



# Business Guide Russia

Bech-Bruun/Mannheimer Swartling

Danske Bank

PricewaterhouseCoopers

## **Preface**

“Business Guide Russia” is intended as a preliminary exploration of the questions that typically arise when a company wishes to enter the Russian market.

This guide has been edited in cooperation between Bech-Bruun/Mannheimer Swartling Ryssland Advokataktiebolag, PricewaterhouseCoopers and Danske Bank/CaRisMa Consulting.

The guide is not intended to cover all issues arising in relation to activities in Russia. However, we hope that it will provide an overview of typical issues.

Independent professional advisory services of a legal, fiscal, financial or marketing nature are indispensable and usually a good investment.

Bech-Bruun/Mannheimer Swartling Ryssland Advokataktiebolag, PricewaterhouseCoopers and Danske Bank/CaRisMa Consulting cannot be held liable for any misinterpretation of the information presented in this guide.

The guide will be featured on the following Web sites, which will be updated regularly: [www.bechbruun.com](http://www.bechbruun.com), [www.mannheimerswartling.se](http://www.mannheimerswartling.se), [www.pwc.com](http://www.pwc.com), [www.danskebank.com](http://www.danskebank.com)

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## **Bech-Bruun**

Bech-Bruun is one of Denmark's leading full-service law firms with 480 employees (230 fee earners), which places Bech-Bruun as one of the largest law firms in Denmark. The firm has 66 partners and is a true partnership organised in legal specialist groups. Bech-Bruun is a full-service law firm providing client-focused, interdisciplinary legal services.

Bech-Bruun's long experience and in-depth industry knowledge are leveraged to serve our diverse client base, which includes multinationals, public authorities, organisations, small entrepreneurial companies and private individuals.

As one of the leading law firms in the Nordic region, Bech-Bruun has the specialist, commercial and human resources necessary to provide comprehensive, tailored and value-added solutions to its clients.

Bech-Bruun was present in Russia with an office in Moscow from 1996-2007. Having operated through the most turbulent period of recent Russian history, Bech-Bruun has gained invaluable experience on how to navigate in the complex and rapidly changing business and legal environment. Furthermore, Bech-Bruun has obtained a comprehensive knowledge as to the legal services market in Russia.

On this basis Bech-Bruun is able to assist clients in identifying the legal and commercial challenges facing Western businesses in Russia and - acting as a value-adding intermediary - in choosing the most suitable provider of legal services for the individual client.

For more information go to: [www.bechbruun.com/en](http://www.bechbruun.com/en)

## **Danske Bank**

Danske Bank is the largest bank in Denmark and a leading player in the Scandinavian financial markets. The Danske Bank Group - which includes Danske Bank, Realkredit Danmark, Danica Pension and a number of subsidiaries - offers a wide range of financial services, including insurance, mortgage finance, asset management, brokerage, real estate and leasing services.

In Denmark, Norway, Sweden, Finland, Northern Ireland, the Republic of Ireland, Estonia, Latvia, Lithuania and Russia, the Group serves 5 million retail customers and a significant part of the corporate, public and institutional sectors. It also has a large number of international corporate clients, particularly in the northern European markets. Some 2.3 million customers use the Bank's online services.

Sampo Bank serves customers of 123 branches in Finland and 46 branches in the Baltic states.

Danske Bank also has branches in London, Hamburg and Warsaw. Moreover, a subsidiary in Luxembourg specialises in private banking services.

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## **Mannheimer Swartling**

Mannheimer Swartling is the leading Swedish law firm and a full service firm with extensive international practice [Law Firm of the Year – Northern Europe, PLC Which Lawyer – 2007]. With some 450 lawyers in twelve offices, the firm provides legal advice to many Nordic and multinational corporations, financial institutions and organisations.

Mannheimer Swartling has a long history in Russia. The firm opened its first Russian office in 1990 and was the first European law firm which established itself in the then Soviet Union. The firm's Russian practice involves a broad range of advisory and transactional work, including M&A and corporate, real estate, banking and finance, litigation and arbitration, competition, intellectual property and information technology, as well as environmental and labour law. The firm has two full-service offices in Russia located in Moscow and St. Petersburg and employs over 50 Russian and foreign lawyers. The Russian practice is fully integrated in the firm and benefits from the entire firm's experience and expertise. Over the years Mannheimer Swartling has gained a thorough understanding of the Russian legal market and business environment and is able to offer its clients high quality legal advice in all areas of business law and cross-border transactions.

*The firm's Russian M&A and Corporate Practice group* regularly act in corporate establishments and the setting up of joint ventures, mergers and acquisitions including due diligence, corporate structuring and restructuring, liquidation as well as purchases and sales of business'.

*The firm's Russian Real Estate Practice group* advises on real estate transactions with regard to transaction structures, due diligence, public filings and registration and assist in construction projects as well as commercial leases. The firm is also experienced in advising both operators and owners in connection with the construction and management of hotels.

*The firm's Russian Banking & Finance Practice group* covers all areas of financing such as corporate lending, acquisition finance, project finance, asset-backed finance, real estate financing, regulatory issues and structured finance.

*The firm's Russian M&A and Corporate Practice group* regularly acts as counsel or arbitrators in international disputes referred to the Arbitration Institute of the Stockholm Chamber of Commerce, the International Chamber of Commerce and the Commercial Arbitration Court at the Russian Federation Chamber of Commerce and Industry. In addition, the group is one of few international law firms that handle court cases in Russian courts.

For further information, go to [www.mannheimerswartling.se](http://www.mannheimerswartling.se)

## **PricewaterhouseCoopers**

Multinational businesses are increasingly affected by tax, legislative and regulatory changes throughout the world. Understanding the impact of such changes on business operations and transactions between countries is vital for a company's survival.

The network of PricewaterhouseCoopers' international tax-structuring professionals is experienced in addressing such issues and issues of international taxation. Their teams are able to help you structure your business in a tax efficient manner, both locally and globally.

PricewaterhouseCoopers can help you prepare efficient cross-border strategies and manage your global structural tax rate. They will also keep you up to date on changes in the international arena that affect your business.

For more information, go to [www.pwc.com](http://www.pwc.com)

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## 1 Facts about Russia

### 1.1 Russian economy and politics

The Russian Federation was founded following the dissolution of the Soviet Union in 1991. Over the past six to seven years, it has been one of the world's fastest growing major economies driven by windfall oil revenues and rapid financial deepening. Russia is a permanent member of the United Nations Security Council, a member of the G8, and is a leading member of the Commonwealth of Independent States (CIS).

#### 1.1.1 Prospects for the Russian economy

Following years of very high growth spurred by a favourable external environment, rising oil and gas prices, and easy monetary and fiscal conditions, things are about to change for the Russian economy. Domestic demand will cool, the key drivers being slumping investments - especially in the construction sector - and slowing private consumption growth. The rouble will come under pressure as external balances worsen, and the central bank is expected to gradually let it slide versus its currency basket in 2009-10. Foreign exchange reserves are expected to drop significantly in the coming years, and the Russian government will have to bring some of its fiscal reserves into play to stimulate the economy.

#### 1.1.2 Facts

##### 1.1.2.1 Politics

###### Official name

Russian Federation

###### Form of government

Federal semi-presidential republic

###### Parliament

Bicameral system: The Federal Assembly of Russia, which consists of the Federation Council (upper house) and the State Duma (lower house).

###### Election system

Universal suffrage for citizens age 18 or above

###### Head of state

The president is elected by the people for a four-year term. The current president is Dmitry Medvedev, and he is independent as all former Russian presidents were. The president is the head of state.

###### Primary political parties

United Russia is the largest party in The Federal Assembly of Russia and has constitutional majority. Prime Minister Vladimir Putin is currently chairman of the party.

Communist Party of the Russian Federation is the second largest Party in The Federal Assembly of Russia.

Liberal Democratic Party of Russia is the third largest party in The Federal Assembly of Russia.

Fair Russia is the fourth largest party in The Federal Assembly of Russia.

###### Central bank

The Central Bank of the Russian Federation is an independent central bank. Its main function is to protect the stability of the national currency.

###### International relations

A member of the UN (and the UN Security Council), the G8, BIS, the OSCE and the WTO (observer), among other organisations.

#### 1.1.2.2 Economic indicators and demographics

##### Population

142 million (March 2008 est.)

##### Religion

Russian Orthodox, Islam, Judaism, Buddhism are traditional religions. Furthermore these are a number of other religions.

##### Languages

Russian, many minority languages

##### Currency

Rouble (RUB)

##### Social and economic indicators

Russia's GDP was USD 2.076tn (est. PPP, 2007), the 6th largest in the world.

Overall fertility rate: 1.4 children born per woman (2008 est.).

Life expectancy: total population: 65.94 years; males: 59.19 years; females 73.1 years (2008 est.).

## 2 Judicial system

### 2.1 The court system

At federal level, the Russian court system consists of the Constitutional Court, the federal courts of general jurisdiction and the arbitrazh (commercial) courts. At Russian-Federation-subject level, for example in Tatarstan and Krasnodarskiy Krai, the system encompasses constitutional courts and magistrates.

The Constitutional Court of the Russian Federation resolves issues of compliance of federal and regional legislation with the Constitution of the Russian Federation, and competence disputes between federal authorities and authorities of the Federation subjects. Furthermore, it interprets the Constitution. Subjects of the Russian Federation have their own constitutional courts or other special judicial bodies that resolve issues of compliance of regional legislation with the fundamental law of the subject.

Federal courts of general jurisdiction and magistrates hear a wide range of criminal and civil cases as well as administrative cases.

The arbitrazh courts resolve commercial disputes that arise between legal entities or registered entrepreneurs and administrative disputes between companies or registered entrepreneurs and state authorities.

### 2.2 The arbitrazh courts

The arbitrazh (commercial) courts are state courts that resolve commercial and certain administrative disputes. Their name originates from Soviet times when disputes between state enterprises were heard before the "state arbitrazh". The arbitrazh courts should be clearly distinguished from both domestic and international arbitration.

Today arbitrazh courts are specialised courts that resolve property and commercial disputes between legal entities and registered entrepreneurs. They also examine claims seeking invalidity of governmental acts allegedly violating rights and legitimate interests of registered entrepreneurs or legal entities. Such claims include tax, land and other disputes arising out of administrative, financial and other legal relations. Arbitrazh courts also hear disputes that involve foreign legal entities or citizens.

Rules of procedure in arbitrazh courts are different from procedural rules that apply to civil cases heard in courts of general jurisdiction: In arbitrazh courts the Code of Arbitrazh Procedure applies.

The system of arbitrazh courts operates at four levels. The first level consists of the federal arbitrazh courts that act as courts of first instance.

The second level has 20 arbitrazh appellate courts. The arbitrazh appellate courts fully re-examine cases with respect to matters of both fact and law.

The third level comprises ten federal circuit arbitrazh courts. Each of them functions as a court of cassation dealing only with questions of procedural and substantive law.

The fourth level is the Supreme Arbitrazh Court of the Russian Federation, which is the superior judicial body for deciding commercial disputes and other cases handled by the arbitrazh courts. The Supreme Arbitrazh Court enjoys a right to review, at request of the parties, cases heard by the arbitrazh courts of the Russian Federation after legal judgments have come into force. It also ensures consistency in interpretation and application of law by the arbitrazh courts.

Historically, the rules of civil procedure in Russia have been inquisitorial as the rules of other continental law jurisdiction and not adversarial. However, the new Code of Arbitrazh Procedure, adopted in 2002, significantly limited the power of the courts to collect evidence independently of the parties' initiative, thus taking the procedure in a more adversarial direction.

In contrast to courts of general jurisdiction, arbitrazh courts tend to rely primarily on documentary evidence rather than on witness and expert statements.

A relatively short trial period is one of the main advantages of the arbitrazh courts. The law provides for a three-month period starting on receipt of the statement of claim and ending at the rendering of a final judgment. This period is, however, usually longer but rarely exceeds one year.

### 2.3 Russian courts in practice

While every national court system has its own characteristics, the Russian court system works differently from courts in western jurisdictions. Russian courts operate within the framework of Russian society, and the limitations of the Russian administration are mirrored in the working of the courts. Leaving aside political and economic factors, some specific features of the Russian court system deserve to be mentioned.

First, it is important to bear in mind that many Russian judges certainly match the professional standards of their western peers, but others, notably those trained in different time under a different regime, are less familiar with many of the principles that characterise a nation under the rule of law. One obvious trait among many Russian judges is their tendency to apply statutes and contractual provision literally, even in situations where the result will appear odd. Arguments related to the purpose and systematics of statutes or contractual provisions will usually be trumped by a literal interpretation of the wording. Therefore, it is advisable to explicitly state contractual obligations and not to rely on a general duty of the parties to do everything to fulfil their contractual claims. For example, successful suing because of a violation of unwritten side duties will be difficult.

While court proceedings in all countries have a tendency to be conducted by the parties like a chess game, this is even more so the case in Russia:

The parties have to send their briefs only three days before a hearing, and distribution of briefs to the parties by courts is not common. Judges have 30-40 cases to prepare for a hearing day, and they have a tendency not to take into account lengthy arguments that are not easy to explain.

When deciding to litigate in Russia, it is important to know whether litigation will take place in St. Petersburg or in Moscow or in the provinces. In the latter case, a lower level of legal professionalism can be expected, and judges in such cases have a tendency to side with more formalistic arguments. Also, suing the main employer in a region may lead the court to take into account non-legal considerations in its decision.

In short, while achieving justice in Russia is not impossible, obstacles exist that are not present in western jurisdictions. But the picture is not as bleak as is commonly assumed – about 80% of the claims made against tax authorities are successful.

#### **2.4 International commercial arbitration in Russia**

As an alternative to the arbitrazh courts, parties may refer their commercial disputes to ad-hoc arbitration or arbitration institutes located in or outside Russia.

Russia is a party to multiple bilateral investment treaties under which investment disputes can be referred to arbitration.

Russia is a party to the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards (New York Convention). Under the convention, foreign arbitral awards can be enforced in Russia, while arbitral awards rendered in Russia can be enforced in jurisdictions of other states that are parties to the New York Convention.

Russia is also a party to the European Convention on International Commercial Arbitration of 1961. The Russian Law on International Commercial Arbitration of July 7, 1993, is based on the Model UNCITRAL Law.

Russia's leading arbitration institution is the International Commercial Arbitration Court at the Russian Federation Chamber of Commerce and Industry (ICAC). One of the advantages of arbitration at ICAC is low costs in comparison with foreign arbitration institutions.

