

# Investing in Russia

A report on the legal framework for investments in Russia



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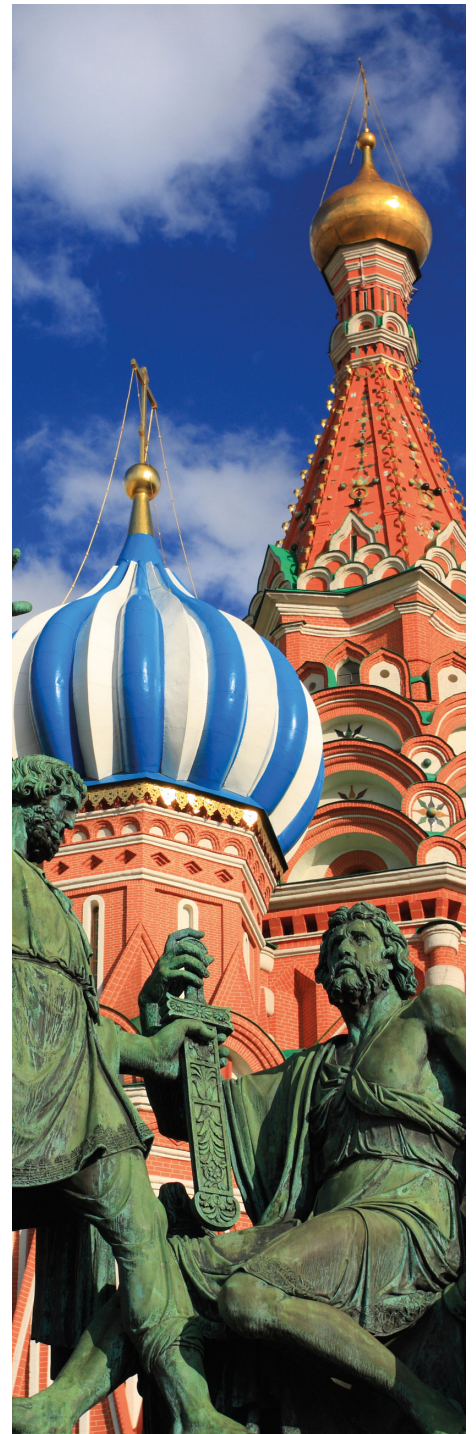
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If you have any questions regarding investment projects in Russia, please do not hesitate to contact our team.

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# Corporate



## Types of companies and suitability for foreign investors

### Local legal entities

The two types of companies most commonly used in save for cases of parent-subsidiary liability or vicarious liability of the shareholders in the event of insolvency.

An OOO is the most popular type of company due to the relative simplicity of its formation and flexible rules on corporate governance, raising capital, and others. OOOs are used by the majority of small to medium-sized businesses in Russia and are well suited for wholly-owned subsidiaries of foreign investors.

Under Russian law, the shares of an AO qualify however as securities. As a result, AOs are subject to rather cumbersome securities regulation,

including detailed statutory procedures for the offering, issue and placement of shares, corporate information disclosure obligations, and others. These rules make AOs a less commonly used type of company than OOOs. AO regulation is also generally relatively rigid and allows less discretion to shareholders in matters relating to corporate governance and decision-making than an OOO would.

In addition to OOOs and AOs, Russian law also recognizes other forms of commercial legal entities (general and limited partnerships, manufacturing cooperatives, etc.) although in practice these are rarely encountered and are therefore not addressed in detail in this overview.

### Branches and representative offices

Instead of setting up a local legal

entity, foreign investors may choose to operate in Russia through branches and representative offices, which are not separate legal entities under Russian law and may act only on behalf of the company they are representing.

Branches and representative offices of foreign companies are subject to special rules summarized below and are not subject to company law requirements.

The representative office of a foreign company represents the interests of the company in Russia and cannot in principle undertake any commercial activity, although this rule is not systematically enforced. The tax authorities will treat a representative office as a branch if it derives income from commercial activities in Russia. Most commonly, the main purpose of a representative office is marketing

research for the Russian market and the promotion of commercial relations with Russian partners.

The branch of a foreign company in Russia may, on the other hand, undertake commercial activities. A branch may choose to keep a separate balance sheet and profit-and-loss account and can be financed by the head office on an "as needed" basis.

Both a branch and a representative office are managed by its head acting on the basis of a power of attorney issued by the company. The head may sub-delegate his/her authorities to third parties provided that such sub-delegation is permitted by the power of attorney and is certified by a notary public.

The main internal document of the branch or the representative office is its regulations approved by the company.

### Incorporation

Overall, the general principles underlying the incorporation of a Russian company are similar to those found in other jurisdictions, especially in relation to general requirements for number of shareholders, the charter, corporate name, registered address and share capital, for example.

Nonetheless, the paperwork necessary for the incorporation of a Russian company is often seen as cumbersome, since the incorporation documents are subject to rather strict formal requirements. If prepared in Russia, they must be

certified by a notary public or sealed with the corporate seal of the issuing entity, if the latter is a company. Documents executed outside Russia must be apostilled or legalized. All official documents in foreign languages must have a certified Russian translation. Several copies of most documents will be required for incorporation purposes. Such copies must also be certified by a notary public.

The timelines and procedures for the incorporation of an OOO or AO are in principle similar. The incorporation of an OOO may take between five to eight weeks (including certain preliminary steps, preparation of the necessary documents, state registration, and post-registration formalities). The incorporation of an AO may take longer as it additionally involves the registration of the share issue.

A period of three to four weeks typically will be required to complete all preparatory steps, i.e. collect, certify and translate all necessary documents for filing. Obtaining a registration certificate requires one week from the date of filing.

Companies engaged in certain businesses may additionally need to obtain operational licenses, while incorporation of others may require anti-monopoly or foreign investment clearance (see Investment regulation below).

Branches and representative offices of foreign companies must be accredited with the Russian State Registration Chamber or other

sector-specific accreditation bodies. Branches and representative offices must also be registered with the Russian tax authorities, social funds and statistics authorities.

## Corporate governance

### Management structure

At the foundation stage, the founders of a Russian company such as an OOO or an AO determine its management structure, describe it in the charter, and appoint the chief executive body and, if applicable, the members of the board of directors. The authority and structure of management bodies follow similar principles to those found in most jurisdictions across the world.

A typical OOO will have a simple two-tier corporate governance structure consisting of (i) the general meeting of shareholders, and (ii) the executive body (most commonly – the general director, but it is also possible to create a management board). An OOO may also have a supervisory body, a board of directors, and a revision body, the internal audit commission.

AOs have a three-tier management structure consisting of (i) the general meeting of shareholders, (ii) the executive body, single or collegiate (the general director or the management board), and (iii) the supervisory body: the board of directors.

### General meeting of shareholders

As in most jurisdictions, the general meeting of shareholders is the highest management body and certain of its core competencies (such as amendments to the charter,

approval of the annual financial statements and balance sheets and decisions on re-organization and liquidation) are exclusive to it and cannot be delegated to other management bodies. Otherwise, the allocation of responsibility in an OOO is much more flexible than in an AO and can be fully determined by the charter of the company.

Rules on the conduct of annual and extraordinary general meetings, quorums, majorities for decisions and voting procedures are mostly set by statute, with more exceptions available in an OOO than an AO.

### Board of directors

The shareholders of an OOO may elect to establish a board of directors to supervise the activity of the company. There is however no obligation to do so. The board of directors may be called upon to decide on strategic issues and supervise the actions of the general director. The powers of the board of directors are set out in the OOO's charter.

The board of directors is a supervisory body which is mandatory in an AO with 50 shareholders or more. In smaller AOs the board of directors is optional. In the absence of a board of directors its functions are delegated to the general meeting of shareholders. In some AOs, the board of directors may also be referred to as the "supervisory board", although such terminology is rarely used. Unlike in many other jurisdictions, neither the board of directors, nor its individual members

have the authority to represent the AO legally, make binding decisions or execute documents on behalf of the AO. Such powers are conferred only upon the AO's chief executive body.

The main role of the board of directors is to determine the general strategy of the company, to supervise and control its executive bodies.

### Executive bodies

Most Russian OOOs have a single chief executive officer referred to as the "general director". Although other titles (e.g., "president") are also possible, they are not commonly used. The general director is vested with extensive powers, encompassing all matters other than those reserved by law or the charter for the competence of the general meeting, the board of directors, or the collegiate executive body (if any).

An OOO may, if so permitted by the charter, have several directors (who may be entitled to act jointly or separately) or delegate the executive functions of the general director to a third party: a management company. Such outsourcing may entail certain practical difficulties, in particular if the OOO is incorporated in smaller towns where the registration authorities have no experience in dealing with management companies.

Although rare in practice, an optional collegiate executive body (the "management board", the "directoriate", etc.) may be created

to decide on strategic issues, while the day to day management of the company is entrusted to one or two directors. Usually, such a collegiate body is chaired by the general director and its competence is determined in the OOO's charter.

An AO may have either (i) a single chief executive officer (i.e., general director); or (ii) a collegiate executive body and a general director presiding over the collegiate executive body. Unlike OOOs, AOs and especially those operating large businesses sometimes have collegiate executive bodies. The executive bodies are appointed and dismissed either by the board of directors or sometimes by the general meeting, depending on the provisions of the charter. Due to the cumbersome procedure for convening the general meeting, it is usually advisable to provide for appointment and dismissal of the executive bodies by the board of directors.

