

KPMG IN RUSSIA AND THE CIS

Doing Business in Russia

Your roadmap to successful investments

2013

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Tax and Legal





SAINT PETERSBURG

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Foreword

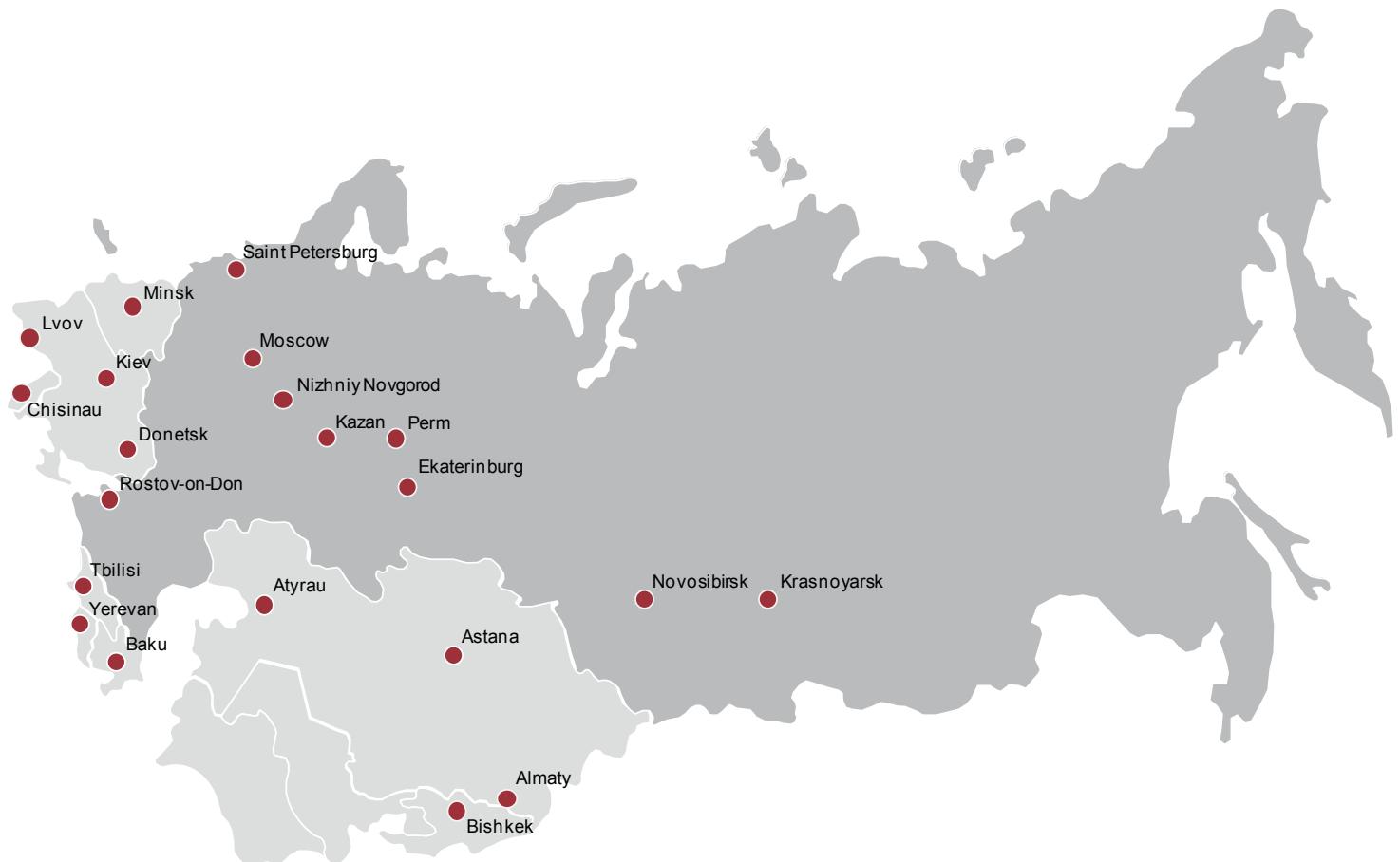
Dear reader,

This brochure has been prepared to provide a brief economic overview of Russia as well as to introduce the tax and legal issues that are important for those planning to do business in Russia. In particular, there is a brief discussion of the benefits of investing in the separate economic zones, including Skolkovo, the new "Russian Silicon Valley" near Moscow. Russian tax and civil legislation is constantly developing and there is sometimes no clear answer to what might be considered a simple question. Therefore, court cases and practice are important sources for interpreting legislation. All information is current as of January, 2013. This brochure is not intended to provide tax or legal advice for any specific person or situation. Readers are strongly advised to seek professional assistance from advisors with experience in Russia for business ventures.

About KPMG

KPMG is a global network of professional firms providing audit, tax and advisory services. The company employs 152,000 outstanding professionals working together to deliver value in 156 countries worldwide. KPMG has been working for more than 20 years in Russia and has more than 3,800 professionals working at 19 offices in seven CIS countries.

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



Introduction to Russia

Country facts

Country snapshot

Capital:	Moscow
Area:	17,098,200 sq km
Population (2013):	143.4 million
Cities over 1 mln:	15
President:	Vladimir Putin
Prime-minister:	Dmitry Medvedev
Currency:	Ruble (RUB)
GDP in PPP (2012):	USD3.380 billion
Real GDP growth (2012):	+ 3.4 percent
GDP per capita (2012):	USD14,061.5
Number of regions	83
FDI (2012):	USD51.4 billion
Inflation (2012):	6.6 percent
Foreign Reserves (01.07.2013):	USD513,772 billion

- The GDP in 2012 grew by 3.4 percent to USD 1.920 trillion
- Industrial output in 2012 was up 2.6 percent year-on-year (YoY).
- Unemployment fell to 2.46 percent in 2012.

Investment climate

In recent years, increasing consumer activity in Russia has contributed to dynamic growth in retail, telecommunications and real estate development. Incomes are rising and consumer lending and mortgages are becoming more widespread. In 1999-2008, Russia experienced continuous, rapid economic expansion, with GDP growing approximately by 7 percent annually.

Russia became increasingly integrated into the global economy over the last decade. This fueled its rapid economic growth in the early part of this century, but integration comes at a price and the headwinds facing the world economy today threaten Russia also. The country was exposed to the crisis that started in the final quarter of 2008, as national GDP fell 7.8% for 2009, but by 2012 a number of regions have largely returned to pre-crisis levels.

In 2011 Russia's per capita GDP (USD12,995) was the highest among BRICS countries¹. President Putin and Prime Minister Medvedev promised to create a modern, innovative economy, less reliant on mineral exports.

Russia is expected to become the largest consumer market in Europe by 2020 as its per capita GDP triples to 35,000 USD², and the fifth largest economy globally (in GDP measured at PPP terms)³.