Arbitrability of disputes is a contradictory issue in Russian legislation. In accordance with the provisions of the Code of Arbitrazh Procedure, arbitrazh courts have exclusive competence over the following disputes with a foreign party:

- Disputes over state property, privatisation of state property and compulsory alienation of property for state needs
- Disputes over real property located in Russia
- Disputes over granting and registration of intellectual property rights

- Disputes over invalidation of entries to state registers
- Disputes over organisation, registration and winding-up of legal entities or registered entrepreneurs in Russia as well as disputes related to the challenging of resolutions made by management organs of legal entities in Russia

Many courts take the position that the disputes listed above are not only excluded from jurisdiction of foreign public courts but also are not arbitrable. In practice, this means that even if a party to a dispute has an award rendered in its favour in arbitration abroad, the Russian courts may deny enforcement stating that the dispute is non-arbitrable under Russian law.

History is full of decisions by Russian courts denying enforcement of foreign arbitral awards. Several of these decisions were based on grounds which are not in conformity with the general practice of courts in western jurisdictions. While enforcement of foreign awards in Russia is possible and occurs in practice, it is not a smooth process that has a positive result in all cases.

### 3 Setting up business in Russia

Generally, a foreign entity has three options when setting up business in Russia<sup>1</sup>:

- Hire a Russian individual to act for the company in Russia
- Set up a representative office or branch office
- Set up a company in the form of a limited liability company or a joint stock company

The choice of strategy has both management and tax consequences, and while some entities, for example a representative office or a branch, may be a good solution in the initial phase, they may not be legal or suitable for further expansion of the company's business.

#### 3.1 Hiring an individual

The easiest and fastest way for a foreign entity to start business in Russia is often simply to hire an individual without establishing a registered presence through a subdivision or company. But employing a person for this purpose requires careful screening and good knowledge of the individual. Generally, an individual may be hired either as a consultant under a civil law (service) contract or as an employee under an employment contract. These two options are described below.

##### 3.1.1 Employment vs. civil law (service) contract

Employment agreements are governed by the Russian Labour Code. The code lays down a number of rules that must be observed if the employee is a Russian citizen and the work is performed in Russia. These rules are at least as beneficial to the employee as are the labour law provisions in the Scandinavian countries. Service contracts, on the other hand, are governed only by general civil law. In practice, this means that the contracting parties are free to contract as they wish, and normally, consultants rendering services under civil law contracts do not enjoy the protection of the Labour Code. No mandatory rules apply to salary, overtime, vacation or termination of contract. The parties are also free to agree on the law to govern the contract.

Generally, the advice to a foreign entity that does not yet maintain a presence in Russia but wishes to hire an individual for its services is to hire an individual as a civil law consultant and not as an employee. This will allow greater flexibility in the entity's relations with the individual. It will also allow the entity to avoid the mandatory rules of Russian labour legislation. Furthermore, it is recommended that the civil law consultant be registered as an individual entrepreneur for the reason described below.

##### 3.1.2 Income tax payments and social fees

An entity that hires a Russian person to perform work in Russia either as a civil law consultant or as an employee would normally have to withhold and pay income tax and pay social fees for that person. But if an individual hired under a civil law (service) contract has registered with the Russian authorities as an individual entrepreneur, the foreign entity does not need to

withhold or pay any taxes or social fees in Russia. Instead, the individual entrepreneur must make these payments, and the entity that hired the individual cannot be made liable for amounts due. Obviously, it is vital that a foreign entity which hires a person as an individual entrepreneur carefully checks that the person is duly registered.

##### 3.1.3 Office space and office equipment

Under Russian law, a foreign entity may rent an office and maintain office equipment there.

A better solution in many cases is, however, to have the Russian individual lease the office space and the office equipment directly from the landlord and reimburse the individual for the lease payments. This will limit the exposure of the foreign entity in Russia. Having the individual lease the office space and the equipment also has the advantage of further reducing the risk that the individual will be regarded as an employee and thus be covered by the Labour Code because the leasing of office and equipment shows that the individual is prepared to take a business risk.

#### 3.2 Representative office and branch office

While hiring an individual on a consultancy basis may be a suitable first step into Russia, activities on a larger scale or the need of the foreign investor to show a more visible presence in Russia will require registration of an entity in Russia. The two simplest and most common forms of a registered presence in Russia is the representative office or the branch office. While they share many characteristics, there are also a few differences worth noting, as described below.

##### 3.2.1 Representative office

A representative office is an office of a foreign entity opened to perform support functions for that entity. It is not a legal entity but a sub-division of the foreign entity that established it. This means that the foreign entity is liable for the debts and obligations of the representative office in the same way as it is liable for own debts and obligations.

A representative office of a foreign entity may, as described in Russian legislation, engage in activities that involve co-operation between Russian and foreign entities, such as finance and investment, science and research, transport, tourism, and marketing and promotion. It may carry out ancillary functions of the foreign entity and promote its business. But a representative office may not generate profits, that is engage in full-scale commercial activity, such as production, warehousing and export/import operations.

In reality, however, many representative offices do engage in commercial activities, most often by rendering consultancy services, but they are effectively barred from commercial activities which entail import or export of goods. The Russian authorities have accepted this practice for nearly two decades on the assumption that representative offices carrying out commercial activities pay all taxes associated with such activities.

<sup>1</sup> This guide does not deal with a fourth option: acquisition of a Russian company or groups of company

The tax rules for a representative office carrying out commercial activities are very similar to those that apply to a Russian company. Tax regulation is described in more detail in Section 4.

Representative offices may employ local personnel and rent offices. They may pay salaries to their employees in roubles or in hard currency, whereas Russian companies may pay salaries in roubles only. Representative offices can open Russian bank accounts only of the types that may be used for their own internal needs, and the use of these accounts is limited to payments directly related to the activity of the representative office.

A representative office of a foreign entity must be accredited with the relevant Russian authority. There are several such authorities, and accreditation is always carried out in Moscow regardless of where the representative office will be located. An accreditation is valid for a maximum of three years, after which it can be prolonged. Prolongation of accreditation has traditionally never been a problem.

Accreditation ensures the representative office exemption from VAT on payments under office space leases. The representative office must also be registered with the tax authorities regardless of whether it carries out commercial activities or not. It is also required by law to comply with all Russian accounting rules and principles, and the accounts must be audited each year. Tax is paid annually on the basis of an assessment made by the tax authorities.

### 3.2.2 Branch office

Just as the representative office, a branch office is a subdivision of a foreign entity. As such, it does not constitute a legal entity; it is merely a part of the entity that created it and therefore remains liable for its debts and obligations. But in contrast to the representative office, a branch office is expressly permitted to carry out commercial operations, engage in production and import and export of goods, and open and operate Russian bank accounts for such purposes. Like representative offices, a branch office can pay salaries to its employees in roubles or hard currency.

As is the case with representative offices, a branch office must keep accounts that accurately reflect its financial activities. The accounts must be audited each year. It must also be registered with the tax authorities whether or not the activities are recognised as yielding taxable profits (income). Tax is paid annually on the basis of an assessment made by the tax authorities.

Any branch of a foreign company must be accredited by the relevant authority, that is the State Registration Chamber of the Ministry of Justice, which is the only competent accreditation body. An accreditation of a branch is valid for five years, after which it can be prolonged. Prolongation of accreditation is usually not a problem.

### 3.2.3 Accreditation

To register a representative office or branch office, a foreign entity must submit an application to the appropriate state body accompanied by the following documents:

- Charter or articles of incorporation (articles of association, or equivalent) of the founding foreign entity
- Registration certificate, certificate of incorporation or extract from the trade register of the foreign legal entity certifying that the parent is a validly existing legal entity under the legislation of its home country
- Resolution of the founding foreign entity to establish the representative office/branch office in the Russian Federation and to appoint the chief representative(s)
- Regulations governing the operations of the representative office/branch office
- Bank letter confirming the good credit standing of the founding foreign entity
- Document confirming co-ordination with the regional authorities of the Russian Federation on the establishment of a representative office/branch office (not required for representative offices/branches to be located in Moscow)
- General power of attorney issued to the chief representative(s) (for representative offices) or manager(s) (for branch offices)
- Power of attorney to submit accreditation application on behalf of the founding foreign entity
- Accreditation card containing information on the representative office, filled out in accordance with a sample form of a particular accrediting body and signed by an authorised representative of the founding foreign entity
- Certification from the tax authorities in the country of the founding foreign entity's incorporation confirming that the foreign legal entity is registered as a taxpayer and specifying the taxpayer identification code (applicable only to representative offices)
- Expert opinions from the respective ministries of the Russian Federation as required by national statutes for certain types of activity (applicable only to branch offices)
- Two letters of recommendation from Russian trading partners (applicable only to representative offices)
- Copy of lease agreement or landlord guarantee letter, together with confirmation of the landlord's right to the property to be leased (applicable only to representative offices)
- Documentation of payment of registration fee (applicable only to representative office)

### 3.3 Company

Most foreign entities that contemplate a permanent presence in Russia and commercial activities of any scale will eventually need to consider setting up a company. One important factor to consider is that often a company is the only set-up that allows the founding legal entity to separate itself from debts and obligations incurred through its Russian operation.

Two company forms exist that are suitable for foreign investors: the limited liability company (abbreviated OOO) and the joint stock company, which can take two forms: the closed joint stock company (abbreviated ZAO) and the open joint stock company (abbreviated OAO). With a few exceptions, both the limited liability company and the joint stock company provide limited liability for the parent company, meaning that the parent company (the shareholder) is not liable for the debts or obligations of the limited liability company or closed joint stock company.

Limited liability companies and joint stock companies may be founded by legal entities, such as other companies and/or individuals, irrespective of nationality. One founder alone is sufficient to establish a company. No particular restrictions apply to foreign founders. Under a peculiar provision of Russian law, a solely owned company (a wholly-owned subsidiary of another company) may not itself be the sole founder of a limited liability company or a joint stock company.

The main differences of practical importance between a limited liability company and a joint stock company to consider are the following:

- It is quite easy to increase the charter capital of a limited liability company, while an increase of the charter capital in a joint stock company is cumbersome and time-consuming
- The provisions on minority protection are well developed and sophisticated in a joint stock company but much less so in a limited liability company

As a rule of thumb, a limited liability company is the better choice for a single shareholder who does not intend to invite other entities to become shareholders of the company. A joint stock company is a better solution if a company has more than one shareholder, for example a joint venture with one or more Russian partners (shareholders).

The two company forms are described in more detail below.

### 3.3.1 Limited liability company (OOO)

A Russian limited liability company has its equivalent in many European countries, for example GmbH in Germany and SARL in France, and continental European laws on limited liability companies seem to have served as a model for Russia. OOOs are regulated by some sections of the Russian Civil Code and by the Law on Limited Liability Companies of March 1, 1998.

The main difference between a Russian limited liability company and a joint stock company is that the charter capital of the company is not divided into shares but into participatory interest. The owners of the participatory interest are referred to in the law as "participants of the company" (cf. shareholders in a joint stock company). An OOO cannot issue share certificates or other similar securities. An OOO does not have a shareholders' register or similar document; instead the parti-

cipatory interest is reflected in the charter (articles of association) of the company. The participatory interest is subject to pre-emptive rights, meaning that a participant who wishes to sell will have to offer his part to the other participants before a sale to a third party can be accomplished. For the above reasons, a limited liability company cannot be listed on a stock exchange.

### Company structure and funds

The participants of an OOO may be both natural and legal persons. The number of participants may range between one and 50.

The company's charter capital must be no less than RUB 10,000 (around EUR 300). The participatory interest may be paid in cash or by contribution in kind, such as machinery or other equipment. Half of the charter capital must be paid before the registration of an OOO. Each participant must pay for his part within a year from the registration of the company.

### Rights and obligations of participants

Participants in a limited liability company are not liable for the company's debts. Should a participant not fulfil his obligation to act properly as a participant of the company, participants holding a tenth of the charter capital may start court proceedings to exclude the participant.

Should participants holding two thirds of the charter capital decide to increase the charter capital, the other participants may also have to contribute to the increase.

Should a participant wish to sell its part to a third party (a non-participant) of the company, the other participants have the right of pre-emption to the part at a price that equals the price agreed upon with the intended buyer.

### Management bodies

The management bodies of a limited liability company are the participants' meeting, the board of directors or the supervisory board and the executive organ (the CEO or a collegial organ). The board function is not mandatory, and many founders of OOOs have come to the conclusion that, from a management point of view, a board is not practical. Most OOOs have only the participants' meeting and the CEO.

The participants' meeting is the company's supreme decision-making management body. The participants' meeting must meet at least once a year, but not earlier than two months before and not later than four months after the completion of the final annual accounts that in Russia takes place on January 1 each calendar year. Participants holding more than one tenth of the parts of the charter capital may convene an extraordinary participants' meeting.

Decisions that are not made or are not required to be made by the participants' meeting may be made by the board, if such exists. The number of board members is unlimited. The board may appoint an executive organ that may consist of only one person (the CEO) or of several persons in a collegial organ. If there is no board,

the CEO or the collegial organ is elected by the participants' meeting. Members of a collegial organ may also join the board but the number of such members must not exceed one fourth of the total number of board members.

The CEO is elected by the participants' meeting unless the charter requires that this decision be made by the board. The CEO is solely, or together with the executive organ, if any, responsible for the day-to-day business of the company. The CEO is always the authorised signatory of the company. The board is not authorised to sign on behalf of the company. The CEO may, however, authorise other persons to sign for the company, and the board may also authorise other persons than the CEO to sign.

### **Annual reports and auditing**

A limited liability company with more than 15 participants must be audited annually by an independent auditor. Other limited liability companies may be subject to auditing.

Book-keeping and accounting in a Russian OOO are carried out by the chief accountant. After the CEO, the chief accountant is the most important person in a Russian OOO. A foreign entity wishing to establish a limited liability company in Russia should therefore assign a chief accountant as early as possible, and preferably before registration of the Russian company.

### **Procedure for establishing a Russian subsidiary**

The tax authorities register companies at issue.

A foreign entity, wishing to establish a limited liability company in Russia will have to file the following documents with the Russian authorities:

- Articles of association of the parent company
- Registration certificate for the parent company (from the Patent and Registration Office)
- Decision by the board of the parent company to establish a subsidiary in Russia
- Articles of association for the subsidiary
- Letter of recommendation from the parent company's bank
- Proxy for the person or persons to carry out the registration in Russia
- Lease agreement for the office of the new company (to be filed within ten days after the registration of the company)

If the company is to be formed by several participants, a so-called foundation agreement must be prepared and submitted to the registration authority.