Similarly to other jurisdictions, directors and officers may be held liable for their actions under civil and employment law, or under administrative and criminal provisions. Such liability may be mitigated by delegating responsibility or increasingly by taking out director and officer ("D&O") insurance.

### Specific corporate approvals

As a general rule, the general director is entitled to represent the company and enter into any transactions on its behalf, subject to the matters reserved by law or the charter for the competence of the general meeting,

the board of directors, or the collegiate executive body (if any).

In order to protect the interests of the company and its shareholders, however, entering into major transactions (direct or indirect acquisition or disposal of assets valued at 25 percent or more of the company's assets (save for certain excluded transactions), and interested-party transactions requires special approval by the company's general meeting or its board of directors. In AOs, the rules on approval of interested-party transactions are more complex than those in OOs. The approval procedure depends on the value of the transaction and the number of shareholders in the company.

In addition, the law and/or the charter of a company may require that transactions affecting the corporate structure or charter of the company (e.g., the issuance of new shares, share buy-backs, etc.) be approved by the general meeting or the board of directors.

### Rights and obligations of shareholders

Shareholders in Russian companies will be bound by the same obligations and enjoy similar rights as most shareholders in any typical jurisdiction. There are many nuances between an OO and an AO, but in terms of rights, all shareholders will enjoy the usual rights granted to shareholders irrespective of the number of shares held (such rights most often cannot be excluded or varied by the charter or otherwise), including rights to: (i) access

information on the company, including information about its involvement in any litigation or corporate disputes, review its books and other documentation, and receive copies of such documents, (ii) participate in the general meetings and vote on all matters within its competence, (iii) receive declared dividends, (iv) participate in the distribution of the company's assets during liquidation, or (v) sell, pledge or transfer their shares subject always to statutory or charter provisions in relation to pre-emption rights, for example, which apply differently depending on the form of the company (OO or AO). A certain number of rights will depend on whether the shareholder attains a precise threshold as a percentage of issued shares, especially in an AO.

In terms of general obligations, a shareholder's principal obligations towards the company are, for example, to pay for its shares or make other financial contributions as required by the charter or to disclose its interest in any transactions which it or its affiliates are intending to enter into with the company. Additionally, in an AO, shareholders are subject to certain disclosure obligations under securities legislation: to disclose changes in shareholding when crossing certain thresholds, for example.

Special rights and obligations may be created by the charter in relation to certain shareholders only (solely in an OO) or by issuing privileged shares in an AO (creating a liquidation preference, for example).

### Shareholder agreements

One of the main subjects of interest for foreign investors in Russia is the regulation of shareholder agreements.

Shareholder agreements had remained a grey area of Russian corporate law (several court decisions even going as far as to declare them generally invalid), until they were finally expressly allowed in 2009. Under the statutory provisions, a shareholder agreement is a private agreement between shareholders which determines the manner in which shareholders exercise their rights with respect to the company. In particular, a shareholder agreement may regulate: (i) voting arrangements (coordination of voting at the shareholder meetings), (ii) share transfers at certain pre-agreed terms, (iii) restrictions on share transfers, (iv) sanctions for breach of obligations under the shareholder agreement and remedies available in case of such breach (e.g., penalties); and (v) other matters concerning the company's foundation, governance, re-organization and liquidation.

Although the statutory provisions introduced in 2009 were a welcome and progressive change, they continue to raise certain questions in relation to their interpretation by the Russian courts. For example, there is still considerable uncertainty as to the way in which put and call arrangements should be structured and how to enforce them in the absence of cooperation from the other party. It is also not clear whether participants' agreements may be governed by non-Russian

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law. As a result many investments continue to be implemented via a foreign holding structure in order to put in place a foreign law governed shareholder agreement.

### Investment regulation

Foreign investments in certain key sectors, including strategic industries, natural resources, banking, insurance, telecommunications and media, are subject to certain restrictions.

In April 2008, a federal law was enacted to regulate foreign investment in companies with "strategic value for national defense and national security" ("Strategic Companies"). The "strategic value" designation applies to any Russian commercial company engaged in any of the 42 activities listed in the law, including nuclear waste handling, transport and disposal, geology, extraction and exploration of certain mineral resources or arms and military technology research and development, design and manufacturing, for example.

The definition of certain activities is not always clear,

which makes determining the scope of the restricted activities not a straightforward exercise. In addition, the restrictions apply even if the activity deemed as strategic constitutes only a fraction of the activities of the company. This can make the foreign investment regulations surprisingly far-reaching. For example, the food industry uses certain biological agents within their laboratories for testing products. This is deemed a strategic activity and thus a company may unexpectedly be subject to restrictive investment regulations. It is therefore advisable to examine very diligently all aspects of the activities of a company prior to any investment operation.

The law requires that prior authorization be obtained from a special Russian Government Commission, chaired by the Prime Minister, for the acquisition of control over Strategic Companies by foreign investors.

Moreover, as part of the strategic industries law package, an amendment was introduced to the foreign investments law, pursuant to which the strategic

industries approval procedure also applies to the acquisition by foreign states (including sovereign funds), international organizations and companies controlled by them of more than 25 in any Russian commercial company (i.e., even outside the scope of strategic industries).

As in many other jurisdictions, investments by foreign investors in areas such as insurance, banking and financial services, media and certain specific industries (aviation sector, including construction and repair of aircraft and carriage by air, water distribution in large cities, or alcohol production) are subject to restrictions and special regulations as well.

Finally, a wide range of corporate transactions may be subject to Russian anti-monopoly (anti-trust) regulations, whereby depending on various parameters (the asset values of a purchaser, a target company and a group, group revenues, whether the parties to a transaction are dominant in certain commodities markets) a transaction may be subject either (i) to the prior approval of the Russian Federal Antimonopoly Service (FAS) or (ii) to a subsequent notification to the FAS.



# Real Estate



In Russian law, ownership consists of the unlimited rights of the owner to possess, use and dispose of property. However, there are other forms of title, such as the right of so-called “full economic jurisdiction” (*khoziaystvennoe vedenie*) and the right of operational management (*operativnoe upravlenie*), which are available only to state and municipal enterprises. These rights extend to the use, possession and disposal of the assets only within the scope of the business activity designated by the owner (the state) in the company’s founding documents and subject to mandatory provisions of law. For land, the primary forms of commercial land use are land leases and land ownership (freehold). Other forms of land use rights, such as the right of perpetual use of a land plot are available only to state enterprises, state-funded

institutions and residences of former RF presidents which have historical heritage status. The right of lifetime inheritable possession of land plots was formerly provided by the state to individuals and can now be acquired only by inheritance of the respective rights. An easement is a form of title to a land plot owned by another person, consisting of the right to use the land for a specific limited purpose. Russian law does not allow for a trust in its Western meaning, i.e., a split between legal and beneficial ownership. Mortgage and fiduciary management (trust management) rights to a property are not treated as rights *in rem* in Russia. Title to the mortgaged property does not automatically pass to the mortgagee in the event of default, and a trustee is not recognized as the legal owner of the property.

## Acquisition of real estate by foreigners

Generally, foreigners may directly acquire real estate in Russia, with the exception of agricultural land and land plots together with property located on them in border areas and specially designated areas.

## Registration systems

To have legal effect, all rights to real estate and transactions giving rise to such rights (except leases with a fixed term of less than one year or an indefinite term) must be registered in the RF Consolidated State Register (Register). The Register contains information regarding the owner of the property and encumbrances on it (registered leases, mortgages, trust management agreements, etc.). Before registration, all land plots, buildings, structures, premises and unfinished buildings

must undergo cadastral registration in the State Cadastre of Real Estate (Cadastre). The Cadastre contains cadastral and other information detailing the specific characteristics of the property. The Register and the Cadastre are maintained by a specialized government agency, the Federal Service for State Registration, Cadastre and Cartography. Upon written request and for a fee, any party may obtain extracts from the Register and from the Cadastre for a certain property containing basic information about its cadastral registration, respective right thereto and its encumbrances, if any.

The procedure for State registration of immovable property rights, and cadastral registration of properties, has been revised, in particular:

- The general processing period for state registration is 10 business days.
- The Register and the Cadastre can be maintained electronically.
- The document submission procedure for registration has been simplified – documents may be submitted online (subject to use of a specially qualified electronic signature).

### Transfer taxes

VAT (18 percent) is payable on property acquisitions (other than land plots and in certain cases apartments). The buyer can generally credit this VAT against the VAT liability on its own sales (refunds are provided for by law, but may be problematic in practice). The transfer

of shares in a Russian company that owns property is exempt from VAT. Both the sale of property or shares in a company owning the property may incur capital gains tax (20 percent) for a non-resident seller (unless such gain is exempt from taxation under an applicable double tax treaty). As of 1 January 2014, for a number of properties the tax base for calculating property tax must be based on the confirmed cadastral value of the real property (as opposed to the balance sheet or assessed (inventory) value). The new rules set the maximum property tax rate for real properties for which the tax base is determined based on cadastral value. For Russian Federation constituent territories (with the exception of Moscow). The maximum tax rate must not exceed: 1 percent in 2014, 1.5 percent in 2015, and 2 percent in 2016 and beyond.

