return is 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 Russian Federation 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 must not be higher than 0.3 percent, and no higher than 1.5 percent of the cadastral value of the land plot for any other purposes. The regional authorities can decrease this rate, and also offer tax incentives or allowances to certain taxpayer categories.

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

Water tax

Water tax is payable by companies that consume water for special and clearly indicated business purposes.

Tax rates differ for various types of water consumption and are set in roubles per 1000 cubic metres of water consumed.

Water tax returns are filed quarterly, with payments also being made quarterly.

Special tax regimes

The Tax Code also provides special tax regimes under which a taxpayer is entitled to pay one single tax instead of numerous different taxes. These regimes can be applied if certain requirements are satisfied. Special tax regimes include simplified tax, unified agricultural tax, tax on imputed income and special rules on production sharing agreement regimes.

Unified tax on imputed income

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

- Domestic consumer services;
- Veterinary services;
- Vehicle maintenance, repair and washing;
- Leasing 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;
- Accommodation provision services (certain restrictions apply).

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

- The average number of annual staff is equal to or lower than 100;
- Other legal entities have contributed less than 25 percent to the taxpayer's share capital.

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

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

- Profits tax;
- VAT (except for VAT payable on imports);
- Property tax (except for tax payable based on cadastral value).

Unified imputed income tax is levied on a taxpayer's imputed income. Imputed income is determined as the base return rate of business activity during the period multiplied by physical indicators (the area of land employed, number of vehicles or number of staff) and adjusting factors.

Imputed income tax is paid at a rate of 15 percent.

The unified imputed income tax that is payable can be reduced (to 50 percent of the initial tax accrual) by deducting insurance contributions for mandatory pensions insurance, medical insurance and social insurance for temporary disability or maternity leave. It can also be reduced for mandatory social insurance against occupational accidents and diseases, as well as temporary disability payments to employees for the first 3 days of temporary disability paid by the employer, and for voluntary insurance payments under insurance contracts covering the employer's expenses.

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 (except for tax payable based on the cadastral value).

A company can 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 (USD734,454)¹¹, though this limit is subject to annual indexation;
- The net book value of fixed assets does not exceed RUB100,000,000 (USD1,632,000)¹²;
- The average annual number of staff does not exceed 100.

The following entities cannot apply the simplified tax system:

- Russian legal entities with branches;
- Foreign legal entities and representative offices (branches) of FLEs;
- Banks, insurance companies, pension funds, investment funds, parties to production sharing agreements, unified agricultural tax taxpayers, etc.;
- Entities in which other legal entities have participation shares exceeding 25 percent.

The simplified tax rate can be:

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

Taxpayers must make quarterly advance payments, making the annual final payment by 31 March of the following calendar year. Advance tax estimates and annual tax returns are due on 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 only if they are referred to in the established list, economically justifiable and properly documented.

The unified agricultural tax rate is six percent.

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

^{11,12} Actual exchange rate of the Central Bank of the Russian Federation as of 1 March 2015 (RUB61,2718 : USD1)

Personal taxation

Personal Income Tax

Personal Income Tax (PIT) in Russia generally 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 for 12 consecutive months. Short-term travel (less than 6 months) outside Russia's borders for medical treatment or educational activities does not qualify as an interruption to the individual's presence in Russia.

The day of arrival and day of departure should be included as days in Russia when calculating the number of days a person has been present in Russia when determining an individual's tax residency status.

If a company makes a salary payment locally in Russia, the company 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 the income was paid. Consequently, the tax withheld may not be the amount of tax ultimately due.

According to official clarifications from the Russian Ministry of Finance, the 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 all their income, irrespective of the country in which it arises; whereas non-residents are subject to PIT only on income sourced in Russia.

Tax base

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

Deemed income results when:

- Interest payments are made on loans from organisations and sole proprietors when the payments are

benchmarked at a rate of 2/3rds of the refinancing rate of the Central Bank of Russia on loans in Russian roubles, or interest is up to 9 percent per annum on loans in other currencies. The use of credit cards issued by non-Russian banks is also likely to trigger deemed taxable income for the cardholder.

- Favourable prices (non-market rates) are paid by an individual on goods or services purchased from related parties.
- Securities and financial instruments are acquired at a price below the market level.

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

Deemed income arises as a result of:

- Interest payments on loans from organisations and individual entrepreneurs at an amount lower than the payments calculated at the rate of 2/3rds of the refinancing rate of the Central Bank of Russia on loans in Russian roubles, or at a rate of 9 percent per annum on loans in other currencies. The use of credit cards issued by non-Russian banks is also likely to trigger deemed taxable income for the cardholder in cases when the overdraft facility is used.
- The acquisition of goods, work or services from related parties at a preferential price.
- The acquisition of securities and financial instruments at a price below the market level.

Tax rates

A 13-percent PIT rate applies generally to all types of income received by a tax resident except for certain types of non-employment income (e.g. deemed income resulting from the interest derived from the use of loans is taxable at the rate of 35 percent);

A 30-percent PIT rate applies generally to all types of income received by a tax non-resident, except for the following rates which specifically apply to particular types of income:

- 15-percent applies to dividend income from Russian companies received by a tax non-resident;
- 13-percent applies to the Russian employment income of tax non-residents who are foreign employees with the status of HQS, and to certain other specific categories of taxpayers.