All documents, except for the articles of association of the subsidiary, must be notarised and legalised/apostilled by a notary public. The documents have to be translated into Russian and notarised in Russia.

### **3.3.2 Joint stock companies (ZAO/OAO)**

Russian joint stock companies may have the form of "closed" or "open" companies, abbreviated ZAO and OAO respectively. These forms correspond to types of

private and public joint stock companies that exist in many European countries. The differences between a ZAO and an OAO are for the most part not significant. The most important difference is, however, that the shareholders of an OAO are always entitled to sell their shares freely to a third party without first making a pre-emption offer to the other shareholders of the company. The large majority of Russian joint stock companies are ZAOs, and unless special considerations, such as a plan to have the company listed on a stock exchange, exist, there is very rarely any reason for a private foreign investor to create a wholly-owned open joint stock company. This section will therefore deal only with closed joint stock companies.

Joint stock companies are governed mainly by the Russian Civil Code and the Law on Joint Stock Companies of January 1, 1996.

### **Establishment and share capital**

A ZAO may be established and owned by both natural and legal persons. The number of shareholders cannot exceed 50. (ZAOs with more than 50 shareholders must be transformed into an OAO within one year.) A company establishing a wholly-owned ZAO must have more than one shareholder.

The minimum share capital in a ZAO is RUB 10,000 (around EUR 300). The share capital may be paid in cash or through contribution in kind. At the formation of the company, the shareholders themselves may agree on the value of the assets contributed in kind. Should there be additional in-kind contributions after the establishment of the company, they must be valued by a special appraiser.

Half of the share capital has to be paid within three months after the registration of the company and the remainder within a year after the registration of the company.

### **Rights and obligations of shareholders**

The shares of the company may either be ordinary shares or preferred shares. Holders of ordinary shares have equal rights to participate and vote at a shareholders' meeting, and receive dividends and part of the company's funds upon liquidation.

Preferred shares may be issued in different categories with different rights to dividends, voting rights, etc. These rights should be stipulated in the charter of the company. Unless otherwise provided, preferred shares carry the same rights to dividends as ordinary shares but carry voting rights only in respect of the company's reorganisation and liquidation. The number of preferred shares must not exceed 25% of the company's share capital.

Should a shareholder wish to sell shares to other parties than shareholders in the company, the existing shareholders have pre-emptive right to buy such shares at the price agreed on with the potential buyer.

## Management bodies

The management bodies of a ZAO are usually the shareholders' meeting, the board of directors and the executive organ: the CEO or the steering committee. The board function is not mandatory, and the company organs may thus comprise only the shareholders' meeting and the CEO (or steering committee).

The shareholders' meeting is the company's supreme decision-making organ. Shareholders' meetings must be held at least once a year, but not earlier than two months before and not later than six months after the completion of the final annual accounts that in Russia takes place on January 1 each calendar year. Owners of 10% or more of the share capital may convene an extraordinary shareholders' meeting.

Decisions that are not made or are not required to be made by the shareholders' meeting may be made by the board. The number of board members is unlimited.

The executive management body may consist of either one (the CEO) or several persons in a collegial organ (the steering committee). Members of the steering committee are also entitled to join the board of directors, but they may not occupy more than half of the board seats. The CEO cannot act as chairman of the board.

A ZAO is usually the most appropriate company form of a joint venture. If a foreign investor would like to establish such a company together with a Russian party, the foreign investor should, however, try to secure a majority holding of at least 75% of the votes. For example, a 75% majority is required in the following cases:

- Amendments to the charter
- Reorganisation
- Liquidation
- Determination of the maximum share capital permitted
- Entering into certain extraordinary transactions

## Audits and disclosure

A joint stock company must set up an internal audit committee or elect an internal audit to oversee its financial and economic activities. These bodies are to be formed by the general meeting of shareholders. A joint stock company must be audited annually by an independent external auditor. It is important that the company's accounting is carried out in a proper manner. As in an OOO, the chief accountant plays a crucial role, and a foreign investor wishing to establish a ZAO in Russia should assign a chief accountant before applying for registration.

An OAO must disclose its annual report and annual accounting and issue prospectuses and certain other information. A ZAO must disclose similar information only for the purpose of public securities offering.

## Share-capital increase

The share capital of a Russian joint stock company may not be increased until the original share capital has been paid in full. The increase may thereafter be executed by raising the par value of the existing shares or by issuing new shares. Increasing the share capital is a complicated procedure that involves the Federal Security Commission.

### 3.3.3 Procedure for establishing a Russian OOO or ZAO/OAO

Under Russian law, a company is founded on the date of its state registration. From this date, the company is considered a legal entity.

Registration of companies is governed mainly by the Law on State Registration of Legal Entities, which came into force on July 1, 2002. Under this law, the Federal Tax Service is the authority for state registration of companies in Russia.

To register an OOO, ZAO or OAO, the founder must submit the following documents:

- Application
- Foundation agreement (only OOOs with more than one participant)
- Protocol of founders' meeting (only OOOs) or resolution of the founder on the establishment of the OOO (only OOOs with one founder)
- Charter
- Copy of the passport of the proposed CEO
- Power(s) of attorney issued by the founder(s) for establishment of the OOO
- Power(s) of attorney issued by the founder(s) for filing the application for state registration of the company
- Confirmation of the legal status of the founder(s) (such as an extract from the trade register or a certificate of good standing)
- The charter (articles of association, memorandum of incorporation, etc.) of any founding foreign companies
- Confirmation of payment of state registration fee
- Foreign tax registration certificate of the founders (to be provided to a bank)
- Bank letter confirming the good credit standing of a founding foreign company
- Confirmation of the foreign company's contribution to the charter capital of the company
- Russian founders must also provide additional documentation. All documents from a foreign legal entity must be notarised and apostilled/legalised in the country of preparation. Any document supplied in a language other than Russian must be accompanied by a Russian translation with a notarised certification
- Documents documenting the registration of issuance of shares with the Federal Service for Financial Markets (applicable only to ZAOs and OAOs)

## 4 Competition

### 4.1 Overview

The significance of competition law is increasing in many countries, and non-compliance with legislation results in ever-increasing penalties. Russian competition legislation, better known as antimonopoly legislation, is still in a stage of formation and adaptation to a new economic system. The first modern antimonopoly legislation was adopted in 1991 but has been significantly amended a number of times since then, most importantly through the enactment of Federal Law No. 135-FZ on protection of competition (the Law), which took effect on October 26, 2006.

The main objective of Russian antimonopoly legislation is the same as that of EU legislation, which is to ensure fair competition in the goods, services and works markets and in the financial markets by preventing behaviour that is incompatible with an undistorted, consumer friendly market. The Federal Antimonopoly Service (FAS) is a state body that, together with other bodies, is in charge of antimonopoly regulation.

Foreign companies doing business in Russia must pay special attention to antimonopoly requirements, since failure to comply with such requirements may result in substantial liability and significant penalties, both commercial (fines, invalidation of transactions and foundation of a company) and personal (administrative and criminal). Russian competition law contains strict requirements and mandatory restrictions that must be observed.

The Law regulates relations on both markets mentioned above. In the financial markets, the relations include activities of credit and other financial organisations (antimonopoly regulation of financial organisations, including credit institutions, is outside the scope of this guide, however).

Antimonopoly regulation in Russia covers the following areas:

- Establishment, mergers and acquisitions of limited liability companies (LLCs)
- Abuse of dominant position
- Concerted actions and agreements restricting competition
- State aid
- Unfair competition

Given the complexity of antimonopoly regulation, the following section gives a simple overview of the requirements for LLCs that covers the majority of legal entities and scenarios<sup>2</sup>:

### 4.2 Establishment, merger and acquisition of companies

To prevent uncontrolled concentration of market power, Russian competition law stipulates that establishment, merger or acquisition of LLCs that meets certain financial criteria must be approved by FAS prior to closing or notified to FAS after closing.

#### 4.2.1 Pre-closing approval of mergers and acquisitions

Financially important transactions require approval by FAS prior to closing, including:

##### 4.2.1.1

Acquisition by a person and the group to which the person belongs (as defined in the Law) of more than 1/3 of participatory interests in an LLC or any increases of ownership exceeding thresholds of 1/2 and 2/3 of the participatory interests in an LLC<sup>3</sup>.

##### 4.2.1.2

The acquisition by a person and the group to which the person belongs of the assets (as defined by the law) of an entity if the balance-sheet value of the assets exceeds 20% of total assets.

##### 4.2.1.3

The acquisition by a person and the group to which the person belongs of the rights to determine the conditions of business activity of an entity or to exercise the powers of its executive body.

To require pre-closing approval, transactions must also exceed one of the following thresholds:

##### 4.2.1.4

The aggregate asset value of the acquirer together with its group and target together with its group exceeds RUB 3 billion (around EUR 83 million) or

##### 4.2.1.5

the total annual revenues of the acquirer together with its group and the target together with its group for the preceding calendar year exceed RUB 6 billion (around EUR 166 million) and (applies to both thresholds in 4.2.1.4 and 4.2.1.5), the total assets of the target together with its group exceed RUB 150 million (around EUR 4.2 million)<sup>4</sup>.

##### 4.2.1.6

Regardless of whether the financial thresholds described in 4.2.1.4 and 4.2.1.5 are met, the market share may be decisive: If the acquirer, target or any entity within the acquirer's group or target's group is listed in the FAS register of business entities having a share of a certain market exceeding 35%, pre-closing approval of the transaction is required.

#### 4.2.2 Pre-closing approval of establishments

Similarly, to prevent uncontrolled concentration of market power and to safeguard fair and undistorted

<sup>2</sup> This Guide does not specifically mention the requirements that apply to financial organisations, JSCs and CJSCs.

<sup>3</sup> The corresponding thresholds for joint-stock companies are 25 %, 50 % or 75 % of the voting shares.

<sup>4</sup> This is a new and important requirement: it stipulates a pre-closing approval only if the target is a rather large company and not a small business (as in earlier legislation).

competition, the establishment of an entity must be pre-approved by FAS if the establishment meets at least one of the following conditions:

#### 4.2.2.1

The charter capital of the entity is paid in shares<sup>5</sup> and/or assets that give the newly-founded entity an amount of assets or shares with corresponding rights as specified in item 4.2.1.1 to 4.2.1.3.

Alternatively, pre-approval is required if one of the following requirements is met:

#### 4.2.2.2

The aggregate value of assets held by the founders (and their respective groups) and by the entities (and their respective groups) whose shares and/or assets are contributed to the charter capital of the newly-founded entity exceeds RUB 3 billion (around EUR 83 million) or

#### 4.2.2.3

the total annual revenues of the founders (and their respective group) and the entities (and their respective groups) whose shares and/or assets are contributed to the charter capital of the newly-founded entity for the preceding calendar year exceed RUB 6 billion (around EUR 166 million) or

#### 4.2.2.4

the entity whose shares and/or assets are contributed to the charter capital of the newly-founded entity is listed in the FAS Register as holding a market share of more than 35 %.

### 4.2.3 Post-closing notification

The following mergers and acquisitions of companies which do not meet the thresholds mentioned above and therefore do not have significant impact on competition as explained above require post-closing notification to FAS (within 45 days of closing):

#### 4.2.3.1

The merger and/or acquisition by a person and group to which the person belongs of the assets (as defined by the law) of an entity if the balance-sheet value of the assets exceeds 20% of total assets provided that

#### 4.2.3.2

the aggregate asset value or total annual revenues of the acquirer with its group and the target together with its group for the completed preceding year exceed RUB 200 million (around EUR 5.5 million) and

#### 4.2.3.3

the total assets of the target together with its group exceed RUB 30 million (around EUR 0.8 million)<sup>6</sup>.

### 4.3 Application review terms

The Law specifies a 30-day review period for pre-closing approval of transactions.

The review period may be extended another two months if FAS believes that the prospective transaction might restrict competition in a particular market.

Such extended transaction reviews must be posted on FAS official website. Parties potentially affected by such transactions may then provide FAS with information about the effect of a transaction on a particular market. FAS has significant discretion in deciding what comprises a particular market both in terms of geographical boundaries and types of product or service.

### 4.4 Intra-group transactions

Russian merger control also covers transactions between entities belonging to the same group of persons. The Law does not generally exempt intra-group transactions from merger control, but it provides for a simplified procedure under which intra-group transactions that normally require a pre-closing approval, are subject only to post-closing notification. For a group to benefit from this simplified procedure, the following preconditions must be met: (a) a list of all the members of the group of persons must be submitted to FAS at least one month before the relevant transaction. The list will be published on FAS's official website; (b) as of the date of performance of the relevant transaction, the list must be correct and up-to-date without any changes in the group; and (c) the relevant transaction must be implemented within the group only.

### 4.5 Joint ventures

As the Law does not set out specific rules for the establishment of joint ventures, a joint venture is treated as an acquisition of assets, shares or rights by the joint venture company from its founders and/or third parties. In many cases, the notification requirements for the establishment and merger of entities may apply to the establishment of a joint venture (see section 4.2.1 Pre-closing approval of mergers and acquisitions).

### 4.6 Foreign-to-foreign transactions

Russian competition law may also apply to foreign-to-foreign mergers. A transaction is subject to merger control if the transaction (i) relates to shares/participatory interests in Russian entities or assets located in Russia, and (ii) may result in restriction of competition in the Russian Federation. According to the current position of FAS, it will decide on (ii) at its own discretion.

### 4.7 Abuse of dominant position

Russian competition law includes criteria to determine whether an entity together with its group or several unrelated entities have a "dominant position" on a particular market. The position of an entity depends the size of its market share, the structure of the market and participants in the market as described in the Law.

Dominant companies are subject to certain activity restrictions of which they are not always aware.

<sup>5</sup> For this purpose, "shares" means shares in a joint-stock company or participatory interests in an LLC.

<sup>6</sup> Under Russian competition law, post-closing notification is required if the acquirer, target or any entity within the acquirer's group or target's group is listed in the FAS register. In practice, however, FAS requires a pre-closing approval in such cases.

A dominant position exist if a company:

- can have dominant influence on the general conditions of the circulation of their goods on a market,
- can remove other companies from such market, or
- can impede another company's access to such market.