### Leases

Leases are freely negotiable. Most provisions of law pertaining to lease agreements are optional and may be varied by the parties, but certain mandatory provisions must be adhered to. The most important restriction concerns the mandatory registration requirement for leases of property for a fixed term of more than one year. The introduction in this rule states that state registration is required as confirmation for third parties, while for the parties the agreement is valid as of its execution. In order to be effective under Russian law, a lease agreement must contain a definitive description of the leased property and the amount of rent payments or a formula for their calculation.

### Privatization claims

A claim arising out of a transfer of assets during privatization would qualify as a claim for a declaration of the transaction as being null and void, being contrary to the law then in effect. The statute of limitations for a null and void transaction is three years, starting from the commencement of the execution of the relevant transaction or, if the claim is brought by a third party, from the date on which the third party learned or should have learned of the commencement of performance. In addition, the statute of repose – 10 years – applies to claims of third parties (i.e., not a party to the void transaction) and runs from the date on which performance of the void transaction began.

### Notaries and notarial fees

Generally, notarial certification of real estate transactions is not required. Notarial certification is mandatory only (i) when required by law (for example, transfer of shares in a Russian LLC, annuity contracts, spousal consents to the transfer of jointly owned real estate), or (ii) if the parties agree on the necessity of such certification even if it is not required by law. The notarial fees for certification of real estate contracts may be a fixed amount or a certain percentage of a contract's value. For example, notarial certification of transactions with a subject requiring appraisal, if notarization is required by law (such as an annuity contract) costs 0.5 percent of the contract value (but not more than 20,000 rubles), while notarial certification of contracts on

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## The Register and the Cadastre are maintained by a specialized government agency, the Federal Service for State Registration, Cadastre and Cartography.

the alienation of real estate costs 3,000 rubles plus 0.2 percent of the contract value (but not more than 50,000 rubles) when the contract is concluded with children, spouses, parents, or siblings, and 0.1 percent of the contract value and higher (depending on the contract value) when the contract is concluded with other persons.

### Language

For the purposes of state registration and/or notarization, real estate transactions must be executed in Russian. In practice, English is often used as a second and controlling language.

### Arbitration

Any transaction involving Russian real estate property must be governed exclusively by Russian law. With regard to the forum for dispute resolution, previously it was in fact limited to Russian state commercial (*arbitrazh*) courts with jurisdiction over the location of such property. However, in 2011 the RF Constitutional Court liberalized the approach to legal provisions restricting the parties' ability to refer a dispute related to real estate property to an arbitration institution. Basically, now it is not possible only

with respect to public-law disputes, such as for example challenging the records in the relevant state registry, challenging the cadastral value of the property, etc. Such dispute shall be exclusively heard and resolved by a Russian state commercial (*arbitrazh*) court at the location of such property. Meanwhile, civil law disputes arising from contracts related to real estate property can be resolved in an arbitration institution (whether international or domestic). The registration of title to Russian real estate on the basis of an arbitration award should be possible provided that the arbitration award is recognized in Russia. Russia is a party to the 1958 New York Arbitration Convention, which means that generally foreign arbitration awards should be enforceable in Russia. The case law on this issue remains unstable but the tendency is definitely towards liberalization. This is however not applicable to jurisdiction clauses: referring disputes related to Russian real estate property to any courts (whether foreign or domestic) other than a Russian state commercial (*arbitrazh*) court possessing jurisdiction over its location remains directly forbidden by the Russian procedural law.

### Mortgage and foreclosure

Any mortgage of real property is subject to state registration in the Register. According to the current legislation, in order to foreclose on a mortgaged property out of court through a notary's writ of execution, the mortgage agreement must be notarized. The mortgagee may take possession of the property (or sell it to a third party) at a price equal to the market value of such property, which is determined in accordance with the RF laws on valuation activity, without having to foreclose via a public auction. There are still certain exceptions in which out-of-court foreclosure is prohibited by law (for example, where the collateral is a cultural landmark, residential premises owned by individuals, or agricultural land).

According to the general rule, a mortgage will always automatically extend to all buildings, structures and other objects located on a mortgaged land plot.

Typically, when a land plot and/or a building on it is purchased, constructed or is being constructed using financing from a bank or a special-purpose loan, the land plot itself, together with all the buildings and structures on the said land plot, are considered to be mortgaged together. Such a mortgage arises by operation of law and is registered simultaneously with the registration of title to the respective real property.

# Tax



The Russian system of taxation is divided into three levels: federal, regional and local taxes. All taxes, however, are administered by the Federal Tax Service and its local departments and inspectorates. Companies are also obligated to pay state insurance contributions to state non-budgetary funds (in fact, payroll tax) which are administered by the management of these funds – the Pension Fund of Russia and the Federal Fund of Medical Insurance.

Regional authorities are empowered to regulate certain elements of regional and local taxes, namely to vary tax rates within a certain range and provide tax reliefs. Many regions have adopted tax incentives for investors, such as a lower rate of corporate income tax and full exemption from property tax on all assets relating to investment projects approved by regional authorities.

In addition, there exist so-called special economic zones in a number of regions for companies whose business lies, in particular, in the fields of mass production, R&D, IT or tourism. Companies which have obtained residential status in such a zone enjoy a favorable tax regime, involving exemption from property and land taxes, lower rates of corporate income tax and social security contributions.

Please find below a brief outline of general taxes imposed on business and their key elements, such as the type of income or property subject to tax, tax base, tax rate and, also, some specific regulations concerning intra-group financial operations and transfer of assets.

## Corporate income tax

The tax is imposed on taxable profit calculated as sales revenue and

other income, less economically justifiable expenses.

The standard rate is 20 percent. The said rate includes, in fact, two rates: one of which represents the part of tax flowing into a regional budget (18 percent), while the other represents the part of tax which goes into the federal budget (2 percent). Regional authorities may lower their rate at their own discretion, but not below 13.5 percent.

The rate of 13 percent is applicable to dividends received by Russian companies. Such dividends may be fully exempt from tax in certain conditions.

Interest, royalties and dividends payable by Russian companies to foreign companies are subject to withholding tax unless the respective double tax treaty provides otherwise. The rate is 20 percent for interest and royalties, and

15 percent for dividends (30 percent in some cases with nominal holders of shares where a beneficial owner is deemed to be unknown).

Active income of foreign companies is taxable only if a company carries on its business through a permanent establishment in Russia. The concept of a permanent establishment is close to the OECD standard.

Strict thin capitalization rules are in effect. According to current court practice double tax treaties do not serve as a remedy against these rules. The rules are essentially built on a debt-to-equity strict ratio which is 3 to 1 (12 to 1 for banks and companies engaged in financial leasing). Excessive interest (i) is not deductible, and (ii) treated as dividends for taxation purposes. The rules are applicable to loans taken by borrowers that are Russian companies from (i) a foreign company owning directly or indirectly more than 20 percent of the share capital of the borrower, or (ii) Russian companies affiliated with such a foreign company, or (iii) any other lenders if a loan is secured by such a foreign company/Russian affiliate company.

This said, equity financing made in cash by a direct parent company, including a foreign one, into a Russian company in the form of (i) a contribution to the share capital, or (ii) a contribution with a view to increasing the net assets of the subsidiary, i.e., financial aid, are completely tax free for both parties to the transaction.

### Value Added Tax (VAT) and excise duties

The Russian system of VAT is in many respects very similar to that of the European Union (the Sixth VAT Directive of 1977 to a greater extent than the Recast VAT Directive of 2006).

The taxable operations are supplies of goods and services and construction work for a taxpayer's own needs. Financial and similar operations (insurance, loans, circulation of commercial papers, etc.) are exempt from VAT. There are some other notable exemptions, for example, transfer of IP rights for patents, software and trade secrets.

The standard tax rate is 18 percent, the lowered rate set for certain goods (mostly food) is 10 percent. The export rate is 0 percent.

The tax base is the value of the goods and services supplied according to a contract. Input VAT is fully recoverable provided the acquired goods and services are intended for taxable operations. If acquired goods and services are used for both taxable and non-taxable operations, input VAT is partially recoverable.

Goods subject to excise duties are mainly alcohol, tobacco, cars and fuel, and the taxable operation is generally their first sale. The base is either a quantity or a value of goods produced (reworked, refined) depending on the kind of goods. A different rate is set for every kind of goods. As a general rule, excise duties paid by a taxpayer to suppliers

of raw materials, also chargeable with excise duties, are deductible from tax liability.

### Property tax

Real property of Russian companies and all fixed assets of foreign companies are subject to tax.

The general tax base is the net book value of taxable assets. However, with regard to some commercial buildings (office buildings, shopping malls, etc.) listed by the regional authorities as well as for real estate belonging to foreign companies without a permanent establishment in Russia the base is the cadastral value (usually equal to or even higher than the market value).

The range of annual rates is up to 2.2 percent. The exact rates are set within this limit by regional authorities, as the tax is regional. Buildings, the tax base of which is determined as their cadastral value, are taxed at slightly lower rates (up to 2 percent as from 2016).

### Transport tax

The tax is levied on motor vehicles (cars) in a taxpayer's ownership and other technical means of transport (boats, bikes, planes, etc.).

The rates are set by regional authorities. For cars the maximum rate is RUB 150 per 1 horsepower (save for luxury cars included on a special list by the Ministry of Industry and Trade).

The tax base is engine capacity in horsepower for cars and other ground vehicles.



### State insurance (social security) contributions and personal income tax

The base for social security contributions is payroll, i.e., payments to employees and other individuals.

The standard combined rate is 30 percent. However, after payments made to an employee within a year exceed a certain limit the payments in excess of this limit are taxed at the rate of 15.1 percent.