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

Tax deductions

Standard tax deductions

Standard monthly tax deductions of RUB3,000 and RUB500 can 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 applies.

In addition, a standard tax deduction of RUB1,400 per child, per month can be granted to a parent of up to two children, and RUB3,000 for each additional child up to the age of 18, or for a child who is a full-time undergraduate student up to the age of 24. The tax deduction is doubled for one parent if the other parent agrees to refuse the deduction or if the parent is divorced.

These tax deductions are available only if cumulative annual income does not exceed RUB280,000.

Social tax deductions

Social tax deductions are available on amounts given to specific charities which qualify against government criteria, though only on up to 25 percent of income received in the tax period.

Social deductions are also available on:

- Expenses incurred by the taxpayer on the education of him/herself and each of his/her children;
- Expenses for medical treatment and medicines for the taxpayer and his/her spouse, parents, children;
- Contributions to 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 any disabled children;
- Additional insurance contributions to the cumulative part of state pensions.

The above deductions cannot exceed RUB120,000 in one calendar year per taxpayer (except expenses for certain expensive medical treatments on a specific list approved by the Russian Government, deductible by the actual expense amounts; and except for expenses for the education of the taxpayer's children, deductible within a limit of RUB50,000 per child).

Property-related tax deductions

Property related tax deductions are available on expenses related to the purchase of (construction of) dwellings and on land plots for the construction of a dwelling (or along with a dwelling place) in Russia (up to RUB2,000,000). Interest on the loans used to pay for the above mentioned purchases / constructions may also be claimed as a deduction (up to RUB3 million).

On the sale of residential property and land plots that have been owned for less than three years, a deduction up to RUB1,000,000 or in the amount of documented actual expenses for the acquisition can be claimed. On the sale of other property owned for less than 3 years, a deduction of up to RUB250,000, or in the amount of the actual documented expenses for the acquisition, may be claimed.

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

As of 2016, new rules on property-related tax deductions will apply to sales of residential property and land plots.

Professional tax deductions

Professional tax deductions can be granted to individuals conducting registered entrepreneurial activity. These deductions apply to documented business related expenses. If business related expenses are undocumented, a

sole proprietor can apply professional tax deductions of up to 20 percent of the income derived from business activities.

Professional deductions can 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 the performance of services under these agreements.

Individuals who receive author's fees or fees for the creation, execution or other use of specific intellectual property can 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).

Individuals who provide services or perform work under relevant civil-law contracts may claim a deduction of expenses (supported by documentation) directly related to their provision of services / performance of work.

Tax residents can benefit from claiming standard, social and property-related deductions, as well as professional deductions.

Filing and payment

Generally, individual entrepreneurs, Russian legal entities, Representative Offices and Branches of Foreign legal entities registered in Russia and which make payments to individuals, are considered tax agents, and they are required to withhold PIT from the compensation payable to such individuals and remit the associated PIT to the Russian financial authorities.

If PIT was not withheld by a tax agent, the latter must notify the tax authorities and the individuals who received the income that was not subjected to tax withholding. The onus then falls on the individuals to file a PIT declaration and pay PIT with regard to any taxable income. Generally, the PIT declaration should be filed no later than the 30 April of the year following the reporting year the item of taxable income was

received. Specific rules may apply to non-Russian citizens who depart from Russia.

Tax refund

A PIT declaration should also be required if individuals want to claim certain tax deductions or refund the PIT which was withheld by the tax agent (under certain circumstances).

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 value of the property. The rates may be adjusted by regional laws.

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 performed not later than the 1 October of the subsequent calendar year.

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

Transport tax

Individuals owning transport vehicles are subject to transport tax.

Taxable vehicles include automobiles, motorcycles, scooters, buses / coaches, airplanes, helicopters, motor vessels, yachts, sailing boats, ships, snowmobiles, etc.

Transport tax is determined based on the vehicle's engine power, seating 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 consisting of four different levels.

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

- The Federal Law on Accounting, which contains basic accounting and reporting requirements.
- 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 requirement that annual financial statements are approved annually, and provides definitions of subsidiary and associated companies, as well as determining the procedures for reorganising and liquidating different kinds of legal entities.

- The Federal Law on Governmental Support for Small Businesses in the Russian Federation provides a simplified procedure covering accounting and reporting compilation.
- The Federal Laws On Joint Stock Companies and On Limited Liability Companies, which establish information disclosure and presentation requirements, stipulate that data contained in the annual financial statements must be confirmed by the internal auditor, and determines the procedure by which the annual financial statements are approved as well as the situations in which an external audit opinion is required.