It is obvious that the Russian government is taking serious efforts towards making changes in the Russian economy and making Russia more attractive to foreign investors. A new International Finance Corporation and World Bank Doing Business report finds that from June 2011 to June 2012, the Russian Federation improved its business regulatory climate by focusing on reforms that make it easier for local

entrepreneurs to pay taxes and deal with construction permits. The 10th edition of the annual Doing Business report also finds that since 2005, Russia has implemented a total of 17 institutional or regulatory reforms that improve the business regulatory environment for domestic firms. "Russia has taken important steps in the last year to narrow the gap in the quality of the business environment with respect to that existing in high-income economies," said Augusto Lopez-Claros, Director, Global Indicators and Analysis, World Bank Group. "That is part of the government's continuous effort to improve the country's investment climate, which was recently highlighted by President Vladimir Putin as a top policy priority."⁴

The ease of tax collection rank for Russia is up from #105 to #64. Tax payments per year are down from 9 to 7, time spent on taxes has decreased from 290 to 177 hours per year. Russia is up from #111 to #101 in the time and cost of setting up a new business, with procedures down by one to a total of eight, and time down to 18 from 30 days⁵.

The country is clearly full of opportunities. According to US Ambassador to Russia, Michael McFaul, "Those doing business in Russia are already fairly satisfied... But there's another 98 percent of American businesses that don't come here, don't know anything, have stereotypes about what the climate is here. We've gotta' reach those folks"⁶.

Russia is a geographically vast market, stretching over nine time zones. There are significant geographical disparities in wealth distribution. Underdeveloped infrastructure causes logistical challenges, especially outside of major cities. Conducting business is often

impeded by burdensome regulatory regimes, excessive bureaucracy, inadequate intellectual property rights, inconsistent application of laws and regulations, lack of transparency, excessive government interference in business matters and other market access barriers, such as protectionism, irrespectively the fact that since August 2012 Russia is an official member of the WTO. The global economic crisis inhibited access to credit, but effective government measures have mitigated this issue. Although special rules apply to highly qualified foreign employees, the Russian immigration and visa system is still complex, requiring time and expertise for business travelers to obtain the necessary permits.

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

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

¹ World Development Indicators database, World Bank. Database updated on 27 September 2012. Accessed on 26 November 2012

² Putin's declaration in 2011 (Baltic News Network citing Interfax <http://bnn-news.com/putin-urges-double-russian-gdp-28057>)

³ Euromonitor International, 'Top 10 largest economies in 2020' (2010)

⁴ <http://www.worldbank.org/en/news/2012/10/23/russian-federation-moves-to-boost-regulatory-environment-for-doing-business>

⁵ http://mfc-moscow.com/index.php?id=61&_newsid=1296

⁶ <http://www.themoscowtimes.com/news/article/mcfaul-to-focus-on-economic-ties/471161.html>

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

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

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

- Establishing an organisational structure for cooperation with foreign investors;
- Providing financial and tax incentives;
- Modernising and developing infrastructure;
- Making use of public-private partnerships (PPPs).

The leading Russian rating agency, Expert RA, has been rating the investment climate in Russia's regions since the late 1990s according to their investment potential and risk. In 2010-2011 the ten regions with the most potential, according to Expert RA, were Moscow, the Moscow Oblast, St. Petersburg, the Krasnodar Krai, the Sverdlovsk Oblast, the Krasnoyarsk Krai, Tatarstan Republic, the Samara Oblast, Bashkostostan Republic, and the Rostov Oblast. The regions with least risk were the Krasnodar Krai, the Belgorod Oblast, the Lipetsk Oblast, the Moscow Oblast, St. Petersburg, the Rostov Oblast, the Leningrad Oblast, the Kaluga Oblast, Tatarstan Republic, and the Tambov Oblast. KPMG's study of regional foreign investment activity highlighted the fact that foreign direct investment (FDI) into Russia is highly concentrated: Moscow, St. Petersburg, Sakhalin and Arkhangelsk attract significant funds, while more than 40 regions were treated as Low Attracting FDI Regions (attracted less than USD25 million per year) during 2006-2011.

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

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

In 2010-11, the regions leading in attracting foreign direct investments were Moscow, the Sakhalin Oblast, the Moscow Oblast, the Kaluga Oblast, St. Petersburg, the Nizhny Novgorod Oblast, the Archangelsk Oblast, the Tyumen Oblast, the Leningrad Oblast

and the Vladimir Oblast. The leading position of the Sakhalin Oblast and the Archangelsk Oblast was due to major oil and gas projects, while the Kaluga Oblast and the Vladimir Oblast were remarkably effective in creating favorable conditions for investors in manufacturing projects. In particular, in the Kaluga Oblast, a special regional development agency was established more than five years ago and six "industrial parks" have also been established in the region.

Volvo, Volkswagen, Peugeot Citroen and Mitsubishi Motors, all initiated car and truck assembly projects in these "industrial parks". Pharmaceutical companies, like Berlin-Chemie and Novo Nordisk, have also invested in the region. In the Vladimir Oblast, due to tax concessions and the development of specialized industrial zones, foreign investors (Dow Chemical, Kraft Foods and others) have also initiated a number of manufacturing projects.

Data for the 1st half of 2011 shows that 81 percent of foreign investment was concentrated in only 5 regions. Three regions (Nizhny Novgorod, Tyumen, Vladimir) experienced significant increases in the levels of FDI attracted in 2010/2011. The governors of most regions appear highly committed to increasing FDI and demonstrate a proactive and supportive approach in cooperating with foreign investors. However, at the lower level of regional government, the support for FDI is notably less, and, without micro-management from the top, the governors' intentions are not being realized.

KPMG's 2010 study "Increasing FDI in the Russian regions" and the 2012 update are available on our web site www.kpmg.ru.

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

Developments in innovation and modernization of the economy

Over the past few years, Russia has made significant strides towards innovation-based economic development. The Russian President and the government have voiced their support and are allocating substantial budget funds towards these goals.

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

The Russian President has already declared that Russia's goal is to gradually change from an oil and raw materials oriented economy to a technology oriented one.

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

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

Russia has already managed to adapt and implement a number of measures to support the development of an innovative economy. A number of state controlled institutions already exist, which invest in "innovative" companies. For example, the Russian Corporation of Nanotechnologies

supports projects in the nanotechnologies field, and the Russian Venture Corporation allocates funds to support venture based projects.

Furthermore, Russia provides an extensive list of tax concessions for companies with a high degree of intellectual capital. For example, reduction of IT companies' social contributions from 30 percent to 14 percent until the year 2017 inclusive, introduction of intangible assets amortization for over 2 years instead of 10 years, adoption of a 0 percent profits tax rate for income received from disposal of shares in Russian hi-tech companies, if certain conditions are met, and development of legislation aimed at improving accounting of R&D expenses for profits tax purposes.