In addition, a contribution for on-the-job accident (workmen's compensation) insurance is collected at the rate in the range from 0.2 to 8.5 percent depending on the type of job and the level of danger attributed to it.

Lower (preferential) rates are applicable for some companies, for instance, IT companies complying with certain requirements.

Also, companies must compute and withhold personal income tax from wages and salaries paid to employees and other individuals. For most kinds of income the rates are 13 percent for Russian tax residents and 30 percent for non-residents (save for highly qualified foreign specialists who in certain conditions are eligible for the 13 percent rate as well as Russian tax residents).

### Land tax

The taxable asset is land in a taxpayer's ownership. The tax base is the cadastral value of the land plot.

The annual rates vary within the limit of 1.5 percent depending on the type of land. The rates are set by local authorities.

### Other taxes

Water tax and mining tax which, as follows from their names, are levied

on companies involved in the usage of water or mining activities. Mining tax is most significant for the oil & gas sector.

Special tax regimes are provided for small businesses (restaurants, food stores, etc.), but they are inapplicable to subsidiaries of other companies.

### Transfer pricing rules

Cross-border transactions within the same group of companies should be at arm's length under the threat of transfer pricing adjustment. As a general rule, intra-group operations between two Russian companies are regarded as controlled transactions subject to transfer pricing rules if the sum total of all sales revenues reported under these transactions by both parties exceeds 1 billion rubles.

The Russian transfer pricing model is mainly based on the OECD guidelines. For example, the rules establish practically the same principles of functional analysis and the same set of pricing methods to determine an arm's length price or margin for controlled transactions (CUP, RPM, CPM, TNMM, PSM).

### CFC rules in Russia

Russian CFC Rules went into effect as from 1 January 2015 (Chapter 3.4. of the RF Tax Code).

As a general rule, a Russian tax resident is deemed to control a foreign company if the resident (i) owns more than a 25 percent interest in the company (50 percent in 2015 as a transitional period) or (ii) 10 percent interest in the company provided that more than 50 percent

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## The rate of 13 percent is applicable to dividends received by Russian companies.

interest is owned by Russian tax residents (in 2016 and afterwards) and (iii) by other means determines (exerts significant influence on) or may determine (exert significant influence on) corporate decisions of this company concerning distribution of income among its equity holders. There are some exemptions (Art. 25.3 of the RF Tax Code). A controlling individual/entity must pay tax at the rate of 20 percent on income earned by a CFC in proportion to his/her/ its share in this company if the CFC fails to totally pay out its net income as dividends to equity holders by the end of a calendar year following the calendar year in which a fiscal period comes to an end.

### Tax control

Tax supervision in Russia is carried out mainly in the form of desk or field tax audits. The subject matter of a desk tax audit is the correctness of a specific tax return filed by a taxpayer. A desk tax audit may be performed within three months from the date of filing the tax return.

A field tax audit may encompass up to three calendar years previous to the year in which the audit is scheduled. During the field tax audit a tax authority may check the correctness of computation and proper payment of all taxes

within the audited period and for this purpose may make use of quite vast powers, such as the search of a taxpayer's office and other premises or compulsory seizure of documents and other material evidence.

Additionally, there is a separate form of tax audit which relates purely to control of prices applied by interdependent companies in their transactions (based on transfer pricing regulations). A special body that is authorized to perform such audit checks the correctness of tax liability calculation with respect to intercompany transactions (the prices of which could considerably differ from the fair market value).

The most notable types of liability for committing a tax offense and/or failure to duly pay tax for corporate taxpayers usually invoked by tax authorities are as follows:

**Late payment interest** at the rate of 1/300 of the refinancing rate of the Central Bank of Russia (currently 8.25 percent) is charged on overdue amounts of tax liability per each day of delay (Art. 75 of the RF Tax Code).

The Tax Code also provides for liability (fines) for different types of violations of tax legislation, including, among others:

- The fine for **late filing** of (failure to file) a tax return is 5 percent of the tax overdue per each month of delay, if any, but in any case no less than RUB 1,000 (approx. US\$25) and no more than 30 percent of the tax overdue (Art. 119 of the RF Tax Code).
- There is a fine for **failure to pay tax** (or for incomplete payment of tax). This fine is charged if the tax liability is understated, or the tax amount is calculated incorrectly. The fine is 20 percent of the overdue tax (40 percent in the event of tax evasion) (Art. 122 of the RF Tax Code).

The Administrative Code also provides for fines for some tax violations; however, the amounts of these fines are very modest.

It also must be noted that company officers may face **criminal liability for corporate tax evasion**. Tax evasion is defined as the failure to file a tax return properly or the filing of a tax return containing knowingly false information on the amount of tax liability if such action (failure to act) leads to a failure to pay a certain amount of tax (as a general rule, more than RUB 6 million). The most severe punishment for tax evasion is imprisonment for a term of up to six years.

However, if a taxpayer pays in full the tax concealed by means of tax evasion, and its officers under prosecution are first-time offenders of this type of crime, they must be exempted from criminal liability.

# Dispute Resolution



## Legal system

Justice in the Russian Federation is administered by two branches of courts: courts of general jurisdiction (including so-called justices of the peace) and commercial courts. In addition, there are the Russian Constitutional Court and regional constitutional (charter) courts.

The commercial courts in Russia are called arbitrazh courts; these are State courts which, despite their name, have nothing to do with the resolution of disputes by way of arbitration. Such courts hear business-related disputes, as well as corporate conflicts and bankruptcy cases. Most of the remaining civil, administrative, criminal and employment cases are dealt with by the courts of general jurisdiction. The justices of the peace as a general rule handle minor civil, administrative and criminal cases.

Arbitration is also recognized and used in Russia as a means of dispute resolution through an independent forum.

Russia belongs to a family of so called 'civil law' countries. Russian law is contained in statutes adopted by the parliament and approved by the president. In addition, there exists a large body of secondary or subordinate legislation, including decrees, regulations and orders by the president, the government, ministries and other executive authorities.

The Russian courts do not create precedents in the same way as common law countries do. However, the Supreme Court issues interpretations of legal issues and reviews of court practice, which have obligatory force and are followed by all Russian courts.

Transactions between Russian legal entities or individuals are normally governed by Russian law. However, if a transaction involves a foreign element, the parties may choose to have it governed by foreign law (subject to a few exceptions where the application of Russian law is mandatory). English law is the law of

choice in many major cross-border business transactions, in particular in mergers and acquisitions, joint ventures and banking transactions. That said, if a foreign-law governed transaction involves Russian assets or parties, certain mandatory requirements of Russian law may apply to them. Russian law must also be applied to certain corporate governance matters concerning Russian companies.

## Court instances / legal remedies

Russia has a multi-level system for appealing judicial acts.

After being examined in the court of first instance, civil and commercial cases may be appealed to an appellate court. The judicial act enters into legal force once that court has examined the case.

However, even a judicial act that has entered into legal force may be further appealed to the third, cassation instance. Then the judicial act may be appealed again in cassation proceedings, to the RF Supreme Court.



Finally, the last instance in Russia is the Presidium of the RF Supreme Court, which examines cases in so-called supervisory review.

At the same time, in practice the number of cases that are reviewed by the Supreme Court in cassation or supervisory proceedings is extremely low.

### Combination of courts

Before 2014 Russia had two high courts (in addition to the RF Constitutional Court): the RF Supreme Court headed the courts of general jurisdiction, while the RF Supreme Arbitrazh (Commercial) Court headed the arbitrazh courts.

The RF Supreme Arbitrazh Court was dissolved in 2014. Thus, the updated Supreme Court of Russia has become the common court for examining almost all court disputes.

The updated Court envisions the creation of seven judicial panels, including panels for economic disputes, civil disputes, criminal cases and administrative cases.

Several amendments have been made to the procedural legislation to further develop this court reform. The amendments are primarily intended to unify the system of appealing judicial acts in the courts of general jurisdiction and arbitrazh courts.

### Length of court proceedings

In comparison to many other countries' legal systems, civil cases are not examined for very long in the courts. The law sets maximum time

limits for the examination of cases at each instance.

For example, an arbitrazh court generally has to examine a case in the first instance within not more than three months from when the arbitrazh court receives the application, including the time for preparing the case for hearing and rendering a decision on the case.

In the courts of general jurisdiction, this time is generally shorter: as a general rule civil cases must be examined and resolved by the court before the end of two months from the date the court received the application, while for justices of the peace the time frame is just one month.

The situation is similar with appealing judicial acts. For example, one month is provided for appeal in both the arbitrazh courts and in the courts of general jurisdiction. The appellate court must examine the appeal within two months.

Although the stated time limits aren't always observed (and the law itself provides for certain situations where the time for examining a case can be extended), on the whole litigation in Russia goes quite quickly. For example, on average, it takes about six months from the time the court receives the claim and until a writ of execution is issued in a case, including appeal of the case. Most court cases can go through practically all of the appeal stages within one year.

It may take much longer (up to several years) to examine individual cases, which may be caused by the higher courts reversing judicial acts, expert examinations being conducted in the case, involving a large number of third parties and the complexity of the case.