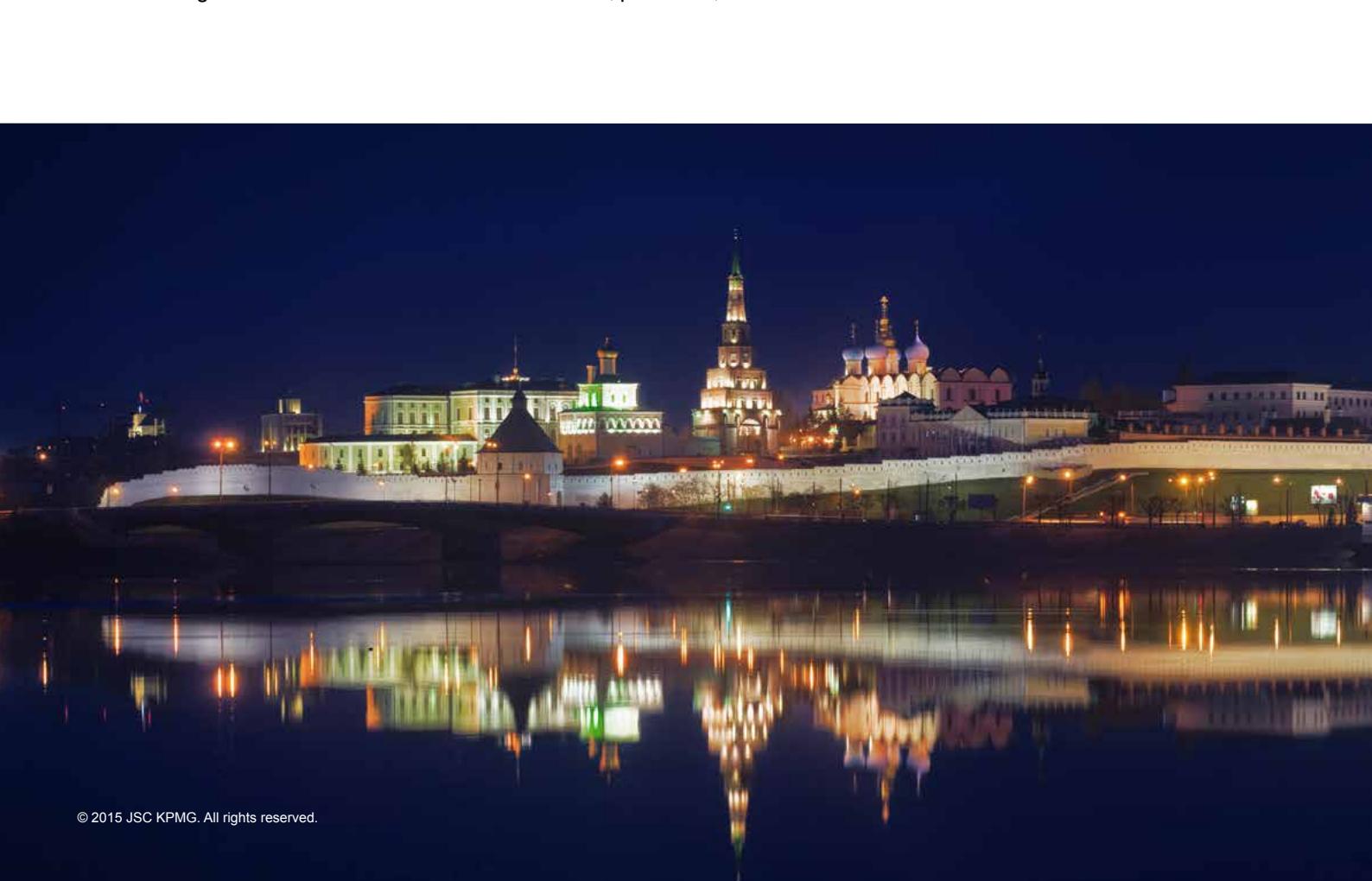
The second level consists of accounting regulations (standards), which regulate accounting policies, the compilation and presentation of financial statements, and accounting for fixed and intangible assets, inventory, loans, income, expenses, financial investments, profits tax, etc.

Many of these regulations are in essence close to International Financial Reporting Standards (IFRS). Bringing the national accounting system into line with IFRS has been part of the accounting reforms that began in 1998.

It is intended that new accounting regulations shall be issued in the future. The topics covered will be in accordance with the current list of IFRS standards. For instance, Russian accounting regulations currently have no standards on the leasing or impairment of assets. Additionally, 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 accounting principles and regulations 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 organisational aspects and are approved by an internal decision taken by the company on its accounting policies. If there are any specific accounting methods that are not specified in the relevant accounting standards, companies have the right to develop them independently and to adopt them by including them in the decision they have taken regarding their 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 Representative Offices are still required to submit annual activity reports to the tax authorities along with their tax returns.

The key accounting principles in the Russian Federation are:

- **Separate entity principle:** in accordance with which the assets and liabilities of the company are separated from the assets and liabilities of the owner or the assets provided to the entity by other persons.
- **Going concern principle:** the assumption 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, or if new accounting methods are developed by the company, or there are significant changes in operating conditions.

- **The matching principle:** this states that business operations are recorded in the reporting period in which they occur, regardless of when receipts or payments related to these transactions are actually made.
- **Principle of timeliness and completeness in recording transactions:** the accountant should make records according to the timelines set 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 their 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 (government) 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 the 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 reflect the company's economic and financial position fully and reliably along with any change in this position and the financial results of the company's activities.

In accordance with Russian legislation, commercial legal entities prepare annual financial statements for each financial year. A financial year is the calendar year (1 January – 31 December) with exceptions for when a legal entity is registered, reorganised or liquidated. If required by law, a commercial legal entity is required to prepare and submit interim financial statements for periods that are shorter than a financial year. Annual financial statements, except for when directed otherwise by legislation, include the following:

- The balance sheet;
- Financial result reports;
- Appendices to the above two reports containing additional information on changes in equity, cash flows, movements of borrowed funds, changes in accounts receivable and payable, notes, etc;

Tax returns and audit opinions are not included in the financial statements.