Moreover, significant tax and customs concessions are granted to residents of special economic zones aimed at innovation and technological development, namely, decreases in major taxes (profits tax/social contributions) up to full exemptions (property tax, land tax and transportation tax).

Some of the measures of the framework for participants of the Russian flagship Skolkovo project are unique in international practice. The purpose of the Skolkovo project is to create favorable conditions (at all stages of innovative project development including commercialization of the results) with all the infrastructure needed to concentrate intellectual capital and generate innovative solutions for priority industries – nuclear technologies, energy efficiency, aerospace technology, IT and pharmaceutical.

Regarding taxes, legislation for Skolkovo residents, the stipulates exemptions from VAT, profits tax and

property tax and a reduction in the rate of social contributions down to 14 percent for a period of up to 10 years. Furthermore, the regime stipulates a reimbursement of customs duties paid for imported qualifying equipment, if certain conditions are met, as well as simplified procedures for attracting foreign specialists.

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

Recognized global leaders in hi-tech, 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 that significant investments will be made into the Skolkovo project (billions of US dollars).

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

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

Living and working in Russia: useful tips

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

Develop personal relationships.

They are quite important in Russian business. Rewards do not always come in cash (and there is a law against bribing 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, in terms of street violence, than other major Western cities. Although walking around the suburbs late in the evening or on days when there are football matches is ill advised, as in other major Western cities.

Beware of traffic. Expats should select drivers for themselves and their children carefully and make sure they are competent and extremely patient. Expats who drive or walk should exercise extreme caution, because cars can make illegal and unexpected maneuvers at any time.

Qualified medical services are available.

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

Good food. There are many quality restaurants in Moscow and St. Petersburg (and elsewhere).

There can be some ethnic intolerance.

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

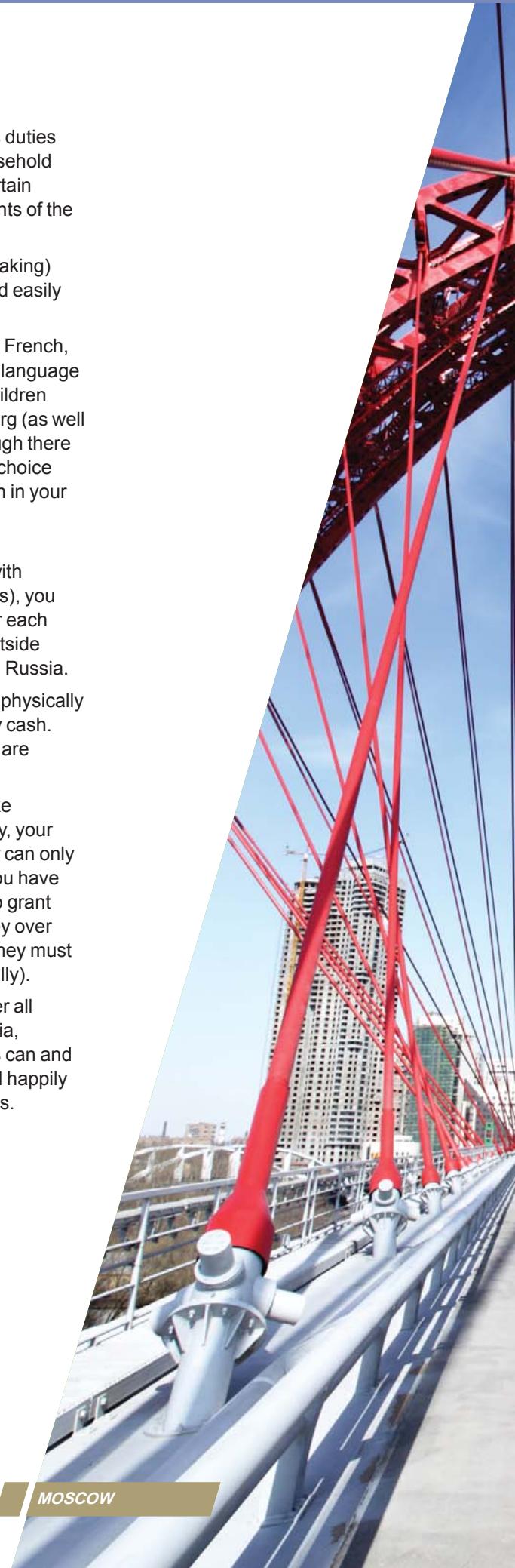
If you are coming to stay:

- 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 (even English-speaking) household help 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 some other cities), although there is likely to be a less diverse choice of schools and curricula than in your home country.

Routine issues:

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

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





Starting a Business in Russia

Legal structures for starting a business in Russia

Investors often face problems when choosing among legal structures for their business in Russia. Below, comments are provided on the following options:

- Direct sales;
- Distributorship contract;
- Representative office or branch;
- Russian subsidiary.

Direct sales

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

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

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

Generally, some goods imported into the Customs Union are subject to non-tariff

regulations (e.g. certification, licensing, quotation, etc.). Currently, legislation on non-tariff regulations is under development both in the Customs Union and Russia.

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

As of the 1st of September, 2012, the disposal charge is also payable for imported vehicles. The rates of this charge can vary depending on the engine power, vehicle mass and seating capacity.

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

In 2012, Russia ratified the protocol on joining the 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 and 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 until the 1st of 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 for the agricultural sector will be USD 9 billion per year. Every year, state subsidies will decrease.

Distributorship contract

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

Representative office or branch

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

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

An appropriate state authority must accredit the FLEs ROs and branches. Typically, the State Chamber of Registration is the appropriate authority. However, the appropriate authority will depend on the FLE's activities – the Central Bank

of the Russian Federation accredits foreign banks' representative offices, and the Federal Aviation Service accredits foreign aviation companies' representative offices. The maximum period of accreditation for an RO is three years and five years for a branch. The accreditation period can be extended.

Once accreditation is obtained, an RO or branch should register with other state bodies – the Federal State Statistics Services, the tax authorities and the state non-budgetary funds. Setting up an RO or branch takes approximately 3-6 weeks after all necessary documents have been submitted to the registration authorities. The accreditation process requires the preparation, approval, and, in many cases, notarization and apostillation (legalization) of a large amount of documentation. The total time required is likely to exceed the registration period stipulated by law.

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

Russian subsidiary

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

held (Russian abbreviation – OAO), or 'closed' (CJSC), meaning privately held (Russian abbreviation – ZAO).

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

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

Joint stock companies

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

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

Both forms of joint stock companies, OAO (OJSC) and ZAO (CJSC), 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 CJSCs.

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, reorganization and liquidation.