### Rights and duties of participants

Participants in litigation in Russia have all of the rights and bear the procedural duties that exist in the legal systems of developed countries. For example, participants in civil cases have the right to access the case file, to make extracts from the case file and to make copies; to make recusals, to present evidence and to access the evidence presented by other persons participating in the case prior to the start of the judicial proceedings; to participate in the examination of evidence; to pose questions to other participants of commercial proceedings, to file motions, to make statements, to give explanations to the commercial court, to state their arguments with regard to all matters arising in the course of the examination of the case; to access motions filed by other persons, to object to motions and arguments of other persons participating in the case; to obtain information on complaints made by other persons participating in the case, on judicial acts delivered in respect of the given case and to obtain copies of judicial acts issued in the form of separate documents; to access a judge's separate opinion on the case; to appeal against judicial acts, etc.

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## Most court cases can go through practically all of the appeal stages within one year.

In addition to these general rights, the parties also have such rights as, for example, to make an audio recording of court proceedings, to petition to participate in a hearing through a videoconferencing system, to file practically all procedural documents, including the claim, with the arbitrazh courts in electronic form via the internet by using a special system. This same system provides public access to all judicial acts of arbitrazh courts in digital form on the internet.

At the same time, parties to the proceedings must exercise all of their procedural rights and perform certain duties in good faith, for example, to prove their position (taking into account the principle of adversarial proceedings).

### Civil proceedings, criminal proceedings and administrative proceedings

In Russia civil proceedings are handled by the courts of general jurisdiction on the basis of the RF Civil Procedure Code and by the arbitrazh courts on the basis of the special RF Arbitrazh Procedure Code.

Administrative proceedings are also handled by the courts of general jurisdiction and, in some cases, by the arbitrazh courts on the basis

of the relevant codes; however, since September 2015, administrative proceedings in the courts of general jurisdiction will be governed by a separate RF Code of Administrative Procedure.

Criminal proceedings are handled only by the courts of general jurisdiction on the basis of the RF Criminal Procedure Code.

Thus, the courts of general jurisdiction act essentially as a universal body for examining most legal issues in court.

### Deadlines / time limits

The general limitation period for civil cases in Russia is three years; however, in some instances it may be shorter. For example, the limitation period under a claim to invalidate a voidable transaction and to apply the consequences of the transaction's invalidity is one year.

However, the mere fact that the limitation period was missed does not affect a party's right to file with the court, which is required to not only accept but also to examine the relevant application. A court may reject a claim for expiration of the limitation period only if the other party declares it. The court cannot apply the limitation period at its own discretion.

Depending on the offense, limitation periods for administrative liability are from two months to one year; however, for certain types of offense the period is up to six years.

The limitation period for criminal prosecution depends on the type of crime. It is two years after a minor crime, six years after a crime of moderate severity, ten years after a serious crime, and fifteen years after a very serious crime. However, some crimes, such as those associated with terrorism, have no limitation period.

### International treaties

International treaties to which Russia is a party (ie which the Russian parliament has duly ratified) have precedence over any internal Russian laws.

Russia is recognized as a successor to the former Soviet Union in international law: it has assumed the USSR's permanent seat on the UN Security Council, membership in other international organizations, rights and obligations under international treaties, as well as the USSR's property and debts.

Russia is a signatory to the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) which provides for a uniform and relatively straightforward procedure for the recognition and enforcement of foreign arbitration awards in Russia.

# Banking and Finance



## Financing a company

A Russian company may be financed by a subscription for capital and/or loan capital. In either case, the financing can be provided by a parent company and/or third party investors and/or lenders. Capital contributions may be made either in cash or in kind. Loan capital may be provided in the form of loans or issuance of bonds.

The minimum charter capital for limited liability companies (OOO) is RUB 10,000. The charter capital must be paid within the term specified in the agreement for establishment of the company, but in any event no later than four months from the date of state registration of the OOO. Each participant in an OOO must pay no less than the share's nominal value for its share (participatory interest) in the OOO.

Joint-stock companies (AO) are divided into two groups: public and non-public joint-stock companies. A non-public joint-stock company (simply AO) must have a minimum

charter capital of RUB 10,000; and a public joint-stock company (PAO) must have minimum charter capital of RUB 100,000. The founders of a joint-stock company are not required to make any capital contributions before the company is incorporated: 50 percent of the shares must be paid within three months of incorporation and the remaining 50 percent within one year upon state registration. No deferred payment is permitted for subsequent share issues.

In addition, the minimum charter capital specified above for both OOO and joint-stock companies must be paid in cash, while other contributions (above the minimum charter capital) may be made in cash or in kind.

A company's net assets must not be less than its charter capital at the end of each year (except for the first two financial years after incorporation). If they are, the company must either increase its net asset value to meet the requirement, or reduce its charter capital to the amount of its

net assets. If company's net assets become less than the minimum charter capital established by law, it must resolve to enter voluntary liquidation. Should the company fail to take such action, the Russian tax authority may compel the company's liquidation. Profit cannot be distributed (dividends declared and/or paid) by a company with negative net assets.

All shares in an AO or a PAO are issued in non-documentary form; they may be ordinary or preferred (i.e., non-voting). All share issuances must be registered with the Bank of Russia. The registration procedure can be quite time consuming and involves preparing a large number of documents. In addition to shares, joint-stock companies can issue securities in other forms, which must also be registered with the Bank of Russia.

There are certain regulated sectors in which special capital rules apply (e.g., in relation to banks and companies dealing in securities).

The Russian Law on Foreign Investments sets out the general framework for foreign investment and establishes the principles of non-discrimination, freedom of investment and fair compensation in cases of nationalization. Prohibitions and restrictions for foreign investors may only be established in exceptional cases and should be justified by the need to protect the foundations of the constitutional system; the morals, health, rights, and legal interests of other persons; or national security. The Russian Law on Strategic Companies imposes certain restrictions on foreign investments. The Law on Strategic Companies provides a list of specific activities that constitute strategic activities in Russia. The acquisition of a controlling stake (by various means) in a Russian company that is involved in any strategic activity requires the preliminary consent of the Russian Government or a post-transaction notification. Apart from that, in most situations the need for governmental authorizations, permits and licenses applies equally to Russian and foreign investors. It is highly advisable to investigate the availability of bilateral investment treaty (BIT) protection in addition to the guarantees given under the Russian Law on Foreign Investments.

### Opening a bank account

Once registration is complete, a Russian company is legally permitted to operate. As a practical matter it will need to open bank accounts. Generally, direct cash settlements cannot be used between companies.

In order to open a bank account, a company must provide its bank with copies of its constitutive documents and registration certificates, notarized signature specimen cards, and certain other documents required by the relevant bank. The bank signature specimen card must be notarized and it must also be apostilled if the signatories are abroad. Under current Russian banking rules, signature rights in respect of company's bank accounts can be granted only to the employees of that company.

The bank must notify the tax authorities within three days of opening any bank account. However, a company must notify the tax authorities within one month of opening/closing any foreign bank account; failure to do so may result in a fine of between RUB 50,000 and RUB 1,000,000. Russian companies and individuals must observe a special procedure for using bank accounts opened in foreign banks.

Russian companies may open bank accounts abroad, although the use of such accounts (including sources of funds to such accounts and permitted payments from such accounts) is regulated under Russian currency control rules. Also, Russian companies must regularly report to Russian authorities on the existence and use of such accounts.

### Security

#### Mortgages

Mortgages ('ipoteki') over land and other real estate are probably one of the most reliable forms of

security existing under Russian law. Mortgages can be used as a security for the performance of various obligations by the mortgagor or a third party, including those arising under credit agreements (loans provided by credit institutions are referred to as credits and are distinguished from loans extended by non-credit institutions) and loan agreements, but also other types of agreements, such as sale and purchase agreements, lease agreements, works contracts etc.

In some cases, unless the parties agree otherwise, a mortgage is automatically established by law (e.g., when the purchase of a land plot is financed by a bank, when a building is constructed on a mortgaged land plot etc.).

As a general rule, if a new mortgage is established over an asset that is already mortgaged, such mortgage becomes a subsequent (second-ranking) mortgage. The parties can change the ranking of the mortgage or establish *pari passu* rights on the basis of a relevant agreement.

Mortgages are subject to registration in the Unified State Register of Immovable Property Rights and Related Transactions. Indeed, security over a mortgaged asset is only effective when registration of the mortgage takes place. Needless to say, state registration of mortgages is an efficient mechanism for securing mortgagee rights, as it significantly limits the owner's right to dispose of its asset.

Mortgage agreements should be drafted carefully as imprecision in certain terms (e.g., imprecise description of the secured obligations) may lead to the mortgage agreement being declared void by a court.

There is a certain amount of flexibility in relation to the enforcement of a mortgage. The parties may agree on an out-of-court enforcement procedure (except for certain cases specifically carved out by Russian law) and/or procedure for judicial enforcement in their mortgage agreement. This enables the parties to better anticipate the likely outcomes of enforcement of the mortgage, if and when it takes place.

### Pledges

Pledges ('zalogi'), like mortgages, can secure performance of various obligations of the pledgor or a third party. The following pledges are subject to mandatory state registration: (i) pledge of rights subject to mandatory state registration; (ii) pledge of participatory interest (in an OOO). Pledges of non-documentary securities are subject to mandatory registration in the relevant register. Pledges of other types of assets should be registered in the register of notifications of pledges of movable property maintained by notaries of the Russian Federation. Such registration does not affect validity of the pledge, but establishes its priority for third parties.

Russian law acknowledges the concept of statutory pledge (i.e.

security created automatically by operation of law). Goods purchased on credit ('prodazha tovara v kredit') are pledged to the seller until paid in full by the buyer, unless the parties agree otherwise.