The information in the financial statement for the reporting year and the previous two years 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 for them 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.

Companies submit annual financial statements to:

- Shareholders;
- Statistics authorities;
- Tax authorities;
- Other interested users (if the shareholders so decide).

Currently, according to the Federal Law "On Consolidated Financial Reporting", only credit, insurance and listed Russian companies are obliged to consolidate financial reporting in accordance with the version of IFRS which was officially adopted and published by the Ministry of Finance of the Russian Federation.

Considering the fact that a typical company's financial statements are prepared in accordance with Russian statutory legislation, and that this differs from IFRS, in order to present the financial statements to foreign owners or investors it is normally a requirement that the statutory financial statements are prepared with an IFRS reconciliation included. Presenting financial statements in accordance with IFRS and, consequently, increasing their transparency, will facilitate the inflow of foreign investment into the economy's production sector and increase the possibility of more companies obtaining credit.

Audit requirements

The Federal Law on Audit requires that the following Russian entities have mandatory 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, and 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 (or the performance of work or provision of services) for the year preceding the financial year exceed RUB400,000,000 (USD6,528,500), or for which the value of assets on the balance sheet at the end of the year preceding the financial year exceeds RUB60,000,000 (USD979,300);
- Companies presenting and (or) publishing consolidated financial reports;
- Companies for which audits are mandatory according to other Federal laws.

A mandatory audit must be carried out every financial year.

Audits of listed companies, credit and insurance companies, non-state pension funds, companies in which the state owns more than 25 percent, state corporations, state companies and consolidated financial reporting can only be carried out by professional audit organisations. Because audits are subject to self-regulation, to provide audit services in the Russian Federation a professional auditing firm should be a member of an appropriate self-regulating organisation.

MOSCOW



Appendix 1.

Chart of Withholding Tax Rates

Country	Dividends percent	Interest percent	Royalties percent
Albania	10	10	10
Algeria	5; 15*	0; 15*	15
Argentina	10; 15*	0; 15*	15
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
Botswana	5; 10*	0; 10*	10
Brazil	10; 15*	0; 15*	15
Bulgaria	15	0; 15*	15
Canada	10; 15*	0; 10*	0; 10*
Chile	5; 10*	15	5; 10*
China	10	0; 10*	10
Croatia	5; 10*	10	10
Cyprus	5; 10*	0	0
Cuba	5; 15*	0; 10*	5
Czech Republic	10	0	10
Denmark	10	0	0
Egypt	10	0; 15*	15
Finland	5; 12*	0	0
France	5; 10; 15*	0	0
Germany	5; 15*	0	0
Greece	5; 10*	7	7
Hungary	10	0	0
Iceland	5; 15*	0	0
India	10	0; 10*	10
Indonesia	15	0; 15*	15
Iran	5; 10*	0; 7.5*	5
Ireland	10	0	0
Israel	10	0; 10*	10
Italy	5; 10*	10	0
Japan	15	0; 10*	0; 10*
Kazakhstan	10	0; 10*	10
Korea (Dem. People's Rep.)	10	0	0
Korea (Rep.)	5; 10*	0	5
Kuwait	0; 5*	0	10
Kyrgyzstan	10	0; 10*	10
Latvia	5; 10*	5; 10*	5
Lebanon	10	0; 5*	5
Lithuania	5; 10*	10	5; 10*
Luxembourg	5; 15*	0	0

* **Algeria:** 5 percent on dividends — this rate applies if the recipient company (not a partnership) directly owns at least 25 percent of the capital in the Russian company; otherwise, 15 percent. 0 percent on interest applies to interest paid by the government or its local authorities or paid to the government, its local authorities or the central bank; otherwise, 15 percent.

* **Argentina:** 10 percent on dividends — this rate applies if the recipient directly owns at least 25 percent of the capital in the Russian company; otherwise, 15 percent. 0 percent on interest applies to interest paid to the government or the central bank; otherwise, 15 percent.

* **Armenia:** 5 percent on dividends — this rate applies if the holding value is at least USD 40,000 or its equivalent in national currencies; otherwise, 10 percent.

* **Australia:** 5 percent on dividends — this rate applies to dividends paid out of profits that have carried 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 AUD 700,000, 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 USD 100,000; otherwise, 15 percent.

* **Azerbaijan:** 0 percent on interest applies to interest paid to the government; otherwise, 10 percent.

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

Country	Dividends percent	Interest percent	Royalties percent
Macedonia	10	10	10
Malaysia	-; 15*	0; 15*	10; 15*
Mali	10; 15*	0; 15*	0
Malta	0; 5; 10*	5	5
Mexico	10	0; 10*	10
Moldova	10	0	10
Mongolia	10	0; 10*	-*
Montenegro	5; 15*	10	10
Morocco	5; 10*	0; 10*	10
Namibia	5; 10*	0; 10*	5
Netherlands	5; 15*	0	0
New Zealand	15	10	10
Norway	10	10	0
Philippines	15	0; 15*	15
Poland	10	10	10
Portugal	10; 15*	0; 10*	10
Qatar	5	0; 5*	0
Romania	15	0; 15*	10
Saudi Arabia	0; 5*	0; 5*	10
Serbia	5; 15*	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
Sri Lanka	10; 15*	10	10
Sweden	5; 15*	0	0
Switzerland	0; 5; 15*	0*	0
Syria	15	0; 10*	4.5/13.5/18
Tajikistan	5; 10*	0; 10*	0
Thailand	15	-; 0; 10*	15
Turkey	10	0; 10*	10
Turkmenistan	10	5	5
UAE	-/0*	-/0*	-*
UK	10*	0	0
Ukraine	5; 15*	0; 10*	10
USA	5; 10*	0	0
Uzbekistan	10	0; 10*	0
Venezuela	10; 15*	0; 5; 10*	10; 15*
Vietnam	10; 15*	10	15

* **Belgium:** 0 percent on interest applies to interest paid to the government, its local authorities, public bodies and to banks and other financial institutions; otherwise, 10 percent.