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

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

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

Limited liability company

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

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

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

A participant, with the exception of a sole participant, also has the right to withdraw upon request, if this option is provided for in the charter.

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

Economic partnership

A recently passed law introduces a new legal form for commercial legal entities – economic partnerships⁷. This legal form is designed for companies involved in innovative activities (including providing venture capital).

The constitutive document of an economic partnership is the Articles of Association. A partnership can be created by two or more persons (both individuals and legal entities can participate in a partnership).

⁷ Federal Law N 380-FZ "On economic partnerships" of 3 December 2011, effective from 1 July 2012



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

Share capital of the economic partnership is divided into shares. Contributions to share capital 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 in allocation of 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, indicating the size of their stakes in the partnership capital and the stakes that belong to the partnership.

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

Taking into consideration that the new law is effective as of the 1st of July, 2012, just few economic partnerships were established (registered) in Russia by now. Therefore, certain practical aspects of commercial activities and managing economic partnerships are unclear. It is, therefore, advisable to establish a Russian subsidiary in one of the more common legal forms – LLC or JSC.

The most common forms of 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.



Foreign investment law

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

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

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

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

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

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

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

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

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

Russian legislation limits the activities of non-Russian investors participating in companies that are of strategic value

to Russia ('strategic companies'), companies that carry out certain activities, including:

- Exploration of subsoil and extraction of mineral resources on land plots of Federal significance;
- Aerospace activities;
- Certain services provided by a natural monopoly or a company with a dominant position on the Russian market;
- Harvesting of live aquatic resources;
- Activities controlling hydro-meteorological and geothermal processes and events;
- Certain activities related to the use of nuclear and radiation-emitting materials;
- Certain activities related to the use of encrypting facilities and bugging equipment;
- Military-technical activities.

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

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

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

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

Russian regions and special economic zones

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

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

The establishment and operation of SEZs in the Russian Federation is regulated by an agreement concluded between the governments of Russia, Belarus and Kazakhstan⁸, by Federal Law No. 116-FZ⁹ and by Federal laws regulating particular SEZs.

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

- Technological implementation SEZ;
- Industrial and development SEZ;
- Tourist and recreational SEZ;
- Port SEZ.

SEZs are established with an intended lifespan of 49 years.

According to law No. 116-FZ, a resident of an SEZ has the right to engage only in activities prescribed for the respective type of SEZ. 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 above SEZs, there are complex SEZs in the Kaliningrad region (effective until 1 April 2031) and the Magadan region (effective until 31 December 2014). In these SEZs, residents, due to a special legal regime, have the right to conduct various types of activities.

Currently, 27 SEZs operate in the Russian Federation.

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

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

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

Current legislation 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 based on a free customs zone customs procedure. Application for this procedure is regulated by an agreement for carrying out activities within the SEZ and provides that goods imported into the SEZ are exempt from import customs duties and import VAT, provided certain requirements are met.

SEZ residents also enjoy the following tax concessions:

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

Law 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, such amendments will not be applied to the residents of SEZs established in accordance with law No. 116-FZ. Generally, this guarantee is granted during the effective period of an agreement on carrying out activities within the SEZ.

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

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⁸ "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

⁹ Federal Law No. 116-FZ "On special economic zones in the Russian Federation" of 22 July 2005

Other business issues

Licensing requirements

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

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

Licensing is carried out on a Federal and regional level.

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

The licensing requirements for most activities are similar.

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

A license's validity term depends on the licensed activity but, in general, licenses are issued for an indefinite term.

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

In accordance with the procedure established by the Administrative Code of the Russian Federation, authorized licensing bodies are entitled to suspend a license if the licensee is violating the licensing requirements and conditions.

If a regulated activity is undertaken without the appropriate license, the competent government agency is likely to request the court's permission to liquidate the company and confiscate all income derived from the unlicensed activity.

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

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

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



Land ownership

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

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

Typically, land is available under lease (sometimes with a right of first refusal to purchase) for a maximum term of 49 years. Renting or acquiring state property (apart from execution of the aforementioned exclusive right) is likely to require winning a tender/auction. If property is rented or obtained through other means, 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 a border.

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

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

Transfer pricing

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

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

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

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

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

- Transactions between related parties, where:
 - Cross-border transactions occur;
 - The amount of income and expenses under the transaction for one calendar year exceeds RUB1 billion (USD31.25 million) (in 2012 – RUB3 billion (USD93.75 million), in 2013 – RUB2 billion, (USD62.5 million), unless this transaction is between companies registered in the same region of the Russian Federation, provided that these companies (a) do not pay CIT in another region of the Russian Federation, (b) do not have tax losses and (c) do not have separate divisions in other Russian regions or outside the Russian Federation;

– One of the parties to the transaction is a taxpayer using the unified tax on an imputed income system, or a unified agricultural tax system, provided that the amount of income and expenses under the transaction exceeds RUB100 million (USD3.125 million) for one calendar year;

– One of the parties to the transaction is a resident of the innovation center Skolkovo and applies a 0 percent CIT rate, or is a resident of a SEZ in Russia, provided that the amount of income and expenses under the transaction exceeds RUB60 million (USD1.875 million) 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 amount of income and expenses under the transaction exceeds RUB60 million (USD1.875 million) for one calendar year.

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

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

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

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

- Notify the tax authorities of controlled transactions carried out within the calendar year before the 20th of May, 2013;
- Prepare documentation justifying the market level of the prices in the controlled transactions before the 1st of June, 2013.

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

Substantial changes were made in 2012 to Russia's rules governing transfer pricing.

Company and Labor Law

Company law

Parent liabilities

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

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

Registration

Registration of a legal entity takes at least 3-5 weeks, including 1-2 weeks for application processing by the registration (tax) authorities.

Registration of a JSC requires 4 additional weeks for registration of issued shares with the Federal Financial Markets Services. Foreign investors are required to have certain documents legalized, translated or notarized, which can significantly lengthen the registration period.

'Express' company creation services are advertised, but caution is advised when using such services. Companies are often registered not according to official procedures and with many steps of the process missing. These missing steps often become apparent only when a change to the constituent documents is required, and the change is rejected by the tax authorities due to an earlier failure in the registration process. Resolving such issues can be more time consuming and costly than standard company registration.

"Off the shelf" companies are available, although it is 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, the change in ownership of a company, involving more than 25 percent of voting shares in a JSC and 1/3 of participation interests in an LLC requires prior approval

from the Federal Antimonopoly Service. In all cases, a change in ownership must be registered, which can take as long as forming a new company.

Number of shareholders or participants

Generally, one participant (individual or legal entity) has the right to establish LLCs and JSCs. However, LLCs and JSCs cannot be established by another solely owned legal entity.