Amendments to the Russian Civil Code in 2014 significantly revised the regulation of pledges. This included the introduction of a new type of pledge (previously unrecognized by Russian law) – the pledge of rights under bank account agreements. Also, pledges in relation to rights of participants in legal entities (shareholders and holders of participatory interests) are now expressly regulated by the Civil Code. This gives the lender much greater flexibility in terms of types of collateral over which it can take security.

As in the case of mortgages, pledges can be enforced either in court or out of court (if the pledgor is a merchant). The pledged collateral can be realized by assumption of title to the pledged collateral or direct sale to a third party. However, it should be noted that enforcement of pledges over certain assets can be more burdensome than over others.

### Retention of title/Lien

While not a security per se, retention of title is often used to protect and secure the rights of the seller to receive payment in the future. For this purpose, the parties may agree that the seller will retain title to the goods sold ('sokhraneniye prava sobstvennosti za prodavtsom') until paid in full or until the occurrence of

certain other agreed events. In such case, the buyer's rights to dispose of such goods are limited and in the event of non-payment the seller has the right to demand the goods be returned.

Liens ('uderzhanie veshi') can be created where the creditor possesses an asset which that should be handed over to the obligor, or a person designated by such obligor. The creditor is allowed to retain such asset until all payments related to such asset (including its price, expenses and losses connected with such asset) have been made in full. In cases where both parties are merchants, retention of an asset is also permitted in connection with performance of obligations not related to such asset. The creditor can retain the asset even when the title to it has passed to a third party. As a last resort, the creditor's claims can be satisfied under a procedure similar to enforcement of pledges. Obviously, the parties are free to eliminate the possibility of a lien being exercised by agreement.

### Suretyship

Suretyship ('poruchitelstvo') is a form of security commonly used in corporate finance. A lender providing a loan to a holding company would typically ask for a suretyship (from either the company's shareholder(s) or other companies in the group). Suretyships provide necessary assurance and support in case of default by the borrower.

Under a contract of suretyship, one party (surety) undertakes to

another party (creditor) to fulfil the obligations of a third party (the principal debtor). Suretyships are void unless made in writing.

At a first glance, Russian-law suretyships may seem similar to English-law guarantees. However, a Russian-law suretyship has one distinguishing feature: it is generally considered a secondary obligation, meaning that it will not survive the termination (or in certain cases, modification) of the secured obligation. For example, a suretyship may terminate if the creditor in the underlying obligation has been changed (as a result, for example, of a debt sale), unless the surety has consented to the change. On the other hand, an English-law guarantee is independent of the secured obligation. This is one reason why Russian-law suretyships are not widely used in finance deals involving Russian companies. Another deficiency of Russian-law suretyships (although we should note that it can be argued that independent guarantees are similarly affected) is the corporate benefit issue, which is particularly relevant for the upstream/downstream suretyships.

### Independent guarantees

Recently introduced changes to the Russian Civil code allow the use of an independent guarantee ('nezavisimaya garantiya'), which is similar to an English-law guarantee. Although the practice of independent guarantees remains untested, this type of security may find great support in Russian finance transactions.

Under an independent guarantee one party (guarantor) undertakes at the request of another party (principal) to pay a third party (beneficiary) a certain amount of money in accordance with the obligation given by the guarantor, irrespective of the secured obligation. An independent guarantee must be in writing and must contain such terms as the date of its issuance, the name of the principal, beneficiary, and the guarantor, the obligation secured by the guarantee, the amount payable by the guarantor (or the manner in which it may be determined), the term of the guarantee, and the circumstances upon which the sum of guarantee becomes payable to the beneficiary.

Independent guarantees replace bank guarantees ('bankovskaya garantiya') in Russian Civil law, which had been considered to be one of the most reliable security instruments, although also, probably, the most expensive one for the debtor. There is now greater flexibility in security arrangements, the creditor can insist on an independent guarantee issued by a bank, or can rely on an independent guarantee provided by the debtor's parent company or affiliate (or an independent third party, as the case may be).

An independent guarantee is similar to a suretyship agreement, but unlike the latter, a guarantee survives termination and/or change of the secured obligation. Additionally, an independent guarantee can only

be given by banks or other commercial entities, whereas suretyships can also be given by individuals. Notably, an independent guarantee cannot be changed or revoked (unless otherwise is provided for in the guarantee).

### Security deposit

Another form of security that is not common in financial transactions but is typically found in large M&A and real estate deals, is the security deposit.

Until recently, although security deposits were used in practice there were not expressly provided for in law. However, recent changes to the Russian Civil Code have made it possible to use and enforce this security instrument with fewer legal risks.

A security deposit is literally a certain amount of money that is paid by the debtor to the creditor upfront. Security deposits are conditional upon certain terms and conditions and usually serve to encourage the debtor to perform its obligations under a contract. For example, a security deposit may secure obligations of the buyer or the seller under a preliminary share sale purchase agreement.

### Credit transactions

Major transactions with Russian borrowers have traditionally been governed by foreign (e.g., English) law. While recent attempts by Russian lawmakers have begun recognizing various concepts commonly used by foreign institutional lenders (such

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## Another form of security that is not common in financial transactions but is typically found in large M&A and real estate deals, is the security deposit.

as lenders' agent, security agent, subordination of debts etc.), these have yet to be properly tested in the courts and foreign institutional lenders still show no inclination to use Russian law.

Points that require particular attention when lending to a Russian borrower are: arrangements in relation to security (especially where upstream and downstream guarantees/suretyships are involved), conducting at least a high level review of the borrower's solvency (both on a cash flow and balance sheet basis), dispute resolution arrangements (many foreign court rulings cannot be enforced in Russia, hence arbitration is often the preferred form), and performing at least a high-level check that the requisite corporate (e.g., approval of major transactions) and other procedures (e.g., transaction passports) have been observed by the Russian borrower.

### Transfer of funds

There are currency control regulations in place in Russia. Russian residents (note that currency legislation sets forth a definition of 'residency' which is completely different to residency under tax

legislation) can only use Russian rubles when settling payments to other Russian residents (with very few exceptions). Where payments are made from a Russian resident to a non-resident (very broadly defined – foreign entities and individuals) foreign currencies can be used as well as Russian rubles.

Russian residents must have a written document in place in order to be able to make payments to and from foreign persons. Russian banks are currency control agents, and hence must ensure that Russian currency legislation is observed in their clients' dealings with foreigners. Therefore, a Russian bank will almost certainly reject a payment if no documents relating to such payment are provided or if the documents do not justify the payment.

Russian resident companies are obliged to use their bank accounts for the vast majority of transactions with non-residents (i.e. cash payments are banned for the vast majority of transactions). Although Russian companies can freely open bank accounts with foreign banks, the use of such accounts (especially permitted sources for funding these accounts) is regulated by Russian currency regulation.

### Transaction passport

Russian residents (companies and individual entrepreneurs) that enter into certain types of agreement (including in relation to the sale and purchase of goods, provision of services, and licensing or alienation of intellectual property rights, as well as taking out or extending a loan) in which total payments will exceed US\$ 50,000 are required to prepare a transaction passport (*'passport sdelki'*) with their bank.

A transaction passport is a standard document containing certain information in relation to the parties to a deal and the contact entered into between them. A transaction passport should usually be issued before the first payments under a foreign trade (or lending) arrangement take place or before the first delivery of goods or provision of services under a foreign contract, depending on the contract type and terms.

Following the issuance of a transaction passport, Russian residents must provide their bank (which issued the transaction passport) in the course of performing the contract with various documents (such as customs declarations, invoices etc.) accompanied by certain other standard form documents (such as currency transaction certificates, certificates confirming documents etc.).

# Regulatory / Compliance

## Filings with the companies register

All Russian companies must be registered with the Consolidated Register of Legal Entities (the Companies Register, often known by its Russian acronym EGRUL). The Companies Register contains copies of the company's charter, information on its standing (e.g., whether liquidation or bankruptcy proceedings have been initiated), registered address, chief executive officers, branches, and other information. All such information is public. Companies must notify the Companies Register of changes to their charters or other information contained at the Companies Register using special forms.

## Accounts and audit

Every company must prepare its financial statements monthly, quarterly and annually. Annual and quarterly financial statements must be filed with the tax authorities.

Banks and financial institutions (credit organizations) are also required to submit special monthly (and sometimes even weekly and daily) statements to the Russian Central Bank.

Only companies whose shares are traded on a stock exchange must make their accounts available to the general public.

Not all Russian companies are required to have their financial statements audited. An external audit is mandatory for joint-stock companies, banking, insurance and investment companies, investment



funds and companies with annual revenues or assets exceeding certain statutory thresholds.

If a limited liability company (ООО) has more than 15 members, an annual audit of its accounts must be carried out by an internal audit committee or an independent external auditor. Otherwise, the audit is optional for ОООs.

## Bribery and corruption

The Russian government recognizes corruption as one of the most serious problems facing the country and has taken various steps to fight it, including increasing sanctions and bringing the legislation in line with international standards. Despite this, corruption remains widespread particularly in such areas as customs, law enforcement, various licensing and registering authorities, public procurement and tenders, universities and others.