* **Botswana:** 5 percent on dividends — this rate applies if the recipient directly owns at least 25 percent of the capital in the Russian company; otherwise, 10 percent. 0 percent on interest applies to interest paid to the government, its local authorities, a political subdivision or the central 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. 0 percent on interest applies to interest paid to the government or public bodies; otherwise, 15 percent.

* **Bulgaria:** 0 percent on interest applies 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. 0 percent on interest applies to interest paid to the central bank; otherwise, 10 percent. 0 percent on royalties — the rate applies to computer software, patents and know-how; otherwise, 10 percent.

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

* **China:** 0 percent on interest applies to interest paid to public bodies, the central bank, the government or its local authorities; 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 USD 100,000 or its equivalent in another currency; otherwise, 10 percent.
- * **Cyprus:** 5 percent on dividends — this rate applies if the holding value is at least EUR 100,000; otherwise, 10 percent.
- * **Cuba:** 5 percent on dividends — this rate applies if the recipient company (not a partnership) directly owns at least 25 percent of the capital in the Russian company; otherwise, 15 percent. 0 percent on interest applies to interest paid to the government, its local authorities or public bodies; otherwise, 10 percent.
- * **Egypt:** 0 percent on interest applies to interest paid to the government, its local authorities, public bodies or the national banks; otherwise, 15 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 USD 100,000 or its equivalent in national currencies; otherwise, 12 percent.
- * **France:** 5 percent on dividends — this rate applies if the French company (i) has directly invested at least FRF 500,000 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 EUR 80,000; otherwise, 15 percent.
- * **Greece:** 5 percent on dividends — this rate applies if the recipient company (not a partnership) directly
- owns at least 25 percent of the capital in the Russian company; otherwise, 10 percent.
- * **Iceland:** 5 percent on dividends — this rate applies if the recipient company (not a partnership) owns at least 25% of the capital in the Russian company and the value of the capital investment is at least USD 100,000; otherwise, 15 percent.
- * **India:** 0 percent tax rate on interest applies to interest paid to the government, its local authorities, public bodies or the central bank; otherwise, 10 percent.
- * **Indonesia:** 0 percent tax rate on interest applies to interest paid to the government, its local authorities, political subdivision, the central bank; otherwise, 15 percent.
- * **Iran:** 5 percent on dividends — this rate applies if the recipient company (not a partnership) directly owns at least 25 percent of the capital in the Russian company; otherwise, 10 percent. 0 percent on interest applies to interest paid to the contracting state, its local authorities, public bodies or the national banks; otherwise, 7.5 percent.
- * **Israel:** 0 percent on interest applies to interest paid to the government, local authorities and the central bank; otherwise, 10 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 USD 100,000; otherwise, 10 percent.
- * **Japan:** 0 percent tax rate on interest applies to interest paid to the government, its local authorities, public bodies or the central bank; otherwise, 10 percent. 0 percent on royalties — this rate applies to copyright royalties; otherwise, 10 percent.
- * **Kazakhstan:** 0 percent tax rate on interest applies to interest paid to the contracting state, local authorities or public bodies; otherwise, 10 percent.
- * **Korea (Rep.):** 5 percent on dividends — this rate applies if the recipient company owns directly at least 30% of the capital in the Russian company and the value of the holding is at least USD 100,000; otherwise, 10 percent.
- * **Kuwait:** 0 percent on dividends — this rate applies if to dividends distributed to the government, local authorities, public entities, the central bank, public financial institutions; otherwise, 5 percent.
- * **Kyrgyzstan:** 0 percent tax rate on interest applies to interest paid to the government, its local authorities, public bodies and the central bank; otherwise, 10 percent.
- * **Latvia:** 5 percent on dividends — this rate applies if the recipient company (other than a partnership) owns directly at least 25% of the capital in the Russian company and the capital invested exceeds USD 75,000; otherwise, 10 percent. 5 percent on interest applies to interest on loans of any kind granted by a bank or other financial institution of one contracting state to a bank or other financial institution of the other contracting state; otherwise, 10 percent.
- * **Lebanon:** 0 percent on interest applies to interest paid to the government, its local authorities, public bodies; otherwise, 5 percent.
- * **Lithuania:** 5 percent on dividends — this rate applies if the recipient company (other than a partnership) directly owns at least 25% of the capital in the Russian company and the value of the capital investment is at least USD 100,000; otherwise, 10 percent. 0 percent on interest applies to interest paid to the government, its local authorities, public bodies, the central bank; otherwise, 10 percent. 5 percent on royalties — this rate applies to equipment rentals; otherwise, 10 percent.
- * **Luxembourg:** 5 percent on dividends — this lower rate applies if the Luxembourg recipient directly owns at least 10 percent of the capital in the Russian company and