A dominant position on a particular market has far reaching for consequences for a company. If a company has a dominant position, it must refrain from any behaviour that restricts competition, including but not limited to the following activities:

- Price fixing
- Withdrawal of goods from circulation resulting in price increases
- Dictating terms unfavourable to a counterparty or irrelevant to the subject-matter of the agreement
- Reduction or termination of production of goods for non-financial or non-technological reasons if demand for the goods exists so long as the goods can be produced at a profit
- Refusal to enter into an agreement with particular buyers or customers if the goods can be produced or supplied
- Fixing of disparate prices (tariffs) for the same goods for non-financial or non-technological reasons
- Creation of discriminatory conditions
- Creation of barriers to enter or exit a particular market
- Carrying out any other activities that result or may result in the prevention, limitation or elimination of competition and/or the infringement of interests of other persons

#### **4.8 Concerted actions and agreements limiting competition**

The Law defines "concerted actions" as actions taken by more than one entity with the prior knowledge of the other entity or entities, the result of which promotes the interests of such entities, if such action has been instigated by one of the entities. The Law generally prohibits<sup>7</sup> any concerted action or agreement of entities on a market that results or may result in certain restrictions of competition for such market. The Law defines such actions, which include fixing or maintaining prices (tariffs), discounts, extra charges or margins; co-ordination of bids for auctions or tenders; division of a market by territory, volume of sales or purchases; refusal to enter into an agreement with certain buyers (customers) for non-financial or non- technological reasons.

The Law does not only prohibit explicit agreements between entities, regardless of whether such arrangements are in writing or oral, but also any tacit co-ordination of entities which results in a behaviour not permitted.

The Law does, however, expressly permit vertical agreements - agreements between customers/potential customers and producers/potential producers who do not compete with each other - if they relate to

commercial concessions or as long as each party does not control more than 20% of a market.

#### **4.9 State aid**

The Law defines state aid as granting a company certain privileges, ensuring more favourable conditions for its activity by transferring property and (or) civil rights or providing priority access to information. The Law regulates the procedure of providing state (or municipal) aid for certain purposes, such as carrying out fundamental scientific research, environmental protection, cultural development and conservation of the cultural heritage, and agricultural production.

State aid is granted with preliminary written approval by FAS unless such aid is directly granted by law, a regulatory act of a local government on budget from reserve funds of the executive body of a constituent entity of the Russian Federation or local-government reserve funds.

#### **4.10 Unfair competition**

Unfair competition is defined as any action aimed at acquiring competitive advantages in commercial activity that do not comply competition law, business customs, good-faith, reasonableness and fairness, and that may cause losses to other market participants. Unfair competition is prohibited. Examples of unfair competition include distribution of false information; misleading consumers about the nature, methods and place of production; incorrect comparison by a commercial entity of goods produced or sold by this entity with the goods of other commercial entities; and receipt, use and disclosure of scientific and technical, production or trade information without the consent of the commercial entity to which this information belongs.

##### **4.11 Sanctions**

If a transaction (or foundation of a company) that requires a pre-closing approval or a post-closing notification is performed without such approval or with procedural violations, it may be contested in court by FAS and declared invalid (a newly-founded company may be involuntarily reorganised or liquidated).

All revenue earned through violations of the antimonopoly legislation may be levied from the violating company by court.

In cases of systematic violations of the antimonopoly legislation, FAS may ask the court to split the entity. To be considered systematic, such violations must take place at least twice during three consecutive years.

Penalties may be levied on entities and individuals engaged in violations of the antimonopoly legislation. The penalties range from fines imposed on individuals, entities and their senior officers to imprisonment of senior officers for up to seven years if evidence exists of their participation in monopolistic activities connected with physical violence and destruction of a third party's property.

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<sup>7</sup> Under Article 13, the Government may permit concerted action if such action would have social or market benefits.

## 5 New legislation on foreign investments in strategic sectors

### 5.1 Overview

Before April 2008, foreign investments in strategic sectors were regulated by many separate un-co-ordinated legislative acts. The rules relating to foreign investments were unclear and, in addition, the Government had intervened in a number of high-profile transactions on an ad-hoc basis.

Russia has seen a trend towards increased economic regulation in recent years. As a result, the un-co-ordinated legislative acts relating to foreign investments in the strategic sector were codified in a single act (The Federal Law on Foreign Investment in Companies Having Strategic Importance for State Security and Defence, No. 57-FZ, dated 29 April 2008 (the Law)) that came into force on May 7, 2008.

The Law was presented as an act to protect Russia's national security and defence. It clearly outlines the sectors in which foreign investments are subject to restrictions and special procedures, and it also puts such procedures into place. The authors of the Law have stressed the fact that the Law was enacted during a time characterised by focus on strengthening governmental control over investments in national economies.

Notably, the Law has extraterritorial effect in the sense that it is applicable not only to direct acquisition of Russian undertakings, but also to foreign-to-foreign transactions if they result in establishing indirect control over a Russian strategic company.

The hope is that the new Law will create greater transparency for foreign investors, but it is yet too early to conclude what actual effect the Law will have on the investment climate in Russia.

### 5.2 Russia's strategic sectors

The Law lists 42 types of activities that are considered to be of strategic significance to national security and defence. These activities can be grouped as follows:

- Natural monopolies, particularly oil and gas, rail transport, transport terminals, ports and airports
- Nuclear energy and nuclear waste industry
- Activities related to aviation and aircraft safety
- Geological exploration and extraction of natural resources at sites of federal importance
- Defence industry
- Space industry
- TV and radio broadcasting on territory covering more than half of the Russian population
- Large-scale printing and publishing
- IT and telecommunications industry: activities related to coding and cryptographic equipment; mobile operators having a market share exceeding 25% of (i) Russia's territory, (ii) five or more Russian regions, or (iii) Moscow and St. Petersburg
- Cryptography and encrypted information systems

### 5.3 Foreign investors

Pursuant to the Law, foreign investors whose acquisitions are subject to control are defined as:

- any non-Russian resident, including foreign legal entities, organisations, individuals, governmental and international organisations
- any Russian legal entity controlled by a non-Russian resident

### 5.4 Transactions covered by the Law

Acquisition of the following types of control of a company within a strategic sector (strategic company) is governed by the Law:

- Direct or indirect control of more than 50% of the votes in a strategic company (or more than 10% of the votes in a strategic company engaged in subsoil activities of federal importance)
- Right to appoint the CEO of a strategic company
- Right to appoint 50% or more of the members of the board of directors or supervisory board of a strategic company (or more than 10% of the members of the board of directors in a strategic company engaged in subsoil activities of federal importance)
- Right to perform the functions of the management company of a strategic company
- Right to make the decisions of the management bodies of a strategic company

Under the Law, acquisition is defined as any type of transaction involving sale and purchase agreements, gifts, swaps, management or any other types of agreement.

Intra-group transfers are also governed by the Law if the group has foreign participants.

The Law also applies to situations where control is acquired through re-distribution of votes as a result of redemption of the strategic company's shares, conversion of shares, etc.

### 5.5 Definition of control

Indirect control means a foreign investor's or its group's right to exercise voting rights through third parties.

Control means a foreign investor's or its group's right to directly or indirectly, through any of the following rights, influence the decisions of a strategic company:

- The right to more than 50% of the votes in a strategic company (more than 10% of the votes in a strategic company engaged in subsoil activities of federal importance)
- The right to sit on the board of directors, management board or other management body of a strategic company
- The right to perform the functions of the management company of a strategic company
- The right to appoint the CEO of a strategic company
- The right to appoint 50% or more of the members of the management board of a strategic company (or more than 10% of the members of the management board of a strategic company engaged in subsoil activities of federal importance)

- The right to appoint 50% or more of the members of the board of directors or other collective body of a strategic company (or more than 10% of the members of the board of directors or other collective body in a strategic company engaged in subsoil activities of federal importance)

The right to block resolutions means that the foreign investor or its group may directly or indirectly prevent resolutions by a management body of a strategic company that may be passed only by a qualified majority.

### 5.6 Special rules for foreign states and international organisations

Foreign states and international organisations are not allowed to acquire control over strategic companies. Foreign state and international organisations must obtain prior approval of transactions resulting in direct or indirect acquisition of 25% or more of the voting rights, the right to block resolutions, or acquisition of 5% or more of the voting rights in strategic companies engaged in subsoil activities of federal importance.

International agreements on investments ratified by Russia may provide exemption from these limitations.

### 5.7 Procedures

The Law establishes two types of procedure. A foreign investor who intends to invest in a strategic company must, to the extent applicable, either

- obtain prior approval of acquisition of control or
- submit post-notification. The state agency to issue prior approval and receive post-notification is the Russian Federal Antimonopoly Service (FAS).

#### 5.7.1 Prior approval of acquisition of control

The foreign investor (or its group) must obtain approval of an acquisition of control over a strategic company (or a series of transactions resulting in such acquisition) prior to the conclusion of the acquisition. If it is not clear whether a prior consent is required, the foreign investor can submit an inquiry to FAS. FAS must send its answer within 30 days.

#### Step 1

The process starts with the foreign investor's filing of a standard form application with FAS. FAS must review the application within 14 days from the day of filing with the aim to identify whether the contemplated transaction will result in the foreign investor acquiring control over a strategic company.

#### Step 2

Should the result of FAS's first review be positive, FAS must continue with the procedure by sending requests to the following state agencies within three days:

- The Federal Security Service (the FSB): a request to check whether the contemplated acquisition may result in any threat to Russia's defence and security. The FSB must reply to such request within 20 days.
- The Inter-departmental commission on protection of state secrets (the Commission): If the strategic

company holds a license to work with state secrets, the Commission must establish whether Russia has an international treaty with the relevant country that would allow the foreign investor's officers and employees to work with state secrets. The Commission must reply to such request within 14 days.

#### Step 3

FAS must submit the application together with the answers from the FSB to the Governmental Commission on Control on Foreign Investments in the Russian Federation (the Control Commission).

The Control Commission must make its decision within 30 days, but in exceptional cases, it may extend this period for up to three months. The Commission can make one of the following decisions:

- Grant prior approval of the acquisition of control
- Grant prior approval of the acquisition of control subject to the foreign investor's agreement to undertake certain obligations imposed by the Control Commission
- Refuse approval

The applicant may challenge the Control Commission's decision in the High Arbitrazh (Commercial) Court of Russia. FAS's actions may be challenged in court in accordance with the regular procedure.

#### 5.7.2 Obligations as a condition for approval

The Law lists eight types of obligation any or a combination of which may be set by the Control Commission as a condition for granting prior approval to the foreign investor.

These obligations include obligations to ensure that the strategic company's management bodies are formed by persons who are allowed to work with state secrets, that the strategic company continues to provide supplies for state defence orders, that the strategic company keeps a defined number of employees, and that the foreign investor prepares a business plan to be submitted to FAS together with an application.

The foreign investor's undertaking to perform such obligations must be formalised in an agreement with FAS.

The agreement must be entered into within 20 days of the day when the Control Commission informed FAS of the need to sign such an agreement, and it must remain in force as long as the strategic company is under the foreign investor's control. Refusal by the foreign investor to conclude the agreement is a ground for refusal of a prior approval.

The entire procedure described above must not exceed three months from the filing date, but in exceptional cases, the Control Commission (see Step 3 above) is allowed to make its decision up to three months after having received the application.

### **5.7.3 Notification of existing shareholding**

The foreign investor must file a post-notification with FAS in the following cases:

- The foreign investors has acquired at least 5% but no more than 50% of the shares of a strategic company
- The foreign investor owned 5% or more of the shares of a strategic company at the date the Law came into force. Notification must be made within 180 days of that date, that is no later than November 7, 2008.

Foreign investors who have acquired control over a strategic company through (i) re-distribution of votes as a result of redemption of the strategic company's shares, (ii) conversion of shares, or (iii) otherwise have acquired control over a strategic company must notify FAS within three months of the day when control was established.

If, as a result of consideration of the notification, FAS refuses to give the foreign investor acquiring control over the strategic company, the foreign investor must dispose of a sufficient number of shares within three months after the date of refusal to reduce holdings to a size that does not give control over the strategic company.

### **5.7.4 Sanctions for non-compliance**

The Law provides for the following sanctions in response to non-compliance with procedures:

- The court may pronounce transactions null and void
- The court may deprive the foreign investor of its voting right at the general meeting of shareholders
- The court may declare resolutions of the shareholders' general meetings null and void
- The court may deprive the foreign investor of voting rights attached to the foreign investor's shares if the foreign investor is in breach of the agreement made with FAS (see 5.7.2). In addition, FAS may impose fines for failure to submit necessary information or to comply with its orders.

## 6 Real property

### 6.1 Introduction

The Russian real property market has been booming in recent years, but the global financial turmoil has severely affected the market and many ongoing development projects have been delayed or even put on hold due to the lack of financing.

The market uncertainties have also led to a halt in real property transactions. Many real property experts are seeing opportunities, however, since prices are falling and transactional work is expected to pick up during the first or second quarter of 2009.

In addition, market consolidation will lead to the restructuring of many real property companies, and some companies active in other sectors than real property are expected to enter into sale-and-leaseback transactions to generate additional working capital.

### 6.2 Concept of real property

Under Russian law, real property includes land plots, subsoil plots, forests, buildings and structures, and everything that is securely attached to the land, that is any object which cannot be relocated without damaging the object and making it unsuitable for its purpose. Therefore, the main characteristic of real property under Russian law is its inseparable attachment to the land.

### 6.3 Russian real property law

Russian real property law is relatively new and is still subject to frequent changes (with new and old regulations often overlapping). Co-ordination between various federal, regional and municipal bodies in charge of enforcing the law is lacking, and therefore law enforcement is sometimes ambiguous.

Property rights are set forth primarily in the Russian Federation Constitution, the Civil Code of the Russian Federation (Civil Code) and the Land Code of the Russian Federation (Land Code).

### 6.4 State cadastre registration of land

Under Russian law, every land plot must undergo cadastre registration and be assigned a unique state cadastre number. Only registered land plots can constitute a subject matter of a commercial transaction, such as a sale and purchase or a lease.

The land cadastre contains a detailed description of each land plot, its location and borders, area, category of land, permitted use, and other important characteristics. All information about the cadastre registration of a land plot must be entered into the Unified State Register of Rights to and Transactions with Immovable Property (the State Register). This information is available to all interested parties.

Recent legislative developments introduced a new cadastre register, which started operating in 2008 and will integrate registration of major types of real property, including land, buildings, facilities, premises and objects of unfinished construction. The new

cadastre will contain information about real property objects but will not include rights over subsoil areas.

### 6.5 Categorisation of real property

Real property is broken down into categories by its intended use. Buildings are generally classified as residential or non-residential, whereas land is divided into the following categories depending on their designated purpose: (i) agricultural land; (ii) land of centres of population; (iii) industrial land; (iv) protected land; (v) forestry land; (vi) water front land; and (vii) reserve land.