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

Minimum capital and contributions

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

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

Payment of capital

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

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

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

Bank accounts

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

Establishment costs (LLC, CJSC)

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

Net assets position

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

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

If, for two consecutive years, an LLC or 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, 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 fulfills 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, now an increase in charter capital may also recover the situation with low/negative net assets if it is done with a premium (including a debt to equity conversion).

Debt to equity conversion

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

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

Shareholders are permitted to set-off their monetary claims against a company by purchasing additional shares of a JSC only if shares are distributed through 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;
- 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 the establishment of a liquidation commission and deregistration with the tax authorities. Tax deregistration can cause significant delays in completing the procedures as a tax audit is often performed before tax deregistration is permitted.

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

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

Insolvency

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

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

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

Reorganization

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

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



Labor law

Labor regulations

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

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

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

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

Social partnership

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

- Negotiation of collective agreements;
- Mutual consultation on employment issues;
- Participation of employees in the management of the company;
- Participation of parties in pre-court negotiations.

Collective agreement

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

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

Role of trade unions

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

Employment conditions

Employee guarantees

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

- Standard working hours are not to exceed 40 hours per week.
- Overtime is permitted for certain categories of employees in certain circumstances, but generally should not exceed four hours in two successive days and 120 hours per year. Overtime is payable at the following rates: not less than 1.5 times of the normal salary rate per hour for the first two hours and not less than 2 times for subsequent hours and for work on weekends and non-working days. Also, employees have the right to demand additional days off as compensation for overtime.
- An employer does not have the right to require an employee to perform 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, which requires lower qualifications, subject to the employee's written consent. Performance of additional functions, if required, from an employee by the employer, is subject to the employee's written consent and relevant paperwork should be prepared.
- Employees are entitled to 12 paid public holidays and an annual leave of at least 28 calendar days. For some categories of employees, the minimum annual leave established by legislation 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 to 100 percent of the salary, depending on the length of service, but may not exceed a specific threshold (e.g., in 2012 – approximately RUB1, 200 (about USD 40) per day for sickness. Employers may pay a sick leave allowance in a higher amount at their own expense.
- Wages for time spent away from work, for the performance of the functions of a trade union officer, appearing in court, going to vote, and fulfilling other state or social responsibilities.
- Severance pay in certain situations.
- Certain social benefits: maternity leave, paid holidays and vacation time.
- Overtime is permitted for certain workers, subject to certain conditions.
- Women are entitled to maternity leave for 70 calendar days (84 days for multiple pregnancies) prior to childbirth and 70 calendar days (86 days in the case of birth complications, and 110 for twin and multiple births) after childbirth. Maternity leave is granted together with social insurance benefits paid in the amount established by statutory legislation. Regardless of the employment period with a specific company, a woman is entitled to annual paid vacation, which can be taken either before or immediately after maternity leave, as well as leave until the child's third birthday. During the period of maternity leave, until the child reaches one and a half years of age, the woman is paid a social insurance allowance. Fathers, grandparents and other relatives are entitled to baby care leave under certain circumstances.

- Employees have the right to organize trade unions and participate in the management of the company. The primary trade union represents the interests of the employees in dealings with the employer, ensures that the terms of the collective agreement are being complied with and participates in the resolution of labor disputes in accordance with statutory legislation.

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

Employment contracts

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

Employment contracts 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 are satisfied. In particular, fixed term contracts are permitted with the following employees:

- Directors, deputy directors, chief accountants;
- Employees working in companies created for a specific project;
- Part-time workers (having more than one job);
- Trainees.

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

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

- Agreement of the parties;
- Expiry of the term of the employment contract;
- Cancellation of the employment contract at the initiative of the employer (as discussed below) or the employee;
- Refusal of the employee to continue working due to a change in the owner/management or subordination of the employer, or its reorganization;
- Refusal of the employee to continue work owing to the relocation of the employer.

In general, an employee has the right to terminate a contract by giving a 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 is unable to perform the required work, if management violates employment legislation or the collective agreement or employment contract, or if the employee has other good grounds for doing so. In some limited instances, the employee has the right to terminate an employment contract without prior notice.

An employer has the right to terminate a contract in a limited number of cases which include:

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

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

- Pregnant women or women with children under the age of three;
- Single women with children under 14 or disabled children under 16.

Where employees are less than 18 years of age, an employment contract can be terminated with the approval of the State Labor 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 favor of the employee when considering cases of alleged wrongful dismissal. In practice, companies seek, where possible, to secure the employee's voluntary resignation.

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

Work book

Russian labor legislation requires that a work book be kept for each employee who has worked for at least five days at a company, if this work is the employee's main employment. This is the basic document in which 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 of rewards for achievements at work, work performed by the employee, transfers to another permanent work, etc.

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

Trial period for an employee

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

The trial period for an employee cannot exceed 3 months.

Salary

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

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

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

Administrative fines can be levied on employing organizations and their responsible officials for delayed salary payments – RUB30,000-50,000 (approx. USD1,000-1.700) and RUB1,000-5,000 (approx. USD30-170), respectively. In some cases, the employer's activities can be suspended for up to 90 calendar days.

If the responsible official has already been penalized 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 case of partial delay of salary payments), criminal liability applies.

Under the Criminal Code, if it is proved that the employees were paid less than half of the salary payable to them due to the general director's personal motives or actions motivated by self-interest, the general director can be fined up to RUB120,000 (approx. USD4,000), or fined in an amount equal to his/her wages or income from another source for a period of up to one year, or the general director may be disqualified from occupying certain positions or engage in a certain activities for a period of up to one year, or the general director may be subject to forced labor for a term of up to two years, or the general director may 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 in an amount below the Federal minimum salary level (in 2012 – RUB4,611) 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 labor legislation, and also to calculate taxes, levies, penalties and other payments.

As of 1 December, 2012, the Federal minimum statutory monthly salary to RUB4,611 (approx. USD150). This minimum statutory monthly salary is used only to calculate labor remuneration and allowances for temporary inability to work.

Different levels of minimum salary may be established by regional local authorities in Russia, but no lower than RUB 4,611. Minimum salary for Moscow is RUB11,700 as of 1 July, 2012.

For other purposes, such as the calculation of taxes, levies, penalties, liabilities under civil transactions, etc., the relevant minimum statutory monthly salary is RUB100 (approx. USD3) 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 rubles. However, in accordance with collective agreements or employment contracts upon an employee's written request, labor 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 Labor Code requires severance pay to be equal to at least two week's average earnings where an employment contract is terminated due to:

- Drafting or enlisting of an employee into military or alternative civil service;
- Refusal of an employee to be transferred to work in another location together with the enterprise, institution or organization upon its relocation;
- Inability to work pursuant to a medical certificate issued in accordance with the legislation;
- Refusal to continue work due to a unilateral change of the labor agreement conditions made by the employer (such a change is only possible in exceptional cases);
- Reinstatement of an employee who previously performed the work;
- Refusal of an employee to change work as prescribed by relevant medical authorities or if the employer is not able to offer relevant work.