- the holding value is at least EUR 80,000 or its equivalent in national currency; otherwise, 15 percent.
- * **Malaysia:** 15 percent on dividends — this rate applies to profits of joint ventures; otherwise, the domestic rate applies; there is no reduction under the treaty. 0 percent on interest applies to interest paid to the government and the central bank; otherwise, 15 percent. 10 percent on royalties — this rate applies to authors' rights, equipment rentals; 15 percent on royalties — this rate applies to films and broadcasting programs and copyrights on items of literature or art.
- * **Mali:** 10 percent on dividends — this rate applies if the value of the holding is at least FRF 1 million; otherwise, 15 percent. 0 percent on interest applies to interest paid by the government or its local authorities, paid to the government, its local authorities or the central bank; otherwise, 15 percent.
- * **Malta:** 5 percent on dividends — this rate applies if the recipient company owns at least 25% of the capital in the Russian company and the total amount of investments into capital is at least EUR 100,000; otherwise, 10 percent. The zero rate applies to pension fund dividends, if such dividends are derived from investments made using the assets of that pension fund.
- * **Mexico:** 0 percent on interest — this lower rate applies to interest paid to the government, the central bank and public bodies and interest paid in respect of a loan for a period of at least three years granted, guaranteed or insured by the specified banks.; in other cases, 10 percent.
- * **Mongolia:** 0 percent on interest — this lower rate applies to interest paid to the government or the central bank; in other cases, 10 percent. Taxation of royalties — the domestic rate applies; there is no reduction under the treaty.
- * **Montenegro:** 5 percent on dividends — this rate applies if the recipient company (other than a partnership) directly owns at least 25% of the capital in the Russian company and the value of the capital investment is at least USD 100,000; otherwise, 15 percent.
- * **Morocco:** 5 percent on dividends — this rate applies if the value of the holding of the recipient company is at least USD 500,000; otherwise, 10 percent. 0 percent on interest — this lower rate applies to interest on foreign currency deposits and paid by the government; otherwise, 10 percent.
- * **Namibia:** 5 percent on dividends — this rate applies if the recipient company (other than a partnership) directly owns at least 25% of the capital in the Russian company and the value of the capital investment is at least USD 100,000; otherwise, 10 percent. 0 percent on interest — this lower rate applies to interest paid to the government, its local authorities or public bodies; otherwise, 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 EUR 75,000 or its equivalent in national currency; otherwise, 15 percent.
- * **Philippines:** 0 percent on interest — this lower rate applies to interest paid to the government, its local authorities or public bodies; 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. 0 percent tax rate on interest applies to interest paid to the government, its local authorities or public bodies; otherwise, 10 percent.
- * **Qatar:** 0 percent on interest — this lower rate applies to interest paid to the government, its local authorities or public bodies; otherwise, 15 percent.
- * **Romania:** 0 percent on interest — this lower rate applies to interest paid to the government, the national bank, foreign trade bank, or Eximbank; otherwise, 15 percent.
- * **Saudi Arabia:** 0 percent on dividends — this lower rate applies to dividends distributed to the government, its local authorities, public bodies, the central bank; otherwise, 5 percent. 0 percent on interest — this lower rate applies to interest paid by the government, its local authorities or paid to the government, its local authorities, public bodies; otherwise, 5 percent.
- * **Serbia:** 5 percent on dividends — this rate applies if the recipient company (other than a partnership) directly owns at least 25% of the capital in the Russian company and the value of the capital investment is at least USD 100,000; otherwise, 15 percent.
- * **Singapore:** 5 percent on dividends — this rate applies if the recipient of the dividends is the government of the other contracting state or company which directly owns at least 15 percent of the share capital in the company paying dividends and has invested in this company at least USD 100,000 or its equivalent in another currency; otherwise, 10 percent. 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 owns at least 30 percent of the capital in the Russian company and has directly invested in this company at least USD 100,000; otherwise, 15 percent. 0 percent tax rate on interest applies 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 EUR 100,000 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. 0 percent on interest — this lower rate