The Land Code requires that each category of land be used in accordance with its designated purpose. Normally, developers of commercial and residential development need to have the land plots on which their buildings/structures are to be located categorised as land intended for centres of population or industrial land.

Land within each particular category is also subject to specific requirements for the use of such land established by federal, regional and local laws. For example, land in urban areas is subject to specific zoning, including residential, administrative and business, industrial, engineering and transport infrastructure, recreational, agricultural, special purpose and military zones.

Following a specific procedure, the land can be converted from one category to another.

### 6.6 Ownership of real property

Russian law recognises municipal, state and private ownership to real property, such as buildings and land plots. Transfer of land and buildings from one person to another as well as transfer of real property from state or municipal authorities to private legal entities and individuals (privatisation) are permitted.

Although ownership of land is allowed under federal law, it remains relatively rare in most parts of Russia, including regions such as Moscow.

Anyone, including foreign legal entities, may own a building without any discriminatory restrictions.

An owner of a building is generally permitted to sell or lease it without any requirement to obtain government approval unless such a transaction falls within the scope of the Federal Antimonopoly Service. In such cases, approval is required.

As a general rule, foreign citizens and legal entities are permitted to own land plots subject to the same restrictions as Russian citizens and legal entities. Russian law prohibits foreign citizens and legal entities to own land located in zones near national borders, however. In addition, foreign citizens, foreign legal entities as well as Russian legal entities which have a foreign ownership share of more than 50% are not permitted to own agricultural land.

Even if buildings are inseparably attached to the land (the sale of a building automatically grants the

purchaser all necessary rights of use to the underlying land), the land plot and the building located thereon are considered separate objects. But under Russian law, the owner of a building is granted exclusive right to lease or acquire the state or municipal land plot on which the building is located. In case of private land, the owner of a building located on another party's private land has a priority right to buy or lease such underlying land.

## **6.7 Other rights to real property**

Apart from ownership rights, Russian law recognises the following rights to real property:

### **6.7.1 Lease rights**

Under Russian law, a lessee is entitled to use and possess the leased property as agreed between the parties. A lease agreement for immovable property must contain sufficient data to identify the leased property. The absence of such data entails a risk that the lease agreement will be considered null and void. Lease agreements for a term equal to or exceeding one year (so called long-term lease agreements) are subject to mandatory state registration. Such agreements come into force at the time of registration. Short-term lease agreements for a term of less than one year or lease agreements for an indefinite term do not require state registration and consequently come into force at the time of execution by the parties. Subleasing of buildings/premises is permitted only with the consent of the landlord. In case of subleasing of a state/municipal land plot, the tenant who concluded a lease agreement for more than five years is entitled to sublease the land without the consent of the landlord.

Sublease agreements are common in Russia. The general rule is that the rights of the tenant under the sublease agreement cannot exceed those provided to the tenant under the primary lease agreement.

It is important to note that leases survive changes in ownership by landlords and/or ownership of the building in which the premises are located.

Agreements made between individuals for the lease of residential premises are called agreements for hire and not lease. The agreements for hire of residential premises are not subject to state registration. A legal entity must, however, lease residential premises under a lease agreement which is subject to state registration on the conditions that apply to all lease agreements.

It is prohibited to use residential real property for commercial (including office) purposes.

### **6.7.2 Perpetual inheritable possession**

This type of right applies to individuals only. These rights appeared before the Land Code was introduced and can no longer be granted to individuals. But rights which were granted before the enactment of the Land Code are still valid.

### **6.7.3 Permanent (perpetual) use**

Individuals and companies used to enjoy the right of permanent (perpetual) use of land, but with the

enactment of the new Land Code, permanent (perpetual) rights of use can be granted only to state and municipal entities and authorities. The right of permanent (perpetual) use does not entitle the holder of this right to dispose of the land. Legal entities other than state and municipal entities and authorities are obliged at their discretion to re-register the right of permanent (perpetual) use into ownership or lease before January 1, 2010.

### **6.7.4 Gratuitous fixed-term use**

A fixed-term use differs from a lease since it always involves use of land free of charge. It also differs from permanent use of the land since the use is temporary.

### **6.7.5 Operational management/financial administration**

State and municipal unitary enterprises and institutions can hold real property under the right of financial administration or the right of operational management. Holders of these rights can use the real property, but are generally not entitled to dispose of it (lease it to third parties for example) without the approval of the state/municipal authorities.

## **6.8 Expropriation of private real property**

Under Russian law, private land may be expropriated for state or municipal needs provided that the state authorities can prove in court that these needs cannot be achieved without expropriation. In addition, if the state authorities can prove that expropriation of the land plot is impossible without expropriation of the building located thereon, the authorities are permitted to expropriate such building as well.

The owner of expropriated real property is entitled to one year's advance notice together with payment of the full market value of the real property and compensation for any other losses suffered. If the state authorities and the owner of the real property cannot reach an agreement about the compensation, such dispute must be settled in court.

## **6.9 State registration of rights to real property**

Under Russian law, ownership rights to and certain transactions that involve immovable property require state registration, and ownership arises only as of the moment of such registration in the State Register. The State Register is currently maintained by the Federal Registration Service (FRS). An entry in the State Register is considered a confirmation of the ownership right to the real property.

Ownership rights to real property that were acquired before 1998 are rare but valid without registration. State registration is required only in case of transactions that involve such unregistered property. Real property acquired before 1998 can, however, be registered in the State Register on a voluntary basis. Therefore, the State Register cannot be considered a comprehensive register of all real property in Russia since ownership rights acquired before 1998 may not appear in the State Register.

The State Register contains data about the owners of real property, associated transactions and registered encumbrances. Such data are available to the public, and the State Register must accommodate requests for data within five business day, provided that the applicant pays the applicable administrative fees. The owner of the real property or an authorised representative acting under a notarised power of attorney can apply to the FRS for more detailed information from the State Register.

The correctness of the information in the State Register is not guaranteed by the state, and it can be contested in court. Although the State Register is continuously improving, it is important to perform legal due diligence of the real property in question to eliminate the risk of contested title and similar risks.

## **6.10 Acquisition of ownership**

### **6.10.1 General**

The right of ownership to real property may derive from a sale and purchase agreement, donation, barter agreement or other agreement on alienation of real property. In practice, sale and purchase agreements are used mainly to acquire real property for commercial purposes.

Special procedures apply to concluding a sale and purchase agreement with state or municipal authorities in the course of privatisation. For example, it is required to follow a specific procedure which normally includes a tender procedure.

In respect of a building, ownership rights can also be acquired by means of construction of a new building.

Under Russian law, the seller provides guarantees for the quality of the real property being transferred. Should the purchaser find defects of which the seller has not informed the purchaser, the purchaser is entitled to claim

- a proportional reduction of the purchase price
- remedy of the defects within a reasonable period at the expense of the seller
- compensation for expenses for the remedy of defects incurred by the purchaser.

If the real property has serious defects which cannot be remedied or result in disproportionate costs of repair, the purchaser has a right to refuse fulfilment of the sale and purchase agreement and claim repayment of the purchase price.

### **6.10.2 Change of ownership**

The new owner takes ownership at the time such right is registered in the State Register. The registration is made on the basis of the transaction documents submitted to the FRS.

### **6.10.3 Form of agreements**

Agreements on real property are executed in writing and do not require notary certification. The agreements are filed with the FRS and serve as grounds for exercising the rights to the real property.

As mentioned above, real property sale and purchase agreements take effect from the moment of signing, but the new owner takes ownership at the time such right is registered in the State Register. In addition, lease agreements executed for a term equal to or exceeding one year, mortgages, easements and some other agreements require state registration to take effect.

### **6.10.4 Language requirements**

All agreements subject to state registration should be executed in Russian. The authorities accept a translation of agreements certified by a notary. This usually means that the bilingual versions of the agreement used during negotiations between the parties are executed only in its Russian version.

### **6.10.5 Due diligence**

It is important to perform comprehensive legal due diligence of the real property as well as the company that owns the real property. The due diligence must focus on aspects such as the transactional documents serving as a ground for transfer and accrual of rights to the real property, current status of rights (including inquiries to state bodies), approvals, encumbrances, zoning and permitted use.

### **6.10.6 Related costs**

The FRS's fee for registration of ownership right is usually paid by the purchaser, and expenses for real property consultants incurred by the parties are usually paid by each party independently, although this is for the parties to decide. The agreement should reflect the parties' decision.

### **6.10.7 Currency regulations**

The purchase price or rent payments made by a foreign entity can be fixed in foreign currency, but payments between Russian residents can be made only in Russian roubles.

## **6.11 Construction**

Russian legislation permits a person or a legal entity to acquire ownership of a building or other immovable construction (a new object) by means of erecting such an object in compliance with relevant legislation.

Under Russian law, in order to construct a new object, a person or a legal entity must have the right to use the land plot on which the new object is to be erected. In addition to valid rights to the land, a number of permits and approvals must be obtained before construction commences.

Development of real property in Russia is governed by both federal and regional legislation. These two levels of legislation can make regulation of the development process quite vague and contradictory.

Formally, regional legislation cannot contradict federal law, but in practice regional authorities require compliance with regional regulation even if it contradicts federal law. At the same time, regional legislation may provide for more detailed regulation of the development process. Such provisions are valid if they do not contradict federal law.

In practice, development of real property in the Russian Federation is a multi stage process, which involves compliance with burdensome regulatory requirements, co-ordination of work between many specialists and authorisations from a large number of authorities at federal, regional and local levels. It is advisable to consult reputable legal and technical consultants before commencing a constructing project.

### **6.12 Taxation**

VAT of 18% (with a few exceptions) is added to the purchase price in a direct sale of real property. VAT is generally included in the purchase price paid by the

purchaser and consequently repaid by the seller to the authorities. VAT does not apply to the sale of land only or to acquisitions involving property-owning companies.

Tax on buildings set by regional legislation cannot exceed 2.2% of the property book value and varies depending on the type of taxpayer and/or property subject to taxation. The land tax set by municipal authorities cannot exceed 1.5% of the land cadastral value and varies depending on the type of land and its permitted use.

The rent under lease agreements is subject to 18% VAT. Rent for office premises paid by accredited representative offices of foreign companies may be exempt from VAT, provided that such VAT exemption is stipulated in an international agreement between Russia and the foreign country that is the jurisdiction of such company. A list of the more than 100 countries that have a VAT exemption agreement with Russia exists.

### **6.13 Encumbrances**

The real property can be encumbered, in particular, with easements, rights of third parties under various rights-of-use agreements, pre-emption rights and mortgages.

#### **6.13.1 Easements**

For example, easements may be imposed to enable:

- owners/users of neighbouring land plots to access their land plots
- construction of communication lines to neighbouring land plots (and, in certain cases, other land plots)
- owners of communication lines to use the land plot to maintain/repair such communication lines.

Easements must be registered in the State Register.

#### **6.13.2 Mortgages**

Under Russian law, a mortgage on real property represents security which gives the creditor a priority right to the real property in case of default of the debtor. Enforcement of the mortgage can be performed only on the basis of a court decision unless the mortgagee and the mortgagor upon occurrence of an event of default conclude a written notarised agreement allowing an out-of-court procedure.

Under Russian law, a mortgage agreement must be made in writing and is normally subject to mandatory state registration in the State Register.

Upon the request of an interested party, the FRS can issue an extract from the register to confirm whether a mortgage on a property exists.

The mortgaged property can be alienated by the mortgagor to a third party by way of sale, gift, exchange, capital contribution or in other ways, provided that the mortgagee consents to such transfer or the mortgage agreement permits such transfer.

Buildings and facilities can be mortgaged only together with the land plots on which the buildings or facilities are located. If they are leased, they can be mortgaged only if the lease includes lease rights to the land plots where the buildings or facilities are located.

The mortgagor can, without consent of the mortgagee, construct buildings and facilities on mortgaged land, and the mortgage automatically extends to such buildings and constructions unless otherwise provided in the mortgage agreement.

## 7 Visa and other employment-related permits

### 7.1 General

Generally, a foreign citizen is allowed to work in Russia only if he or she holds a work permit, a work visa or a residence permit. This does not apply to citizens of some of the former Soviet republics, however, who may work legally in Russia without a work permit or a work visa.

#### 7.1.1 General visa requirements

Citizens of countries that have a visa regime with Russia (for example all EU member countries) must apply for a visa at the Russian consulate in their country of origin. Before obtaining a visa, the applicant must obtain official visa support in the form of a letter of invitation from the Russian Ministry of the Interior (MVD), the Russian Foreign Ministry (MID) or a legal entity incorporated in Russia.

#### 7.1.2 Types of visa

Business visa and work visa are the two types of visa usually needed by foreign citizens who travel on business to Russia or work there.

#### 7.1.3 Business visa

Citizens of countries that have a visa regime with Russia must obtain a business visa prior to entering Russia for business purposes. The term "business purposes" includes all kinds of activities undertaken on behalf of and for the benefit of a foreign employer in Russia, including but not limited to participation in negotiations, seminars and exhibitions.

The types of business visa that may be applied for vary depending on the expected visit period. A business visa may be valid for 30, 90, 180 or 365 days. A 30- or 90-day business visa does not allow its holder to enter Russia more than twice, whereas a business visa valid for 180 or 365 days allows its holder to enter Russia an unlimited number of times from the date of issuance to the date of expiry. It is important to remember that a business visa valid for 180 or 365 days allows its holder to stay in Russia for a limited period of time only, that is 90 days in total within a six-month period.

The processing time and fees for a business visa vary depending on the country where the application is made.

#### 7.1.4 Work visa

To work legally in Russia, foreign citizens must, in addition to a work permit, obtain a work visa.

Generally, a work visa is valid for a period of 12 months and allows its holder to enter Russia an unlimited number of times from the date it is issued until the date it expires. A work visa does not limit the number of days its holder is allowed to stay in Russia.

The application for a work visa must be submitted to the Russian embassy in the country of origin of the applicant on the basis of an invitation issued on behalf of the Russian employer. The processing time and fees vary depending on the country where the application is made.

## 7.2 Employment: Quota placement, employment and work permit

### 7.2.1 General

Russian legal entities (companies and representative and branch offices) that wish to employ non-Russian citizens must obtain a quota placement and an employment permit for the citizens they would like to hire. In addition, non-Russian citizen must obtain a work permit and a work visa (see above) to work legally in Russia. Only after the above permits and visas have been obtained may the non-Russian citizen legally be appointed to a particular position and commence working in Russia.