The Russian Criminal Code contains the following corruption-related offenses:

- Giving a bribe (including bribing a foreign official or a representative of an international organization)
- Receiving a bribe
- Acting on behalf of a giver of a bribe or of its recipient or otherwise assisting either of them to reach an agreement with respect to a bribe
- Abuse by an officer of his authority or position contrary to the interests of the relevant organization motivated by pecuniary or other personal interest
- Issuing or amending official documents, which include incorrect information motivated by pecuniary or other personal interest.

A bribe may be in the form of money, valuables, property or services of a monetary nature or other proprietary rights.

The offenses apply to state and municipal officials, as well as to persons performing managerial functions in private companies, foreign officials and representatives of international organizations.

Sanctions for bribery offenses vary depending on the amount of the bribe and other circumstances and can include fines, imprisonment and/or prohibition from holding certain positions. The fines have been significantly increased recently and



can now reach up to 100 times the amount of the bribe.

Only individuals (and not companies) can be subject to criminal liability in Russia. However, if an act of bribery is carried out on behalf of or in the interest of a company, such company may be subject to additional administrative liability and large fines (of no less than RUB one million).

### Merger control and strategic investments

The main source of merger control regulation in Russia is the Federal Law No. 135-FZ on Protection of Competition (the Competition Law). The authority dealing with merger control and other competition issues is the Federal Antimonopoly Service (FAS).

The following types of transactions related to Russian companies may require FAS clearance:

- Merger or accession transactions
- Setting up companies (in case the charter capital is paid by shares/assets of another company)
- Takeovers and acquisitions of shares or participatory interests in Russian companies, as well as acquisitions of certain assets or rights to control the business of Russian companies.

Importantly, transactions taking place outside Russia and not directly involving Russian companies may in certain circumstances be subject to Russian merger control rules. In particular, FAS clearance is required

for the acquisition of more than a 50 percent stake in a foreign target which supplied goods to Russia with a value in excess of one billion rubles during the year preceding the transaction.

The rules are quite complex, but very broadly speaking, the transactions require prior FAS clearance if the combined value of the assets of the acquirer and the target and their respective groups (excluding the seller's group) exceeds seven billion rubles or their aggregate turnover exceeded ten billion rubles last year.

Special merger control and competition rules apply to banks and certain other financial organizations.

Failure to obtain FAS clearance may result in fines for the acquirer and its officials. Transactions which are not duly authorized by FAS may also be declared invalid. If FAS clearance was required for setting up a company and it was not obtained, the company may, in certain cases, be liquidated or reorganized.

In 2008, new legislation was passed to regulate foreign investment in companies with "strategic value for national defense and national security". The new law contains a list of strategic industries, including nuclear waste handling, geology and exploration of certain mineral resources, arms and military technology research and development, fishing and development of the continental shelf, aerospace, aviation, media and publishing and subsoil use in respect of specified subsoil land plots.

Acquisition of shares (above specified thresholds) in Russian companies engaged in the strategic industries requires prior authorization from a special government foreign investment commission. The respective application is filed with FAS as well.

### Financial services regulation

As in many other jurisdictions, financial services are highly regulated in Russia and before providing such services, a company may need to obtain a license or otherwise register with the relevant regulator.

On 1 September 2013, the Central Bank became the single "mega" regulator for the entire Russian financial market. Its functions are very broad and include supervising commercial banks and non-banking financial institutions (such as insurance companies, pension and investment funds, brokers, etc.), regulation of foreign exchange, issuance of and trading in securities and many others. The functions previously carried out by the Federal Financial Markets Service (FSFR) have now been transferred to the Central Bank.

### Data protection

The main sources of data protection regulation in Russia are the law on Data Protection and the law on Information, Information Technologies and Information Protection. Various provisions on data protection may also be found in the Russian Labor Code and subordinate legislation.

As a general rule, any processing of personal data requires the explicit consent of the natural person whose data is processed (data subject). However, there are various exceptions to this rule. For example, the data subject's consent is not required if processing of his personal data is necessary to perform a contract between the data subject and the data processor. A company is also allowed to process personal data without the data subject's consent if it is necessary to perform such company's statutory obligations.

Processing of certain categories of personal data (such as data relating to an individual's health, private life, nationality, race, political or religious views) is subject to stricter rules and in most cases can be carried out only with the explicit and written consent of the data subject.

Any natural person has the rights to:

- Access personal data related to them
- Require the processor to delete such data if its processing is illegal or if the data is not necessary for the purposes for which it is processed
- Require that their data be corrected or updated
- Revoke their previously given consent to personal data processing, in which case, the processor must promptly comply with such request

(except where the processing is permitted without the data subject's consent).

In order to start personal data processing in Russia, the data processor must send a notification to the Russian Federal Service for Supervision of Communications, Information Technologies and Mass Media (Roscomnadzor). This rule also has some exceptions. In particular, employers processing their employees' personal data without transferring it to third parties are exempt from this requirement.

Data processors must take appropriate technical and organizational measures against unauthorized or unlawful processing, accidental loss, disclosure or damage to personal data. Various technical requirements specifying such measures are set out in subordinate legislation.

It is worth noting that on 1 September 2015 Federal Law No. 242-FZ On Amending Certain Legal Acts of the Russian Federation to Clarify the Procedure for Processing Personal Data in Information and Telecommunication Networks dated 21 July 2014 will come into force. At that point, a number of new provisions will be added to Russian legislation, the most significant of which is the following: "When collecting personal data, including over the Internet information and telecommunications network, the operator must ensure that the recording, systematization, compilation, storage, modification

(updating, alteration), and extraction of personal data of citizens of the Russian Federation is done using databases located on the territory of the Russian Federation". The wording of the above rule is uncertain and even politicians hold different positions on what it means. In particular, there is no clear answer to the question about the possibility of creating a "duplicate" database of Russian citizens' personal data outside of Russia after the law becomes effective. Thus, it must be admitted that actual interpretation of the new rules will be determined by Roscomnadzor, which continues to be silent on its official position as to the actual meaning of the regulation.

Failure to comply with the data protection legislation may result in administrative fines, suspension of the data processor's business or, in the most serious cases, criminal prosecution and even imprisonment. Moreover, from the time when Federal Law No. 242-FZ takes effect personal data subjects will be entitled to request of Roscomnadzor that it take measures to restrict access to information processed in violation of Russian personal data legislation (in other words, personal data subjects will be given the ability to initiate the blocking of access to those web sites on which their personal data is being processed in violation of Russian law). However, a court ruling confirming violation of the data subjects' rights will be necessary to enforce the power under consideration.

# Employment and Migration



## Governing legislation

Employment issues are governed primarily by the RF Labor Code (the “Code” or “Labor Code”). Pursuant to Article 5 of the Labor Code, regulatory provisions on employment relations may also be adopted by (i) other federal laws, (ii) decrees of the RF president, (iii) resolutions of the RF government, (iv) regulatory acts of federal executive authorities, (v) regulatory acts of the constituent members of the Russian Federation, (vi) acts of local authorities and, (vii) corporate bylaws. Article 423 of the Code confirms that aspects of former USSR legislation continue to apply in the Russian Federation to the extent not in conflict with the Russian Constitution or the Code. Thus, legislative gaps may be filled, as necessary, by USSR acts on certain labor law issues (e.g., compensation for work in Far North regions, certain social security allowances, etc.), in respect of which new Russian legislation has not yet been adopted (or has not yet entered into force).

Article 5 of the Labor Code establishes the precedence of the Code over all other federal laws containing labor law provisions. Another basic principle established by Article 5 is that newly adopted federal laws contradicting the Code will apply only after relevant amendments are made to the Code.

## Types of employment contracts

The Labor Code distinguishes between two types of employment contract: (i) unlimited-term contracts, and (ii) fixed-term contracts for up to five years, unless a longer term is established by the Code or other federal laws (Art. 58 of the Code). There is a strong legal preference for unlimited-term employment contracts, and this preference has been confirmed by Russian courts.

## Fixed-term employment contracts

Fixed-term employment contracts may be concluded for five years maximum and only under an

exhaustive list of grounds directly stipulated in Article 59 of the Labor Code. The list is extensive; however, many of its items are (industry) specific and rarely referred to.

The legal ground for signing a fixed-term employment contract (with reference to the specific provision of the Labor Code) should be indicated in the employment contract and supported by documents.

The main grounds for signing a fixed-term employment contract that are used in practice are the following:

- For the period of performance of duties of an absent employee
- For the performance of work outside the normal business of the employer (refurbishments, installation and adjustment, other work), and work relating to an inherently temporary (up to one year) expansion of production or services

- With persons hired to perform specific work in cases where completion cannot be determined as a specific date
- With old-age pensioners
- With directors (sole executive body), deputy directors, and chief accountants
- With persons in secondary employment (i.e., for whom the job is not the main one).

### Probation period

If the employment contract so provides, an employee may be engaged on a trial basis for up to three months (except persons hired in the capacity of general director (individual executive body), deputy general director, chief accountant, deputy chief accountant, heads of branches or representative offices or of other separate structural divisions of the company, for whom a longer probation period of up to six months is allowed). This probation period must be envisaged by the employment contract. Probation periods cannot be applied, in particular, to (i) pregnant women, (ii) employees under the age of 18, (iii) newly qualified graduates of institutions of higher, secondary and primary education who are hired for the first time after graduation in a position corresponding to their professional qualification for one year from graduation, (iv) in cases of transfers from another employer, etc. (Art. 70 of the Code).

If the result of the probation period is unsatisfactory, the employer may

dismiss the employee according to the simplified procedure, namely with three days' written notice indicating the reasons for their dissatisfaction. During the probation period the employee may also resign according to the simplified procedure, by serving the employer three days' written notice.