- applies to long-term loans (minimum 7 years) granted by credit institutions residing in a contracting state; otherwise, 5 percent.
- * **Sri Lanka:** 10 percent on dividends — this rate applies if the recipient company (other than a partnership) directly owns at least 25 percent of the capital in the Russian company; otherwise, 15 percent. 0 percent on interest — this lower rate applies to interest paid to the government, its local authorities, public bodies, the central bank; otherwise, 10 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 USD 100,000 or its equivalent in national currencies; otherwise, 15 percent.
 - * **Switzerland:** 0 percent on dividends — this rate applies if dividends distributed to a pension fund (or similar institution, the government, any political subdivision or local authority or the central bank; 5 percent rate on dividends applies if the Swiss company (other than a partnership) directly owns at least 20 percent of the capital in the Russian company and the holding value exceeds CHF 200,000 or its equivalent in another currency; otherwise, 15 percent.
 - * **Syria:** 0 percent on interest — this lower rate applies to interest paid to the government, its local authorities, public bodies; otherwise, 10 percent. 4.5 percent on royalties — this rate applies to films and broadcasting programs; 13.54.5 percent on royalties — this rate applies to copyrights on items of literature, art or science; otherwise, 18 percent.
 - * **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. 0 percent tax rate on
 - interest applies to interest paid to the government, its local authorities, public bodies or the central bank; otherwise, 10 percent.
 - * **Thailand:** 0 percent tax rate on interest applies to interest paid to the government, public bodies, the central bank, Export-Import Bank of Thailand; 10 percent tax rate on interest applies to interest paid to financial institutions. The domestic rate applies in other cases; there is no general reduction under the treaty.
 - * **Turkey:** 0 percent tax rate on interest applies to interest paid to the government or the central bank; otherwise, 10 percent.
 - * **UAE:** 0 percent on dividends — this rate applies only if the recipient is a financial or investment institution. 0 percent tax rate on interest — this rate applies only if the recipient is a financial or investment institution. The treaty does not cover royalties.
 - * **UK:** 10 percent on dividends — applies if dividends are subject to tax in the hands of the recipient company; otherwise, 15 percent.
 - * **Ukraine:** 5 percent on dividends — this rate applies if the holding value is at least USD 50,000; otherwise, 15 percent. 0 percent tax rate on interest applies to interest paid to the government or the central bank; otherwise, 10 percent.
 - * **USA:** 5 percent on dividends — 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 to interest paid to the government, its local authorities 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 holding value is at least USD 100,000; otherwise, 15 percent. 0 percent tax rate on
 - interest apply to interest paid by (or to) the government, its local authorities, the central bank or public bodies; 5 percent tax rate on interest applies to interest paid to a bank; otherwise, 10 percent. 10 percent on royalties — this rate applies to fees for technical services; otherwise, 15 percent.
 - * **Vietnam:** 10 percent on dividends — this rate applies if the recipient company has invested in the capital of the Russian company at least USD 10 million; otherwise, 15 percent.

CFC rules

With effect from 1 January 2015, the profits of controlled foreign companies (CFC) may be taxable if the controlling person is a Russian, i.e. if the parent company or individual, under the so-called CFC rules, is Russian.

Under the provisional regime for 2015, CFCs encompass:

- FLEs (Foreign Legal Entities), in which a resident of Russia effectively owns at least 50% of the capital, and foreign structures that do not possess a legal personality (funds, partnerships, trusts, etc.) over which a Russian resident has control.

From 2016, the CFC rules will also extend to:

- FLEs in which a resident of Russia effectively owns at least 25% of the capital, and
- FLEs in which a resident of Russia effectively owns at least 10% of the capital, if residents of Russia cumulatively own at least 50% of the capital.

The Tax Code provides for a number of exemptions, which – if applicable – exempt CFC profits from taxation in Russia. Two principal exemptions are available for CFCs that have:

- an effective tax rate not lower than 75% of the weighted average Russian profits tax rate, or
- a share of passive income not exceeding 20% of the total income.

Both exemptions only apply to CFCs that are resident in treaty-protected jurisdictions, provided that these jurisdictions exchange tax information with Russia (as determined by the Ministry of Finance).

The undistributed profits of CFCs are subject to:

- profits tax at 20% if a controlling person is a Russian-resident company, or
- PIT at 13% if a controlling person is a Russian-resident individual.

Taxes on CFC profits, such as foreign income tax and withholding tax levied at source, are creditable against the Russian CFC tax.

New residency rules

Normally, only legal entities incorporated in Russia are considered Russian tax residents. However, new residency rules, effective from 1 January 2015, provide that an FLE can also be recognised as tax resident in Russia if it is effectively managed in Russia.

Russia will be acknowledged as the place of effective management if at least one of the following is true for the FLE:

- Most board of director meetings take place in Russia (i.e. more than in any other country),

- Executive functions are performed regularly in Russia by the management board or top-level employees, or
- Certain (listed) administrative functions are performed in Russia, namely: bookkeeping or accounting, the generating or processing of company documents, and operational HR functions.

However, the effective management rule cannot see an FLE recognised as a tax resident of Russia if it carries out its business activities at its place of residence using qualified personnel and its assets are outside Russia (that is, providing the business is resident in a treaty-protected jurisdiction). Some exceptions apply to FLEs engaged in specific listed activities.

An FLE whose tax residency shifts to Russia becomes subject to unlimited tax liability in Russia, i.e. its worldwide income becomes subject to Russian profits tax.

Beneficial ownership requirement

A domestic beneficial ownership requirement has been introduced into the Tax Code as a condition controlling whether reduced withholding tax rates can be applied in accordance with the treaties signed with Russia.

The Tax Code defines a beneficial owner as:

- a person who has the right to independently use and/or dispose of the income by virtue of:
 - participation (direct or indirect) in the company,
 - control over the company, or
 - other circumstances, or
- a person in whose interest another person has the power to dispose of the income.

Further, the Tax Code provides a negative list of persons who could not be considered beneficial owners of income. This relates to persons who:

- possess limited powers in relation to the disposal of that income, or
- carry out merely intermediary functions in relation to that income in the interest of another person, without performing any other functions and without assuming any risks.

The payer of income, who acts as a withholding tax agent, has the right to request documentary proof of beneficial ownership from an income recipient. If the latter is not able to provide such proof, the tax agent may withhold tax at the full domestic rate.

In addition, the Tax Code provides for a so-called "look-through" approach, i.e. the right to apply (under certain circumstances) a reduced withholding tax rate under the treaty with the beneficial owner's jurisdiction, even if another person is an immediate recipient of income.