### 7.2.2 Quota placement

Russian companies that wish to employ foreign citizens must submit to the relevant authorities, before a certain deadline, an application for a quota placement. The application must include information about the number of non-Russian citizen the company wants to employ for the next calendar year, the nationality of the citizens, their intended positions and the approximate expected monthly salary. Based on the total number of applications, the relevant authorities will establish an employment quota for non-Russian citizens for the following calendar year. The quota is usually equal to the aggregate number of foreign citizens indicated in all the applications plus an extra margin (the quota for 2008 was 300,000). The extra margin for Moscow for 2008 was around 20%. The quota is the maximum number of employment permits that the relevant authorities will issue for the following calendar year.

Each of the 83 administrative units in Russia, the so-called federal subjects, of which Moscow is one, may establish its own quota. Two quotas exist: one for citizens of countries without a visa regime with Russia (mostly former Soviet republics, so called CIS countries) and another for citizens of countries that have a visa regime with Russia (non-CIS countries). The federal subjects may divide their quotas into smaller, nationality specific quotas. In Moscow, there are only two quotas, one for CIS countries and one for non-CIS countries.

Quota placement applications for a certain calendar year must be submitted no later than May 1 of the previous year. Hence, May 1, 2008, was the deadline for 2009. In general, all applicants get shares that match their requirements.

Any Russian company that has applied for quota placement is entitled, when the time comes, to apply for employment permits for the non-Russian citizen(s) in question and employ the number of foreign citizens indicated in the employment permit.

Special rules apply to newly established entities. If the employment quota for the federal subjects for a specific year is not fully used, newly established entities may obtain employment permits out of the unused part of the quota. This means that a newly established entity can obtain employment permits even if the application for employment permits is submitted after May 1.

Applications from newly established companies for employment permits out of the unused part of the quota should be considered by the authorities before other applications.

The quota system described above was introduced in Russia in 2006.

### **7.2.3 Employment permit**

A Russian company must apply for an employment permit after having obtained a quota placement. With such a permit, the Russian company may legally employ non-Russian citizen(s).

The employment permit is, generally, valid for one year or for any shorter period of time if the work permit of the non-Russian citizen is valid for such shorter period of time. Employment permits may be renewed.

### **7.2.4 Work permit**

The Russian employer must apply for a work permit for its non-Russian worker(s). When applying for a work permit, the draft employment agreement and other required documents must be submitted to the relevant authorities. Furthermore, it should be noted that a work permit cannot be obtained for a non-Russian worker who wishes to work in Russia through a secondment arrangement.

The work permit is generally valid for one year after which it can be renewed.

## 8 Taxation

### 8.1 General

Corporate taxation has changed constantly as new legislation has been implemented in the wake of the reforms that began more than ten years ago. Taxpayers have experienced many inconsistencies in tax administration at both federal and regional levels, and to improve the situation, the government launched a comprehensive tax code. Currently, almost all parts of the new code are in effect, including the general part and the parts on VAT, excises, personal income tax, unified social tax, profits tax from organisations, natural resources exploration tax, property tax from organisations, special taxation of production sharing arrangements, transport tax, gambling tax, special taxation of small and medium-sized businesses and producers of agricultural products, land tax and stamp duty.

Customs duty, property tax for individuals and some other (minor) types of tax are currently governed by separate legislative acts.

This business guide provides only a general overview of taxation, and although no landmark changes to major components of the tax code are expected, some changes will occur. Therefore it is recommended to obtain confirmation of the current position from PricewaterhouseCoopers.

### 8.2 Tax on corporate income

Profits earned by enterprises are taxed at a rate not exceeding 24%, of which 6.5% is paid to the federal budget and 17.5% is paid to the regional budgets. Regional legislative authorities are allowed to reduce, for certain categories of taxpayers, the tax payable to their respective budgets by up to four percentage points. In some regions of Russia, the regional portion of profits tax may therefore be lowered to 13.5%.

#### 8.2.1 Corporate residence

The tax system in Russia distinguishes between entities incorporated in Russia and entities incorporated abroad. Foreign entities are subject to Russian tax on profits from activities conducted through permanent establishments in the territory of the Russian Federation and on income from sources in Russia. Russian entities are taxed on their worldwide income. Certain concessions apply under double taxation treaties.

All taxpayers are required to obtain a tax registration and will be assigned a taxpayer identification number, regardless of the taxability of their activities.

#### 8.2.2 Branch income

The term “permanent establishment” (PE) is defined as a bureau, office, division, agency, or any other permanent place where regular business activity is carried on and/or is connected with exploiting natural resources, executing work under contract on the construction, installation, erection, assembly, adjustment, and maintenance of equipment, supplying services or carrying out other work. Organisations and individuals

in the territory of the Russian Federation authorised to represent foreign legal entities on the basis of a contract, act on behalf of foreign legal entities, conclude contracts in the name of foreign legal entities or negotiate significant terms of contracts are also considered to constitute a PE of a foreign legal entity. If a Russian legal entity or an individual acts as an agent in the course of its ordinary business, this entity is not considered a PE. Profit earned by a foreign legal entity through a PE in the Russian Federation is subject to tax.

The definition of branch income is similar to the definition of income by a Russian legal entity, with the exception that in the case of a branch, only income from activity in the Russian Federation is subject to tax. Profit from business activities of a PE in the Russian Federation is calculated according to the profits tax chapter of the tax code based on tax accounting records using the direct method. The indirect method is allowed only for preparatory and auxiliary activity in favour of third parties on a free-of-charge basis.

#### 8.2.3 Income

Taxable profit is broadly defined as total income less expense/loss allowances. The total income is sales income, that is income from sale of goods, works, services, property and property rights, plus non-sales income (all other types of income). Foreign currency income is converted into roubles at the rate of exchange set by the Central Bank of the Russian Federation.

The accrual method applies by default. There are special rules for the recognition of income from the transfer of title, transfer of results of work and provision of services as well as interest income, royalties, and rents. The cash method can be used only if average quarterly sales for the past four quarters do not exceed RUB 1 million.

Free-of-charge receipts of property, cash, services, works, and property rights are subject to profits tax. Income is recognised at market price, which cannot be lower than the residual value (for depreciable property) and production (acquisition) costs (for goods). Transferors may not deduct costs related to free-of-charge transfers.

The receipt of property from a Russian or non-Russian shareholder (individual or legal entity) owning more than 50% of the recipient’s capital is not, however, subject to tax provided that the property (other than cash) is not transferred to third parties within one year from receipt. This exemption applies only to Russian legal entities.

##### 8.2.3.1 Inventory

Several methods to calculate the value of purchased goods exist (FIFO, LIFO, weighted-average, and historical value of a unit). FIFO, LIFO, and historical value of a unit may be applied to securities but not the weighted-average method.

##### 8.2.3.2 Capital gains

Profit from the sale of fixed assets and other property

is calculated as the difference between the sales price and the historical cost of the asset (net book value for fixed assets and intangible assets subject to depreciation/amortisation). Losses on such sales reduce taxable income and may be deducted on a monthly basis by equal amounts during a period equalling the time difference between the useful life of the asset and the actual time in use.

### 8.2.3.3 Interest and dividends

Dividends distributed by Russian entities are taxable at a rate of 9% if the dividends are paid out to Russian residents. Dividends to non-residents are taxed at a rate of 15% subject to double taxation treaties. The rate of 9% also applies to dividends paid out to Russian parent companies of foreign subsidiaries. Tax is withheld by the paying entity. A special offset mechanism applies to dividends paid out by group companies to its shareholders. This mechanism does not apply to distributions to recipients outside Russia.

Dividends received by a Russian entity may be exempt from taxation in Russia under the participation exemption rule, provided that certain conditions are met, for example that the cost of investment exceeds RUB 500 million. The participation exemption rule does not apply to dividends received from a number of countries (see list established by the Ministry of Finance).

Interest on state and municipal bonds is taxed at 15% with certain exemptions that stipulate tax rates of 9% and 0%. Other interest income is generally taxed at 20%.

### 8.2.3.4 Foreign income

Tax payable by legal entities under the law of the Russian Federation is calculated on the basis of their worldwide income. Non-Russian taxes paid by such enterprises on profits earned outside the Russian Federation can be offset against the profits tax payable in Russia in an amount not exceeding the profits tax payable in Russia. Foreign taxes paid on dividends received from abroad are not deductible under domestic law.

### 8.2.3.5 Exchange gains and losses

Exchange gains and losses on the revaluation of monetary assets and liabilities, payables, and receivables in hard currency are generally taxable/deductible for profits tax purposes. Securities denominated in foreign currency are disregarded for these purposes.

## 8.2.4 Deductions

### 8.2.4.1 General

Tax deduction is available if expenses are financially justifiable, supported by underlying documentation and relate to income-generating activity. Documentary support is vital. Certain expenses must be capitalised or deferred (development of natural resources, R&D, losses on sales of fixed assets). Although an open list of deductible expenses exists, there are also some specific non-deductible expenses and statutory limits

for deductibility of certain expenses, including business trip expenses, representative expenses, expenses for the training of employees, compensation for the use of private cars for business purposes and certain advertising costs.

### 8.2.4.2 Loss carryforwards

Loss carryforward provisions are available for total tax losses. Special rules apply to the utilisation of losses on operations related to securities and derivatives and some other operations. The carryforward period is ten years. Loss carrybacks are not allowed. A surviving company may utilise the losses of a liquidated company in a reorganisation.

### 8.2.4.3 Interest

Interest on business loans is deductible regardless of source and use (current and investment) subject to the following limitations:

- Deduction is allowed within a  $\pm 20\%$  limit of the average interest rate for similar loans.
- In the absence of a similar loan type, or at the taxpayer's choice, interest may be deducted at a rate not exceeding the 110% central bank refinancing rate for roubles, and the 15% rate that applies to foreign currency.

Thin capitalisation rules apply to loans provided by non-Russian owners (direct or indirect) who own more than 20% of the share capital or by Russian entities affiliated with such owners, and to loans provided by third parties but guaranteed by such owners or affiliated Russian entities thereof. If the above criteria are met, the maximum deduction on such loans is calculated at a 3:1 debt/equity ratio.

### 8.2.4.4 Provisions for doubtful debts

Provisions for doubtful debts may be made by a taxpayer based on an inventory of debtors prepared at the end of the reporting (tax) period. A doubtful debt is any debt (other than loans) arising from the sale of goods, works or services that is not repaid within the period agreed on and for which no collateral or guarantee has been provided. For debts outstanding for more than 90 days, provisions for the full amount may be set aside. For debts outstanding for 45 to 90 days, provisions made may equal up to 50% of the debt outstanding. Provisions may not be established for debts outstanding for less than 45 days. If a newly created provision exceeds the provisions balance of the preceding period, the difference must be recognised as an expense incurred in the current reporting period. Provisions cannot exceed 10% of the revenue generated in the reporting (tax) period. Taxpayers (except for banks) are not allowed to deduct provisions for overdue interest.

### 8.2.4.5 Insurance premiums

Expenses for mandatory insurance are deductible subject to existing state tariff limitations. Certain types of expenses for voluntary insurance, mainly various types of property insurance, are also deductible. Expenses for third-party-liability insurance are

deductible provided the insurance represents a condition established by international obligation of the Russian Federation under customary international business practice. Long-term life and pension insurance is deductible within 12% of the payroll fund. Voluntary medical insurance is deductible within 3% of the payroll fund. Accident and injury insurance of employees is deductible within a limit of RUB 15,000 per annum per employee.

#### 8.2.4.6 R&D expenses

Generally, R&D costs as defined by law, including expenses for R&D that has not yielded positive results, are generally fully tax deductible one year from completion. Deductions must be distributed evenly during the period.

#### 8.2.4.7 Depreciation and amortisation

Two methods of depreciation (amortisation) for profits tax purposes (at the option of taxpayer) exist: straight line method (evenly over the useful life of assets) and non-linear method which allows significant depreciation in the first years of use. This method cannot be used for buildings and facilities with useful lives of more than 20 years. Accounting depreciation (amortisation) is not taken into account for profits tax purposes.

Property with initial value lower than RUB 20,000 is not considered depreciable property. Revaluation of fixed assets for tax purposes after January 1, 2002, is not possible. Tangible depreciable property is broken down into ten groups by statutory useful life. The useful life of fixed assets is determined on the basis of the statutory-life classification. Intangible assets (intellectual property and exclusive rights to it, except goodwill) are amortised on the basis of their useful life, or ten years by default. In some cases, a special coefficient may be applied to calculate the general depreciation allowance:

- A coefficient of 0.5 for expensive light vehicles and minivans (initial acquisition cost higher than RUB 600,000 and RUB 800,000, respectively). With effect from January 1, 2009, this provision no longer applies.
- Up to 2 for fixed assets used in aggressive environments.
- Up to 3 for fixed assets that are objects of financial leasing (for leases of expensive cars, the coefficient of 0.5 should also apply until January 1, 2009). From January 1, 2009, this acceleration co-efficient will not apply to assets in groups 1-3.

#### 8.2.4.8 Payments to foreign affiliates

No special tax provisions address the deductibility of payments to foreign affiliates for services provided. Royalties (periodical payments for non-exclusive rights), payment for the provision of personnel, management service fees, information, consultancy, legal and similar fees, and lease payments are deducted in full, subject to transfer pricing rules. Deductibility of audit fees other than fees for Russian statutory audit, for example IFRS or US GAAP, is questionable. General and administrative expenses incurred by foreign affiliates may be deductible, but care must be taken to ensure documentary support.

#### 8.2.5 Group taxation

In general, Russian tax law does not include provisions for consolidated reporting by affiliates or group relief. Furthermore, PEs of a foreign legal entity report separately for profits tax purposes. Under special permission from the Ministry of Taxes and Levies, a foreign legal entity with several PEs in Russia carrying on activity within a "unified technological process" can, however, consolidate computation and payment of profits tax.

#### 8.2.6 Tax incentives

Regional authorities may introduce tax concessions in the form of reduced profits tax rates for their part of profits tax, but the regional tax rate cannot be lower than 13.5%. Regional authorities may introduce property tax concessions. Tax exemptions for income received by certain taxpayers (non-commercial organisations, organisations financed from the Russian budget, religious organisations and other qualifying organisations) exist. Certain tax concessions apply to residents of special economic zones.

##### 8.2.6.1 Tax accounting

Tax accounting has been mandatory since January 1, 2002. Tax accounting may be based on statutory accounting records or separate tax accounting may be prepared.