In the event of the dissolution of an enterprise, institution, or organization, or staffing cuts, a one-off payment of monthly average earnings is required. Additional payments are required if the dismissed employee is unable to find work, but no more than two months 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 installation, supervision of installation or servicing of 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 notification on vacancies available in the company to the Employment
- Service for subsequent conclusion of the authorities on the expediency of the engagement of foreign citizens for such vacancies (Conclusion);
- Application for a corporate Permit for engagement of foreign labor at the Federal Migration Service of the Russian Federation (FMS) or the Department of the Federal Migration Service of the Russian Federation (Corporate Permit);
- Application to the FMS for each expatriate's individual Work Permit (Individual Permit).

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

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

Further, with respect to the regular category of the work permit, each year by May the 1st, companies must report the number of foreign employees they anticipate to engage in the next calendar year. This procedure effectively constitutes a quota application. If the employer does not comply with this and does not receive notification of the approval of a quota, the employer will have work permit applications rejected. 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, only if the application meets all the quota exempt requirements.

Work permit application for Highly-qualified Specialists (HQS)

From the 1st of July, 2010, a simplified procedure of obtaining work permits for HQS came into force. An HQS is a highly-skilled professional who is a foreign employee and has work experience and skills or achievements in a certain area and whose annual salary generally exceeds RUB2,000,000 (approx. USD67,000). It should also be noted that Representative offices of foreign legal entities cannot apply for employing HQS professionals.

Obtaining work permits for foreign national as per HQS has the following benefits:

- Obtaining an employment permit for the Russian employer is not required;
- The quota system is not applied to HQS professionals;
- The work permit can be issued for a term of up to three years;

- An HQS professional has the right to obtain multiple work visa for a term of up to three years;
- The procedure of obtaining a work permit for HQS professionals takes about fourteen business days from the moment of submission of complete package of documents;
- Income tax rate of 13 percent applies to salary paid to an HQS under the relevant employment contract irrespective of their tax residence status in Russia;
- Extended lengths of business trips outside the region/regions for which the HQS work permit was obtained as compared with the standard work 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 such registrations. The hosting party for this purpose is either the hotel or the employer (visa sponsor) or a landlord, if the foreign national is not staying in 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 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 traveling in 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 on the Federal, regional and local levels.

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

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

- Value-Added Tax (VAT);
- Excise tax;
- Personal Income Tax (PIT);
- Profits tax;

- Mineral extraction tax;
- Water tax;
- Levies for natural and biological resources consumption;
- State duty.

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

Local taxes and levies are those introduced by the Tax Code and by the regulations of municipal authorities and are paid in the appropriate municipal

areas. Local taxes are represented by land tax and personal property tax.

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

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

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



Tax registration requirements

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

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



Business taxation

Profits tax

Tax base

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

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

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

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

Tax rates

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

Certain types of income are taxed via a withholding mechanism at flat rates stipulated by the Tax Code (see section Withholding income tax, p. 28).

Tax concessions

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

- The recipient's or transferor's ownership in the other party's share capital amounts to more than 50 percent;
- The individual owns more than 50 percent of the recipient company;
- The property received (except for money) is not disposed of within one year from the date of receipt.

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

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

Tax losses can be carried forward for 10 years.

Tax accounting

The Tax Code requires taxpayers (including permanent establishments) to maintain separate accounts for profits tax purposes. Tax accounting rules 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 cases of changes of legislation.

Taxation of FLEs

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

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

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

FLEs having no PE in Russia are subject to withholding tax on Russian source income (for details see the section withholding income tax below, p.28).

Filing and payment

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

Withholding income tax

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

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

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

Tax rates

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

Tax rates for dividend income are:

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

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

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

For a list of double tax treaties and the withholding tax rates applicable under these treaties to dividends, interest and royalties, see Appendix 1. Chart of Withholding tax rates, p.40.

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

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

Filing and payment

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

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

Value added tax

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

Taxable supplies

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

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

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

Place of supply rules

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

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

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

Taxable base

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

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

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

Input VAT

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

- Goods, works, services and property rights are acquired for the purpose of carrying out VAT-able transactions.

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

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

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

When both VATable and non-VATable supplies are delivered or supplies are subject to different VAT rates, in most of such cases, taxpayers should account for supplies and 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 specific document serving VAT recovery and is distinct from a commercial invoice. A VAT invoice can be issued either in hardcopy or in electronic format.

Tax rates

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

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

The Tax Code stipulates a list of goods (works, services) that are subject to a 0 percent VAT rate. This list includes, inter alia: export sales; international transportation services and related freight forwarding services; transport and certain related services for oil, oil products, natural gas and electrical power transmission; services provided at river

and sea ports; and services provided by Russian railway carriers. To apply the 0 percent VAT rate, the supplier should collect specific supporting documents within the established term and submit a VAT return with these supporting documents to the tax authorities.

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

Exemptions

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

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

Import of specific types of goods into Russia can also be VAT exempt.

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

Reverse charge mechanism

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

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

Customs Union

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

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

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

VAT payable to the Russian budget

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

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

VAT payment and filing

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

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

Social Security Contributions

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

Insurance contributions are levied on companies, individual entrepreneurs and individuals making payments to other individuals in the scope of employment relations and under civil contracts for the provision of services or the performance of work and other specific types of contracts, as well as for self-employed individuals, including individual entrepreneurs, notaries and advocates. 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. Certain compensation is exempt from insurance contributions, including business trip expenses, temporary disability allowances, employee dismissal expenses (excluding compensation for unused paid vacation days), professional development expenses and some others.

For 2012, the total social insurance contribution rates are equal to 30 percent of an employee's salary up to RUB512,000 (approx. USD17,000) per annum and 10 percent of salary payments over the RUB512,000 threshold. The threshold is subject to annual revision by the Russian government. The detailed breakdown of the rates is provided in the following table.

A foreign national's contributions are paid in full on remuneration earned in Russia based on a permanent or temporary residence permit.

An employer of foreign nationals staying temporarily in Russia on a visa must pay personal contributions only to the Pension Fund (i.e., at a rate of 22 percent on annual remuneration up to the above mentioned threshold and at 10 percent on remuneration above this threshold).

Social and Social Mandatory Medical Insurance contributions are not paid on remuneration of foreign employees temporarily staying in Russia – employees who come to Russia on a visa and do not have residency or temporary residency permits – if they work under a fixed-term labor contract for less than 6 months or are employed under the HQS regime.