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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 USD163) if the registration deadlines are missed. If activities have been conducted without registration: 10 percent of the income received as a result of the activities, though not less than RUB40,000 (approximately USD653)*
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 USD16.3)*
Substantial violation of the rules governing the accounting of taxable income and expenses	RUB10,000 (approximately USD163)* If committed in several tax periods: RUB30,000 (approximately USD490)* If this has resulted in understatement of the tax base: then 20 percent of the amount of tax underpaid (if any), but not less than RUB40,000 (approximately USD653)*
Payment default 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 the additional taxes and late payment interest payable, fines for erroneous bookkeeping and tax calculation should not be assessed.

Normally late payment interest is charged at 1/300th of the refinancing rate of the Central Bank of the Russian Federation (8.25 percent as of 5 February 2015) for each day the tax payment was delayed. At present, the interest would be 0.027 percent per day.

Fines based on the Administrative Code

Type of infringement	Fine
Violation of the terms of registration with the tax authorities	RUB500–RUB1,000 (from USD8 to USD16) for missing registration deadlines; RUB2,000–RUB3,000 (from USD33 to USD49), if the activity is executed without registration.
Violation of the terms for submission of tax returns	RUB300–RUB500 (from USD5 to USD8), or a warning.
Non-submission of essential information for tax control purposes	For individuals: RUB100–RUB300 (from USD3 to USD9), For company executives: RUB300–RUB500 (from USD9 to USD15) for the non-submission of information, or submission of information that was incomplete for completion of the necessary tax control purposes.

Fines based on the Criminal Code

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

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

In particular, material tax evasion can result in imprisonment terms of up to six years, prohibitions on the execution of specific activities for three years, and a

fine of RUB200,000–RUB500,000 (from USD3,260 to USD8,160), or a fine of the amount of salary or other income the offender accrued over a period from one to three years.

Tax evasion is considered material if the amount of unpaid taxes over three years exceeds RUB10,000,000 (approximately USD163,200), and provided that the amount of unpaid taxes exceeds 20 percent of the total amount of taxes

payable or exceeds RUB30,000,000 (approximately USD489,630).

An organisation or an individual is free of criminal liability if they have committed tax evasion for the first time and have paid to the budget, in full, all of their tax arrears and late payment interest, and all associated 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 the goods and/or vehicles, with the possibility of the goods / vehicles being seized.
Non-declaration of goods and/or vehicles via the established procedures	Fine of 50 percent to 200 percent of the value of the goods and/or vehicles, with the possibility of the goods / vehicles being seized.
Incorrect declarations (e.g. provision of incorrect information regarding the name, description, classification code of goods, etc), if the declaration led to underpayment of customs duties	Fine of 50 percent to 200 percent of the underpaid customs payments, with the possibility of the goods / vehicles in question being seized.
Violations of the requirements of the customs procedure	Fine of 100 percent to 200 percent of the value of goods and/or vehicles, with the possibility of the goods / vehicles being seized.
Illegal acquisition, use, storage, or transportation of goods and/or vehicles	Fine of 50 percent to 200 percent of the value of goods and/or vehicles, with the possibility of the goods / vehicles being seized.
Evasion of customs duties	<p>Fine of RUB100,000–RUB500,000 (from USD1,632 to USD8,160) or of 1–3 years' salary, or confinement for a period of up to two years.</p> <p>If there has been an especially large customs duties evasion, a fine of RUB300,000–RUB500,000 (from USD4,896 to USD8,160) or of 2–3 years' salary, or confinement of up to 5 years with a forfeit of the right to hold some posts or carry out some activities for a period of up to 3 years (or without any forfeit).</p> <p>The evasion of customs duties is considered large scale if the total sum of unpaid customs duties exceeds RUB1,000,000 (approximately USD16,321) and is considered exceptionally large scale if it exceeds RUB3,000,000 (approximately USD48,964).</p>

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

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 extensive knowledge of tax advisory services in Russia, Mikhail Orlov, the Head of Tax & Legal in Russia and the CIS, also chairs the Tax and Customs Law Expert Council of the Russian State Duma and drafts legislation and works as a Public Tax Ombudsman under the Russian Federation's Presidential Commissioner for the Rights of Business People.

As the head of a strong and cohesive team of professionals, Mikhail makes it the department's priority to be not only our clients' consultants who help solve urgent and sensitive issues quickly and efficiently, but also to be their trusted partners.

Our approach to key issues:

- **International tax planning (including de-offshorization services).** 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 structure their activities.
- **Transfer pricing.** We have completed more than 100 complex analyses of transfer prices for Russian and international clients across many different sectors.
- **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 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.

Personnel services

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

Legal advice

In addition to our standard corporate registration services, KPMG assists with mergers and acquisitions and provides legal support for both companies and individuals undertaking projects, including legal due diligence and drafting transaction documents.

Complex tax projects

The specialists at KPMG Tax & Legal have experience supporting, from a tax and legal perspective, IT projects and projects requiring financial and strategic consulting. We analyse financial risks, develop progressive approaches and adapt systems to conform with Russian and international legislation. Our experience with such projects includes introducing new software systems, overseeing commercial restructuring of holding companies, advising on money laundering, advising on 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.



Glossary of terms

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 (Federalniy Zakon)
GDP	Gross domestic product
HQS	Highly qualified specialist
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 Link Exchange
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

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