##### 8.2.7 Withholding taxes

Under profits tax law, passive income (such as dividends, interest, royalties), income from sale of immovable property and shares in companies with immovable property accounting for more than 50% of assets, lease income, and freight income from international transport received by foreign legal entities from sources in Russia are subject to withholding of profits tax at source provided that profits are not earned through a PE of a foreign legal entity (in such case, income is taxed via the PE). Any other income received by foreign legal entities that do not have PEs in Russia is not subject to withholding tax. Unless lower treaty rates apply, the domestic withholding rate for dividends is 15%. Other income earned by a foreign legal entity, including interest, income from intellectual property, such as royalties, copyrights, licences, rentals, and other types of income listed in the tax code (excluding freight income, which is taxed at 10%) from sources in the territory of the Russian Federation is taxed at 20%. Gains on the sale of immovable property and shares may be taxed at a rate of 24%. To enjoy double taxation treaty benefits, a foreign legal entity must provide a Russian tax agent (a company paying income) with a residence certificate from the tax or other competent authorities.

The Russian tax authorities recognise the terms of treaties made with the former USSR until renegotiated by the Russian government. The tax treaty network is continuously being updated.

## 8.2.8 Tax administration

### 8.2.8.1 Returns and payments

Legal entities may choose between two profits tax payment systems: quarterly assessment of tax with monthly advance payments or monthly payment of tax on actual profit. The quarterly assessment system without monthly advance payments may be applied only by entities with average quarterly revenues of less than RUB 3 million (calculated on the basis of revenue generated in the preceding four quarters), organisations financed from the Russian budget, PEs of foreign legal entities, and some other organisations. The method chosen must be applied consistently through the year.

### 8.2.8.2 Filing

An annual declaration must be filed by March 28 of the year following the end of the reporting year. Interim declarations (quarterly or monthly) must be filed within 28 days following the end of a reporting period. The same deadlines apply to payment of profits tax. Foreign companies operating through a PE are required to submit a return by March 28 of the year following the calendar year. Because of the regional tax systems, companies are required to file tax returns in each place in which they conduct business.

## 8.3 Individual taxation

### 8.3.1 Significant developments

The following information on individual taxation in the Russian Federation is accurate as of October 27, 2008. For subsequent developments, refer to the contact listed.

With the recent revision of Russian tax legislation, the following significant changes will apply as from January 1, 2009:

- Increase from RUB 20,000 to RUB 40,000 as the maximum cumulative annual income that may be subject to a standard tax deduction of 400 roubles. Increase of child allowance from RUB 600 to RUB 1,000. The amount of income to which this allowance applies is increased from RUB 40,000 to RUB 280,000.
- When the taxpayer receives income in the form of material benefit from favourable interest rates on borrowed (credit) funds, the tax base will be calculated at a rate equal to two-thirds of the refinancing rate of the Russian central bank.
- The tax base for income in the form of interest received on rouble deposits in banks is calculated as the interest that exceeds the interest calculated using the central bank refinancing rate plus five percentage points.
- Fees for the taxpayer's primary and secondary education and vocational education programmes, training and retraining in licensed Russian educational institutions or foreign educational institutions with the appropriate status are not subject to PIT and unified social tax (UST).

- Amounts paid by employers to employees to compensate for the payment of interest on loans (credits) to finance acquisition and/or construction of dwelling are not subject to PIT and UST. This rule will remain in force until January 1, 2012.

### 8.3.2 Territoriality and residence

According to the tax residence rules effective since January 1, 2007, an individual is a Russian tax resident if he/she spends 183 days or more in Russia during a period of 12 consecutive months (instead of 183 days within a calendar year under the previous rules). Days of arrival in Russia are considered days spent in Russia, and days of departure from Russia are counted as days spent in Russia.

Letters from the Russian Ministry of Finance imply, however, that the "final" tax residence status of an individual taxpayer is determined by counting the number of days spent in Russia within the relevant fiscal year (calendar year).

Consequently, the approach remains the same as under previous legislation: To benefit from the 13% resident rate, a taxpayer must spend at least 183 days in Russia in a given calendar year. The new residence rules essentially affect only tax agents and bring with them additional complications because employees' movements must be tracked to ensure that the correct withholding tax rate is applied.

Russian residents are taxed on total worldwide income received in a calendar year, while non-residents are taxed on income received from sources in Russia. Some tax treaties provide for periods of exemption from Russian taxation of Russian-source income received by non-residents. Consequently, it is important to check the details of any applicable tax treaty before commencing work in Russia.

Income from Russian sources includes income received from property located in Russia, dividends received from Russian legal entities, remuneration for activity performed in Russia (also if it is paid by a foreign legal entity from abroad).

### 8.3.3 Gross income

#### 8.3.3.1 Employment income

Income from employment received in the course of a calendar year is subject to personal income tax. Income includes all earnings, bonuses and other forms of payment or remuneration in cash or in kind. For expatriates, taxable income includes allowances paid to employees living in Russia and compensation for school fees, food, travelling expenses incurred by employees and their families on holidays and expenses for other non-business purposes. Benefits in kind are taxed at their monetary equivalent (market price).

#### 8.3.3.2 Capital gains

A special tax rate for capital gains does not exist. Instead, gains from the sale of property and assets are subject to income tax at the normal rate. The taxable

amount is calculated as the difference between sale proceeds and historical cost. Statutory exemption applies, however, to property sold during a calendar year with a limit of RUB 1 million on real property and RUB 125,000 on other property. Proceeds received from the sale of property are fully excluded from taxation if the property is owned for three years. This statutory exemption does not apply to gains on assets disposed of in the course of entrepreneurial activities. Additionally, legislation sets special rules for securities transactions.

### 8.3.3.3 Other taxable income

Other types of income taxable in Russia include

- interest income from deposits outside Russia
- dividends on shares
- income from property leasing, both in Russia and abroad
- royalties from the creation, publication, performance, and use of works of literature, art, and science, as well as from inventions, discoveries, and industrial prototypes [subject to deductions]
- interest and gains on deposits with banks and other credit institutions in Russia [see limits above]
- material benefits [the difference between interest paid on all loans and a notional interest amount calculated with reference to a benchmark rate set by the Russian authorities].

### 8.3.3.4 Non-taxable income

The following types of income are not taxable:

- In limited circumstances, reimbursement by an employer of expenses arising from a work-related change of domicile
- Payments by an employer to compensate for injury or damage to health suffered in the performance of employment duties
- Severance payments upon dismissal [within established limits]
- Business travel expenses [within established limits and conditional on compliance with certain documentary requirements]

## 8.3.4 Deductions

### 8.3.4.1 Non-business expenses

Donations to qualifying charities are deductible from taxable income [within a limit of 25% of the individual's income].

Deductions for expenditures incurred by an individual on the acquisition or construction of a flat or house and payment of interest on mortgage loans are allowed up to RUB 1 million plus the full amount of interest. This is an once-in-a-lifetime exemption.

### 8.3.4.2 Personal allowances

Individuals are granted a deduction of RUB 400 per month. This deduction applies until the individual's cumulative annual income reaches RUB 20,000. Furthermore, individuals are entitled to a monthly allowance of RUB 600 for a child or a dependent.

This deduction applies until the individual's cumulative annual income reaches RUB 40,000. Individuals can also deduct fees paid for their own and their children's education in Russian-licensed institutions, fees for medical services (for themselves and close relatives) and medication expenses. The limit on each type of deduction is RUB 50,000.

### 8.3.5 Tax credits

Residents of Russia are entitled to a tax credit against their Russian tax liabilities if provided by a relevant double taxation treaty. The credit cannot exceed tax payable in Russia.

To make a foreign tax credit claim, an individual must provide the Russian Tax Authorities with supporting documentation to obtain approval of the credit for taxes paid in another country. Documentation must be submitted to the Russian tax authorities by December 31 of the year following the reporting year.

## 8.3.6 Other taxes

### 8.3.6.1 Social security taxes

The following social security taxes are payable:

1. Unified social tax (UST) – All Russian and foreign legal entities registered in Russia are required to make UST payments for their employees and contractors. UST is calculated on the basis of remuneration, bonuses, and other income paid in cash or in kind accrued by an employer in favour of employees, as well as remuneration paid under civil law contracts for provision of works/services and copyright agreements. The amount payable is calculated for each individual. UST is the liability of the employer only; employees are not liable to make any social security contributions.

The maximum UST rate is 26%. Regressive tax rates apply. The actual rate depends on the annual salary received from an employer:

- Salaries not exceeding RUB 280,000: 26%;
- Salaries from RUB 280,001 to RUB 600,000: RUB 72,800 + 10% of the amount exceeding RUB 280,000
- Salaries exceeding RUB 600,000: RUB 104,800 + 2% of the amount exceeding RUB 600,000

UST for non-Russian nationals is payable in accordance with the rates above.

2. Statutory pension contributions – Russian and foreign legal entities registered in Russia are required to make statutory pension contributions to the State Pension Fund for their Russian employees and certain categories of non-Russian employees and contractors. Such contributions are fully deductible against UST. Russian pension contributions are not payable for non-Russian employees temporarily residing in Russia under Russian law. Only non-Russian employees with residence permits are eligible for pension and social reimbursements from the Russian state pension system. Statutory pension contributions are calculated

on the same basis as that used to calculate UST. For individual entrepreneurs, the basis consists of the income related to their entrepreneurial activity, excluding related expenses. Tax rates depend on age and gender of employees and on the tax base. Amounts paid are divided into insurance and investment portions.

3. Statutory accident insurance – Employers must contribute to an insurance scheme covering accidents at work and work-related diseases. The rate of this contribution varies from 0.2% to 8.5% of the payroll fund, depending on the type of activity of the employer.

#### **8.3.6.2 Property tax**

Property tax is imposed on property located in Russia and owned by Russian and non-Russian citizens. The tax applies to buildings, houses, and flats and is levied at a rate of 0.1% to 2% of the value of the property. It should be noted that the “inventory value” of property used for tax calculation is usually less than market value.

#### **8.3.6.3 Transport tax**

Transport tax is imposed on cars, motorcycles, buses, vans, planes, helicopters, yachts, boats, ships, and other water, air, and land transport registered in Russia and owned by Russian and non-Russian individuals. Fixed rates per unit of horsepower, gross ton, or unit of transport differentiated on the basis of engine capacity, gross tonnage and type of transport apply.

### **8.3.7 Tax administration**

#### **8.3.7.1 Returns and payment**

Tax on employment earnings and certain other payments must be withheld at source by the entity making the payment. This includes tax on income from the performance of labour under civil law contracts. Individuals receiving income from non-Russian sources and some other types of income on which tax is not withheld at source have a duty to report taxable income and pay Russian tax.

Income must be reported no later than on April 30 of the year following the reporting year. Tax payments are generally due no later than on July 15 of the year following the reporting year. Payment must be made in cash or from the taxpayer’s personal rouble account with a Russian bank. With effect from January 1, 2007, tax payments from abroad in a foreign currency are no longer possible. Tax overpaid may, at the taxpayer’s request, be either refunded or credited against future liabilities.

The actual income received during a stay in Russia must be reported one month prior to permanent departure from Russia. Joint returns with a husband or wife are not permitted. There is no provision for a taxable year other than the calendar year.

### **8.3.8 Tax rates**

Income tax is payable in roubles at the rates applicable to certain income categories.

Income in foreign currency is converted into roubles at the exchange rate of the Central Bank of the Russian Federation on the date the amount is received. The flat tax rate is 13% for all types of income received by residents, except the following:

1. Dividends received by tax residents are taxed at 9%. A special offset mechanism applies to dividends paid out by group companies to its shareholders.

2. A tax rate of 35% applies to the following types of income:

- The value of any awards and prizes received during contests, games, and other events conducted for the purpose of advertising goods, work, and services, in excess of the set limits.
- Insurance payments under voluntary insurance agreements in excess of the set limits.
- Interest on deposits with Russian banks in excess of the amount calculated using the central bank’s current interest rate for rouble deposits during the interest-accrual period and 9% annual interest on foreign currency deposits.
- The difference between interest paid on all loans and a notional interest amount calculated with reference to a benchmark rate set by the Russian authorities.

Income, except dividends, received by individuals that are non-residents of the Russian Federation is taxed at rate of 30%. Dividends received by non-residents since January 1, 2008, are subject to a flat rate of 15%.

#### **8.3.8.1 Exchange rates**

For tax calculation purposes, foreign income is translated into roubles at the exchange rate quoted by the Central Bank of the Russian Federation on the date income is received.

### **8.4 Value added tax**

VAT was introduced in Russia with effect from 1992. The current VAT legislation took effect on January 1, 2001. The VAT system, while not originally based on the EU model system, is gradually moving toward it. VAT applies to the value added by each element in the chain of production from producer to consumer. The standard rate is 18% (with a lower rate of 10% applying to certain basic foodstuffs, children’s clothing, drugs and medical goods, and printed publications). The same VAT rates apply to goods imported into the territory of Russia. Exports and directly related services are taxed at a zero rate.

Taxpayers (except taxpayers selling excisable goods) can be exempt from VAT if sales proceeds for the three preceding months do not exceed RUB 2 million (excluding VAT).

The list of exempt goods and services includes basic banking and insurance services, educational services by certified establishments, certain vitally important medical equipment, a range of domestic passenger transport services, and certain other socially important services. Accredited representative offices of foreign legal entities may be exempt from VAT on property rental payments. Similarly, citizens of accredited states may also benefit from the VAT exemption that applies to rental property. Most exemptions from VAT carry no right to input credit in Russia. Instead, input VAT may be deductible for profits tax purposes.

Most taxpayers apply an EU-type input-output VAT system, under which VAT payers add VAT to their selling prices and deduct VAT added to costs of inventory and related expenses. Since January 1, 2006, VAT has been calculated on an accrual basis only.

While VAT on inventory and services acquired can generally be reclaimed at purchase and documented by a VAT invoice, VAT on a fixed asset acquired also requires that the asset be booked in the taxpayers accounts. Since January 1, 2006, input VAT related to capital construction have generally been recoverable in accordance with the general input VAT recovery rules. Furthermore, taxpayers are obliged to account for VAT on construction activities using the taxpayers' own resources. Exports of goods to destinations outside Russia, including to the CIS (Commonwealth of Independent States) countries, transport and other services related to exports of goods from and imports of goods into Russia, international passenger transport, sales to diplomatic functions, and certain other transactions are zero-rated with a right to offset input VAT. To apply the zero rate and achieve input credit for exported goods, presentation of proof of actual export is required. A significant volume of documents have to be submitted to the tax authorities within 181 days to confirm application of the zero rate.