Personal contribution concessions

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

Mandatory social insurance against occupational accidents and diseases

Apart from the aforementioned insurance contributions, employers are required to pay contributions for mandatory social insurance 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

Type of insurance contribution	Rates on remuneration up to RUB512,000	Rates on remuneration in excess of RUB512,000
Pension Fund	22 percent	10 percent
Social Insurance Fund	2.9 percent	–
Federal Mandatory Medical Insurance Fund	5.1 percent	–

one – 8.5 percent. Generally, office activity is subject to contributions for insurance against injuries and professional illness at 0.2 percent.

Filing and payment

Insurance contributions are payable to the Pension Fund, the Social Insurance Fund and the Medical Insurance Funds on a monthly basis.

Payers should file various reports with the Pension Fund and the Social Insurance Fund generally on a quarterly basis.

Property tax

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

Tax base

The tax base is the average annual fixed assets net book value per Russian statutory accounting. Movable property acquired since 1 January 2013 is exempt from the tax.

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, power lines, and on assets constituting an integral, technical component of the above. The list of such assets is established by the Government of the Russian Federation. The rates for such assets are 0.4 percent in 2013, 0.7 percent in 2014, 1 percent in 2015, 1.3 percent in 2016, 1.6 percent in 2017, 1.9 percent in 2018.

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

Tax concessions

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

Property tax paid by an RLE on property located outside of Russia can be offset when paying property tax in Russia.

To carry out related offsetting, the taxpayer should submit a document confirming payment of property tax abroad.

Filing and payment

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

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

Other taxes

Transport tax

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

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

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

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

Land tax

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

Under the Tax Code, the land tax rate for lands intended for agricultural purposes and housing facilities must not be higher than 0.3 percent and not higher than 1.5 percent of the

cadastral value of a land plot for other purposes. The regional authorities can decrease this rate to 0 percent. The regional authorities can also stipulate tax incentives or allowances for certain taxpayer categories.

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

Water tax

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

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

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



Special tax regimes

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

Unified tax on imputed income

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

- Consumer domestic services;
- Veterinary services;
- Vehicle maintenance, repair and washing;
- Lease of car parking places and car parking services;
- Passenger and cargo transportation services (certain restrictions apply);
- Retail trade and catering (certain restrictions apply);
- Certain kinds of advertising;
- Services related to providing accommodations (certain restrictions apply).

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

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

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

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

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

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

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

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

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 (USD1,406,250) and this limit is subject to annual indexation;
- The net book value of fixed assets does not exceed RUB100,000,000 (USD3,125,000);
- The average annual number of staff does not exceed 100.

The following entities cannot apply the simplified tax system:

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

The simplified tax rate 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 category.

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

Unified agricultural tax

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

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

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

The unified agricultural tax rate is 6 percent.

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

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 during 12 consecutive months. Short-term travel (less than 6 months) outside Russia's borders for medical treatment or educational activities does not interrupt the individual's presence in Russia.

Days of arrival and days of departure should be counted as Russian days when calculating days of presence in Russia for the purpose of 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 of income payment. Consequently, the tax withheld may not be the amount of tax ultimately due.

According to official clarifications of the Russian Ministry of Finance final tax liabilities are determined based on the individual's tax residency status for the reporting calendar year. This status is determined based on a 183-day period in the reporting calendar year.

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

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 on loans from organizations and sole proprietors when the payments are benchmarked at a rate of 2/3 the refinancing rate of the Central Bank of Russia on loans

in Russian rubles, or to 9 percent per annum on loans in other currencies. The use of credit cards issued by non-Russian banks is also likely to trigger deemed taxable income for the card holder.

- Favorable prices are paid by an individual for goods or services purchased from related parties.
- Securities and financial instruments are acquired at a price below market level.

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

Deemed income arises as a result of:

- Interest payments on loans from organizations and individual entrepreneurs in an amount lower than the payments calculated at a rate of 2/3 of the refinancing rate of the Central Bank of Russia on loans in Russian rubles, 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 card holder in cases of overdraft.
- Acquisition of goods, work or services from related parties at a preferential price.
- Acquisition of securities and financial instruments at a price below market level.

Tax rates

A 13 percent PIT rate applies generally to all types of received by a of tax resident except for the following rates which are specifically established with respect to particular types of income:

- 9 percent applies to dividend income received by tax residents (both from RLEs and FLEs), and also to interest income on specific debt securities;
- 35 percent applies to certain types of non-employment income (e.g., deemed income resulting from favorable interest for the use of loans);

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

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

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

Tax deductions

Standard tax deductions

Standard monthly tax deductions of RUB3,000 (approx. USD100) and RUB500 (approx. USD15) 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 (approx. USD45) per child per month can be granted to a parent of up to two children, and RUB3,000 (USD100) for each additional child up to the age of 18 or for a child – daytime undergraduate 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 there is only one parent.

These tax deductions are available only if cumulative annual income does not exceed RUB280,000 (USD9,300).

Social tax deductions

Social tax deductions are available in the amount of qualified charity expenses, only up to 25 percent of income received in the tax period.

Social deductions are also available for:

- Expenses for education of the taxpayer and each of his/her children;
- Expenses for medical treatment and medicines for the taxpayer and his/her spouse, parents, children;
- Contributions for voluntary medical insurance for the taxpayer and his/her spouse, parents and children;
- Contributions to a private pension fund for the benefit of the taxpayer, his/her spouse, parents and disabled children;
- Additional insurance contributions to the cumulative part of state pensions.

The above deductions cannot exceed RUB120,000 (approx. USD4,000) in one calendar year per taxpayer (except expenses for certain expensive medical treatment within on the list approved by the Russian Government deductible in amounts of actual expenses and except for expenses for the education of the taxpayer's children deductible within the limit of RUB50,000 (approx. USD1,700) per child).

Property-related tax deductions

Property related tax deductions are available for expenses related to the purchase of (construction) dwellings and to land plots for construction of a dwelling (or along with a dwelling) in Russia (up to RUB2,000,000 (approx. USD67,000)). Interest on loans used to pay for above mentioned purchase/construction may be also claimed as a deduction (without a cap). On the sale of residential property and land plots owned for less than three years a deduction up to RUB1,000,000 (approx. USD33,000) 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 (approx. USD8,300) or in the amount of documented actual 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.

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, the sole proprietor can apply professional tax deductions up to 20 percent of 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 performing 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 documentary supported expenses directly related to the provision of services/ performance of work.

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

Filing and payment

Individual entrepreneurs, RLEs, ROs and Branches of FLEs registered in Russia which make payments to individuals are considered tax agents, and they are required to withhold PIT from compensation payable to such individuals and remit the 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 income not subjected to tax withholding; the individuals in turn should 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 rule 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 PIT, which was withheld by the tax agent in certain cases.

Other taxes payable by individuals

Personal property tax

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

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

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

Individual property tax is assessed by the tax authorities annually and should be paid by taxpayers based on a tax assessment not later than the 1st of November 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, autobuses, airplanes, helicopters, motor vessels, yachts, sailing boats, boats, 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 which consists of four different levels.