### Working hours

The normal working hours in Russia are 40 hours per week. Most employees work five days per week, eight hours per day with a one-hour lunch break. Some categories of employees must work reduced hours (e.g., those working in specific harmful or hazardous conditions, minors aged under 18 years, etc.).

Under a general rule, during the working day the employer must provide the employee with a break for meals and rest lasting from 30 minutes up to two hours, which is not included in the working time.

An employee may be required to work overtime only if they have consented to it in writing (except for cases specified by law, which mostly concern emergency situations). A consultation with the trade union (if any) is also generally required for overtime work. Overtime work is not permitted for employees who are pregnant, for minors, and in some other instances envisaged by the law. Overtime work must be paid at increased rates.

If an employee's working hours are defined in the employment contract as "unrestricted" (*nenormirovanniy rabochiy den*), such employee may

occasionally be required to work overtime and the above-described rules on additional pay and consultation/consent will not apply to such overtime work. However, such employees are entitled to at least three additional days of annual holiday.

### Vacation

The standard paid annual holiday is 28 calendar days. An employee becomes eligible for the main annual paid vacation after having worked six months continuously.

### Maternity leaves

Statutory maternity leave is (generally) 140 days compensated at capped rates from state funds. Thereafter, a mother may choose to stay at home until the child is three years of age and to receive reduced maternity pay. The employer must keep the employee's position open during her leave and reinstate her in her position upon expiry of the three-year period or earlier, if the employee wishes to return to work.

### Equal treatment

The Labor Code prohibits any direct or indirect discrimination in the work place on the grounds of gender, nationality, origin, marital status, age, religious and political beliefs or other grounds that do not relate to the employee's professional qualities.

An individual who has been refused a job has the right to request a written explanation of the reasons for such refusal, and the company must comply with this request.

A company must not refuse to employ a woman on the grounds of her pregnancy or having children under the age of three, or dismiss a woman on these grounds; such refusal or dismissal is a criminal offense.

The Labor Code does not contain any express provisions prohibiting sexual or other forms of harassment at work. However, some forms of harassment may constitute a criminal offense.

### Termination of employment

The employer can dismiss its employees in the following circumstances:

- Winding-up of the employer
- Redundancy
- Professional incompetence of the employee
- Repeated failure by the employee to carry out their duties
- Single gross misconduct (e.g., unjustified absence from work for more than four consecutive hours, being drunk at the work place)
- Disclosure of the employer's sensitive commercial information or personal data of other employees
- Theft, destruction of or damage to the company's property (if confirmed by a court or other competent state authority)

- Presenting false documents to the employer when being hired
- Certain other circumstances.

In cases of unlawful dismissal, the employer may be forced to pay employees their average salary over the period of unemployment until they are reinstated in their former position by a court.

Employees cannot waive their statutory rights, including the right to file a claim against the employer for wrongful dismissal or other breach of their employment rights. Any kind of agreement to this effect will be unenforceable.

Employees dismissed in a redundancy situation are entitled to compensation of between a base salary for three months and an average salary for five months. When selecting employees for redundancy, the employer must try to retain certain categories of employees (including those with two or more dependents).

When the employer wishes to part with the employee it commonly offers a settlement agreement, which as a rule implies payment of some compensation to the employee for leaving the company.

### Pay

A minimum monthly salary is set by the Federal Law on the Minimum Wage No. 82-FZ of 19 June 2000 (as amended); it is equal to RUB 5,965 (higher rates may be set for constituent territories of the Russian Federation, for example, in Moscow

the minimum monthly salary is RUB 15,000).

### Immigration control

Rules on immigration and employment of persons subject to immigration control can be found in various Russian statutes, including the laws on the Status of Foreign Citizens in Russia, on entry to and exit from the Russian Federation and on Migration Records for Foreign Citizens and Persons without Citizenship.

### Visa requirements

Many foreigners require a visa to enter Russia. Visas are issued by the Russian consulate of the country in which the applicant resides. Consulates should be able to give further guidance on visa requirements. Business travelers normally need a business visa, which is issued usually on the basis of an invitation from a Russian organization accredited with the Ministry of Foreign or Internal Affairs. For citizens of the European Union and the US, the invitation can be issued by any Russian host company, and no accreditation is required. Most business visas give the opportunity to stay in Russia only for 90 days within each period of 180 days.

Some Russian cities and towns have restricted entry regulations. As a result, foreigners have to undergo stricter than usual passport controls.

### Registration

Upon arrival, foreign visitors normally need to register with the local migration service if they are staying in Russia for more than seven



working days (or one month, in case of citizens of Kazakhstan, Belarus and Armenia). Hotels normally handle registration formalities; however, if one is staying with a friend or in a company flat, the host or the landlord will need to take care of the registration. Highly qualified specialists (see the 'Working in Russia' section below) and their family members have 90 calendar days from the date of their arrival to register with the local migration service.

### Working in Russia

To work in Russia foreign citizens (unless they hold a permanent or a temporary residency permit in Russia) need a work permit. Obtaining one is not straightforward: first, the employer needs to obtain:

(i) a so-called "quota" (a permit to hire a certain number of foreign workers); (ii) then a permit to employ foreign citizens; (iii) and separately a work permit for a particular foreign employee. Obtaining a quota can take up to one year. Certain positions are exempt and do not fall within the quota (mostly actors, musicians, high-level managers, engineers, producers, etc.). Even if a position is exempt from the quota requirement, it can still take 90-120 calendar days to obtain a permit to employ foreign citizens and a work permit. Hiring permits and work permits are valid for one year.

Citizens of Ukraine, Moldova, Azerbaijan, Kyrgyzstan, Uzbekistan and Tajikistan are required to obtain only a patent to work in Russia. Obtaining such patent takes 2-3 weeks.

Obtaining a work permit or a patent requires foreign citizens to provide the migration authorities with certain documents, including:

- Medical certificates confirming absence of the following infectious diseases (HIV infection, leprosy (Hansen's disease), tuberculosis, syphilis, clamidiosis, lymphogranuloma (venereal) chancroid) and drug addiction
- A certificate confirming his/her knowledge of Russian, Russian history and basic Russian Federation law
- A diploma or other document confirming higher (professional) education – duly legalized copy.

Citizens of Kazakhstan, Belarus and Armenia do not require any permits or patents to work in Russia.

Foreign citizens whose gross salary under a local employment contract is at least RUB 167,000 per month can use a special simplified procedure for obtaining a work permit prescribed for highly qualified specialists. Obtaining the work permit under such procedure has the following advantages:

- No "quota" is required for the employer
- A work permit can be issued for any position and for the term of the employment of the employee, but not for more than three years (renewable using the same simplified procedure)
- The period for obtaining such work permit is 3-4 weeks
- No medical certificates, certificate confirming his/her knowledge of Russian, Russian history and basic Russian Federation law or diploma are required
- The salary (remuneration) of a highly qualified specialist is always subject to Russian personal income tax at the lowest rate of 13 percent; and some other advantages

The formalities necessary for obtaining a work permit may only be commenced after the company has been incorporated. As a result, a company cannot appoint a foreign chief executive officer or employ foreign citizens immediately upon its incorporation. If a foreign general

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The standard paid annual holiday is 28 calendar days. An employee becomes eligible for the main annual paid vacation after having worked six months continuously.

director is required for a Russian company, its founder(s) usually first appoint(s) a Russian national on a provisional basis until the necessary permits are obtained.

A foreign national may be a general director or a member of a collegiate executive body in any Russian company, provided that they have a valid work permit or a permanent or temporary residency permit.

The members of the board of directors of a Russian company are normally not employed by such company. Accordingly, foreign citizens do not need a work permit to be on the board of a Russian company.

Performing installation works / maintenance and service works in relation to technical equipment produced abroad does not require obtaining work permits and work visas for employees of a foreign supplier or manufacturer of such technical equipment. Such employees of the foreign supplier or manufacturer receive so-called visas for "technical services".

Visas for "technical services" are issued for engineers and other foreign employees holding blue-collar positions.

### Secondment

It should be noted that Russian law does not at present regulate staff leasing (also referred to as outstaffing, outsourcing, or secondment) – although in practice staff leasing is widely used in Russia. In recent years there have been ongoing attempts to introduce statutory regulation of staff leasing, with fierce debate over whether there should be a full ban, or use should be permitted subject to certain limitations.

A federal law regulating staff leasing was finally adopted last year and will enter into force on January 1, 2016. Starting from January 1, 2016 staff leasing will be permissible only subject to certain conditions:

- Staff can be leased from a staffing agency or an affiliated company, or from a company party to a shareholders' agreement with/ with regard to the receiving party.

- Staff leasing agencies must be accredited (the accreditation procedure is not yet regulated).
- The federal law regulating staff leasing from an affiliated company has yet to be adopted.
- Staff leases must be temporary (maximum three years for staff leased from affiliated companies as per the draft law; the lease period from a staff agency is unclear, in some cases it is nine months).
- Additional documentation is envisaged for leased staff (annexes to employment contracts, entries in labor books, etc.).
- Employees leased from staff agencies cannot be used in specific harmful/ hazardous environments, or in jobs that require licenses or other special permits for the receiving company.
- The law establishes that the receiving party has subsidiary (additional) liability for the obligations of the employer arising from its employment relations with the supplied staff, including the obligation to pay salary.

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