The first level consists of the 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 obligatory approval of annual financial statements, provides definitions of subsidiary and associated companies and determines procedures for reorganization and liquidation of different kinds of legal entities.
- The Federal Law on Governmental Support of Small Business in the Russian Federation provides for accounting and reporting compilation based on a simplified procedure.
- The Federal Laws On Joint Stock Companies and On Limited Liability Companies, which establishes information disclosure and presentation requirements, stipulates the requirement for the data contained in the annual financial statements to be confirmed by the internal auditor and determines the procedure by which the annual financial statements are approved as well as instances in which an audit opinion is required.

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

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

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

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

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

The fourth level includes documents issued by the company itself, which determine its accounting policies in all systematic, technical and organizational aspects and are approved by the company's internal decree.



on accounting policies. If there are any specific accounting methods that are not specified in relevant accounting standards, companies have the right to develop them independently and to adopt them by including them in the order on accounting policies.

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

The key accounting principles in the Russian Federation are:

- **Separate entity principle:** in accordance with which, assets and liabilities of the company are separate from assets and liabilities of the owner or assets provided to the entity by other persons.

- **Going concern principle:** in accordance with which, it is assumed that the company will continue operating in the foreseeable future.
- **Principle of accounting policy consistency:** the accounting policy selected by the company is applied consistently from one reporting year to another, and a change in the accounting policy is only possible if there are changes in the legislation of the Russian Federation or in accounting regulations, new accounting methods developed by the company or significant changes in operating conditions.
- **A matching principle:** this states that business operations are recorded in the reporting period in which they occur, regardless of when receipts or payments related to these transactions are actually made.

- **Principle of timeliness and completeness of recording transactions:** the accountant should make records according to the set timelines and reflect all of the transactions made.
- **Prudence principle:** the accountant should record liabilities and expenses rather than assets and income and should not allow for any hidden reserves.
- **Substance-over-form principle:** transactions should be accounted for based on their economic substance and business circumstances rather than legal form.
- **Principle of non-contradiction:** analytical accounting data should be identical to synthetic accounting data on the last calendar day of each month.
- **Rationality principle:** application of a rational accounting method based on the company's size and business environment.
- **Materiality principle:** data on material assets, liabilities, income, expenses and transactions should be recorded separately if this information is essential for evaluation of the entity's financial position or financial results.

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

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



Statutory reporting requirements

A company's financial statements must 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.

According to 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 the exception when a legal entity's registration, reorganization and liquidation. The interim financial statements are prepared by commercial legal entities for periods shorter than a financial year in cases stipulated by legislation. Annual financial statements include:

- Balance sheet;
- Income statement;
- Appendices to the above two reports containing additional information on changes in equity, cash flows, movement of borrowed funds, changes in accounts receivable and payable, etc.;
- Notes;
- Audit opinions (issued in cases stipulated by legislation).

Tax returns are not included in 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 in addition to the company's own financial statements. The consolidated financial statements must include figures from the reports of companies located both in the Russian Federation and abroad.

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

Companies submit annual financial statements to:

- Shareholders;
- Statistics authorities;
- Tax authorities;
- Other interested users (upon shareholders' decision).

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 the 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 which differs from the IFRS, in order to present the financial statements to foreign founders or investors, the statutory financial statements are normally obligated to comply with the IFRS. Presenting financial statements in accordance with the IFRS and, consequently, increasing their transparency will facilitate the inflow of foreign investment into the production sector of the economy and increase the possibility of more companies to obtain credit.

Audit requirements

The Federal Law on Audit requires that the following Russian entities to 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 and commodity and stock exchanges, incorporated investment funds, non-budgetary state funds, management companies of incorporated investment funds, unit investment funds or non-state pension funds (apart from non-budgetary state funds);
- Companies (except for agricultural cooperatives and unions of such cooperatives) whose annual earnings from the sale of goods (performance of works, provision of services) for the year preceding the financial year exceed RUB400,000,000 (USD12,500,00), or the value of assets on the balance sheet at the end of the year preceding the financial year exceeds RUB60,000,000 (USD1,875,000);
- Companies presenting and (or) publishing consolidated financial reports;
- Companies for which audits are mandatory under other Federal laws.

A mandatory audit must be carried out every financial year.

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

MOSCOW



Appendix 1.

Chart of Withholding Tax Rates

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

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

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

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

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

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

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

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

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

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

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

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

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

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

***Cyprus:** 5 percent on dividends – this rate applies if the holding value is at least USD100,000 (under a new protocol to the Cyprus-Russia double tax treaty – EUR100,000); otherwise, 10 percent.

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

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

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

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

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

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

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

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

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

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

***Luxembourg:** 10 percent – this lower rate applies if the Luxembourg recipient owns at least 30 percent of the capital in the Russian company and the holding value is at least EUR75,000; otherwise, 15 percent. Under a protocol to the DTT between Luxembourg and Russia, a 5 percent rate applies to dividends if the Luxembourg recipient owns at least 10 percent of the capital in the Russian company and the holding value is at least EUR80,000 or its equivalent in national currency.

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

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

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

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

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

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

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

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

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

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

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

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

***Switzerland:** 0 percent rate on interest applies to interest paid in connection with the sale on credit of any industrial, commercial or scientific equipment; 5 percent on interest – this rate applies to loans of any kind granted by a bank; otherwise, 10 percent. Under a protocol to the DTT between Switzerland and Russia, a 0 percent rate applies to interest paid.

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

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

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

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

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

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

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

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

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

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

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

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

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



Appendix 2.

Fines for Infringement of Tax and Customs Legislation

Fines based on the Tax Code

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

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

Normally late payment interest is charged in the amount of 1/300 of the Central Bank of the Russian Federation refinancing rate (8.25 percent as of 31 December 2012) for each day of delay in tax payment. Currently interest would be 0.027 percent per day.

Fines based on the Administrative Code

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



Fines based on the Criminal Code

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

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

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

amount of RUB200,000 - 500,000 (from USD6,250 to USD15,625) or in the amount of the salary or other income of the offender for a period from one to three years.

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

amount of taxes payable or exceeds RUB30,000,000 (approximately USD937,500).

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

Fines for customs violations

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

Appendix 3.

KPMG's Tax & Legal Department:

Cutting Through Complexity

Why KPMG

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

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

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

Our team

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

Our approach to key issues:

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

Corporate tax services

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

- Indirect tax,
- Transfer pricing,
- Effective management of tax liabilities (and its outsourcing),
- Development of problem-solving methods,
- Tax considerations during restructuring,
- International tax planning,
- Tax structuring for mergers and acquisitions, including support for after companies have been integrated.

Glossary of terms

Personal services

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

Legal advice

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

Complex tax projects

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

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

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