Russian VAT legislation includes a reverse-charge mechanism. With this mechanism, a Russian entity is required to account for VAT on any payment it makes to a non-tax-registered foreign entity if the payment is connected to the sale of goods (works and services) supplied on the territory of the Russian Federation. VAT falls due to the state budget on the day the taxpayer pays the foreign supplier for the supply. The VAT withheld may be considered an input VAT credit to the Russian taxpayer subject to the normal rules for input VAT recovery. A foreign supplier may offset Russian VAT paid through the reverse-charge mechanism, Russian VAT paid at import of supplies and on domestically acquired supplies only by registering for taxes in Russia. No special VAT registration applies.

Furthermore, EU-type of place-of-supply rules exist for determining where services are supplied for VAT purposes. These rules divide services into different categories. For example, certain services are supplied at the place of performance, some at the location of the "buyer" of the services, and others at the location of certain property.

All Russian-registered taxpayers that are providers of goods and services must be able to issue a VAT invoice for VAT purposes. A standard-format invoice must be issued within five days of the supply of goods (services). The duplicate copy of the invoice is registered in a sales journal, and incoming invoices are to be recorded in a purchase book. Compliance with invoicing and accounting procedures is critical to the supplier's ability to recover input VAT.

Quarterly filing of VAT returns has been mandatory since January 1, 2008. With effect from the VAT period ended on September 30, 2008, any amount due on the return filed has been payable in three equal instalments on the 20th day of each of the three months following the return period.

Individual entrepreneurs are VAT payers and liable to VAT reporting requirements. Individual entrepreneurs and companies generating quarterly revenues of less than RUB 2 millions may be exempt from VAT liability on application to the tax authorities.

#### **Import VAT**

A limited range of goods is exempt from import VAT. The list of such goods includes humanitarian aid and goods designated for the diplomatic corps. Exemption from import VAT is available on a range of technological equipment, their components and spare parts imported as contributions to the charter capital of enterprises.

## 9 Banking environment

### 9.1 Overview

#### Introduction

One third of Russian banks were created in 1990 by splitting large Soviet banks into smaller banks. By 1992, second-tier banks represented 55% of the 1,400 banking entities in existence.

Russia saw the second wave of bank creation between 1992 and 1994 when large enterprises and organisations established their own small banks. Bank registrations totalled 2,400 at the peak of the sector's expansion in 1995.

At the same time, however, the shareholders and owners (enterprises, associations, ministries, social organisations, etc.) of these banks were, at least nominally, public sector entities themselves. Hence, this metamorphosis of state-owned banks took place almost entirely within the public sector.

Banking crises in 1995, 1998, and 2004 were generally the result of banks' deteriorating liquidity or partial default on the part of the state itself as was the case in 1998.

#### 9.1.1 The central bank

##### Background

The Central Bank of the Russian Federation (CBR) is an independent legal entity accountable only to the State Duma. It operates in accordance with the Constitution of the Russian Federation and the Federal Law on the Central Bank of the Russian Federation (Bank of Russia).

##### Responsibilities

The principal function of the central bank is to protect the rouble and guarantee its stability. The central bank supervises the Russian banking sector.

As a rule, the State is not liable for the central bank, and the central bank is not liable for the State.

#### 9.2 ZAO Danske Bank

ZAO Danske Bank forms part of the Danske Bank Group, one of the largest banks in northern Europe that offers a wide range of financial services, including insurance, mortgage finance, asset management, brokerage and real property and leasing services.

The bank's products and services include those most widely used by subsidiaries of non-Russian companies that have set up in Russia.

The bank offers:

- accounts and payment services
- international payments through SWIFT
- rouble clearing
- credit and deposit facilities
- treasury products
- trade finance
- cash management solutions
- electronic banking services
- customs cards
- currency control services

The bank offers deposit accounts and loan facilities in roubles and all other major currencies, and provides domestic and international transfer services, including SWIFT.

Most companies thinking of setting up in Russia will find that local conditions and regulations are quite different from what they are used to. Therefore, the assistance of a professional financial service provider is worth considering for companies that are planning to enter the Russian market.

ZAO Danske Bank knows the ins and outs of Russian business life, and can help customers set up banking transactions that comply with local legal requirements.

The financing of activities in Russia will often be easier if handled by a bank operating locally. From the office in central St. Petersburg, the customers are offered a targeted range of products and services based on deep insight into the local business environment in Russia.

ZAO Danske Bank is licensed for all banking operations in all currencies, and the staff is trained specifically to help and advise non-Russian customers trading or doing other types of business in Russia.

See [www.danskebank.ru](http://www.danskebank.ru) for further information.

### 9.3 Legal & regulatory issues

#### 9.3.1 Introduction

Regulations develop in step with the state of the Russian economy. The following is general information only, and individual legal advice should be sought.

#### 9.3.2 Resident and non-resident status

Resident organisations include legal entities, established under Russian laws and located in Russia, such as financial partnerships, companies, production co-operatives, state and municipal unitary enterprises as well as non-profit organisations.

Non-resident organisations include foreign legal entities, companies and other corporate associations with a civil legal capacity set up in accordance with the legislation of foreign states, international organisations, their branches and representative offices set up on the territory of the Russian Federation.

#### 9.3.3 Account ownership

Accounts in roubles as well as in foreign currency can be held by residents, domestically and abroad, and non-residents that have registered with the relevant local tax office in Russia. The tax office has to be notified of each bank account opened with a Russian bank. Effective from June 2005, Russian resident companies are allowed to open accounts in OECD and FATF countries (from January 2007 also in other countries) without the permission of the Russian central bank but subject to subsequent notification of the tax authorities.

### 9.3.4 Cash pooling regulations

There is no specific legislation on cash pooling and no specific restrictions to the accounting and tax treatment of pooling arrangements. At the same time, each arrangement requires good understanding of all legal, taxation and operational aspects. Therefore no common cash pooling market practice exists.

### 9.3.5 Account types and charges

Banking transaction fees are not standardised and banks follow their own individual policies. Fees can vary a lot depending on the relationship between the bank and the customer as well as on the transaction. Lifting fees are not applied. Russia has not adopted the IBAN.

### 9.3.6 Foreign exchange controls

The Russian rouble is currently pegged to a basket composed of US dollars (55%) and euros (45%). The central bank sets the exchange rate between the rouble and the basket as well as the allowed fluctuation corridor. After some years of currency stability and even appreciation, at the end of November 2008, the central bank confirmed that it has decided to pursue a governed depreciation of the rouble.

It is expected that, in the coming years, Moscow will shift from a monetary policy based on exchange-rate management to an interest-rate-managed policy – in line with most developed countries. Exchange rates for the most prominent foreign currencies are calculated daily, based on RUB/USD quotes in the domestic foreign exchange market and other currency quotes against the US dollar in the global exchange market.

The central bank applies currency controls. Export proceeds can be kept in residents' bank accounts outside Russia, but a CBR permit is required to establish or acquire capital in financial institutions abroad.

All transactions between residents and non-residents must be reported to the central bank. Reporting is usually effected by the banks on behalf of customers.

### 9.3.7 Money laundering

Russia has implemented anti-money laundering legislation (Law RF 115-FZ on Combating Legalisation (Laundering) of Criminally Gained Income and Financing of Terrorism in 2002 and article 174 of the Criminal Code). Federal law 275-FZ on Amendments to Articles 5 and 7 of the Federal Law and on Counteracting the Legalisation (Laundering) of Criminal Income and Financing of Terrorism came into force on 15 January 2008. Together they tightened disclosure requirements for customer details on payments that used to be anonymous.

Russia is a Financial Action Task Force (FATF) member and observes most of the FATF-49 standards. Russia is also a member of the Council of Europe's MONEYVAL Select Committee and the Eurasian Regional Group on Combating Money Laundering and Financing of Terrorism (EAG). Russia has established a financial intelligence unit (FIU), the Federal Financial Monitoring Service (FFMS), which is a member of The Egmont Group.

Financial institutions in the broadest sense must record and report suspicious transactions to the authorities (FFMS). They must also identify their customers and report transactions exceeding RUB 600,000 (around EUR 17,000) involving cash, bank deposits, precious materials, life insurance payments, gambling and entities in certain high-risk countries to the authorities.

Account operating procedures require full identification. Correspondent relationships with non-resident credit institutions that do not have a physical presence in the country of incorporation are not permitted. All foreign financial institutions must operate solely through subsidiaries incorporated in Russia subject to domestic supervision. Banks are required to keep all records for at least five years after account closing.

### 9.3.8 Electronic transaction regulations

On 10 January 2002, Federal Law No. 1-FZ on Electronic Digital Signature came into force. Under this act, an electronic digital signature can be used to sign all civil law contracts unless specifically prohibited by legislation. For example, real-property purchase agreements must be drafted in the form of a physical document and signed by the parties.

Electronic signing cannot be used for electronic documents submitted to the government authorities or civil law documentation that will subsequently need state registration (or notarisation).

## 9.4 Payment and collection

### 9.4.1 Introduction

Paper-based payment methods are rapidly being replaced by electronic solutions. Electronically processed payments represent more than 77%, measured by volume, and 90%, measured by value, of all domestic payments. In the CBR payment system, this figure is higher than 99%. Nonetheless, the importance of cash payments is still considerable, although decreasing. Credit transfers are the dominant payment instrument in terms of both volume and value. Cheques are not used in Russia except for companies' withdrawal of cash from their own accounts (a regulatory requirement).

The retail credit card market in Russia is developing fast, and banks in Russia are issuing an increasing number of credit cards. The infrastructure of the payment card industry is fairly developed and has advanced further since 2002, when 99% of consumer retail cards were used to make ATM cash withdrawals. This figure is now 70%, with more people using their cards for purchases at points of sale.

On the non-retail side, businesses are now well aware of the advantages of using corporate cards instead of cash for corporate expenses. Both debit and credit cards are used for corporate purposes and use is expanding rapidly.

#### 9.4.2 Card payments

While the use and issuance of payment cards have increased steadily in recent years, Russia remains essentially a cash-based economy. The coming into force on April 10, 2005, of Bank of Russia Regulation of December 24, 2004, No. 266 P on The Issue of Bank Cards and Payment Card Operations further facilitated expansion of the payment card market. The number of cards issued by credit institutions increased by 36.8% to 74.8 million (54.7 million in 2005), while the number of payment card operations reached 1,198.5 million (up 39.0%) in 2006, and their value totalled RUB4,396.7bn (an increase of 47.3%).

Since the introduction of credit cards in 2001, their popularity has continued to increase. By 2006, the number of credit cards had increased by 128.3%, while the number of credit card operations had risen by 77.2% and their value expanded by 88.4%. Despite this growth, credit card operations accounted for only 2.0% of total payment card operations.

#### 9.4.3 Credit transfers

The payment order is the dominant cashless payment instrument in Russia in terms of both volume and value. Credit transfers can be paper-based or automated, but electronic credit transfers account for the majority of transfers, and their popularity continues to increase. Nearly all interbank transactions are effected electronically.

#### 9.4.4 Direct debits

Direct debits (payment requests), standing orders, collection orders and letters of credit account for a very small proportion of cashless payments in Russia.

#### 9.4.5 Cheques

Cheques as a means of payment are used only to withdraw cash from corporate accounts because it is required by law.

There is no interbank cheque clearing system in Russia.

### 9.5 Electronic banking

#### 9.5.1 Introduction

Electronic banking services are offered by leading Russian banks as well as international banks. There is currently no electronic banking standard. Banks either offer standard platforms provided by local or foreign vendors (such as Germany's MultiCash system) or their own proprietary software (which usually does not feature multibank functionality) for corporate banking purposes.

Internet banking by retail customers is not widespread. The Russian electronic banking system has been used to establish corporate-to-bank connectivity for many years. Recent trends include solutions for connectivity between corporate enterprise resource planning (ERP) systems and electronic banking systems, and global solutions that link accounts across different countries.

#### 9.5.2 EDIFACT / host-to-host solutions

Businesses' growing effort to streamline payment processing is supported by a number of banks. Host-to-host (H2H) solutions are available that provide direct connectivity between the customer's ERP system and the bank's processing engine with no bank software in between.

#### 9.5.3 E-payments

Micropayments are offered by domestic and global players, such as Webmoney, Yandex.Money, E-Gold, E-port, Rapida, Assist, CyberPlat, PayPal, MoneyMail, Rupay, Moneybookers and Internet. Money, as well as via web-based remote banking platforms. In general, such solutions rely on two important prerequisites: (1) prepayment and (2) settlement by debit or credit card.

#### 9.5.4 E-invoice / EBPP

No industry-wide electronic bill presentment and payment (EBPP) solutions exist on the market, although various providers operate in Russia.

### 9.6 Cash pooling solutions

With the liberalisation of the Russian currency regulations, which now allow the holding of offshore accounts, large Russian businesses are increasingly looking for global solutions that enable them to access their accounts not only with Russian banks but also with foreign banks through one screen and one system.

The current state of cash pooling in Russia is as follows:

- Rules on currency restrictions were changed in 2006
- Resident and non-resident accounts are legal
- All pooling variations are legal – but not common practice
- A market practice is required before cash pooling becomes widespread among businesses

## 10 Useful Links – Russia

### Embassies

#### Foreign embassies in Russia

<b>Embassy of Denmark in Russia</b> <a href="http://www.ambmoskva.um.dk">www.ambmoskva.um.dk</a>	<b>Embassy of Lithuania in Russia</b> <a href="http://ru.mfa.lt">http://ru.mfa.lt</a>
<b>Embassy of Estonia in Russia</b> <a href="http://www.estemb.ru">www.estemb.ru</a>	<b>Embassy of Norway in Russia</b> <a href="http://www.norvegia.ru/norsk/ambassaden">www.norvegia.ru/norsk/ambassaden</a>
<b>Embassy of Finland in Russia</b> <a href="http://www.finland.org.ru">www.finland.org.ru</a>	<b>Embassy of Poland in Russia</b> <a href="http://www.polandemb.ru">www.polandemb.ru</a>
<b>Embassy of Germany in Russia</b> <a href="http://www.moskau.diplo.de">www.moskau.diplo.de</a>	<b>Embassy of Sweden in Russia</b> <a href="http://www.swedenabroad.com">www.swedenabroad.com</a>
<b>Embassy of Ireland in Russia</b> <a href="http://www.embassyofireland.ru">www.embassyofireland.ru</a>	<b>Embassy of UK in Russia</b> <a href="http://www.britaininrussia.ru">www.britaininrussia.ru</a>
<b>Embassy of Latvia in Russia</b> <a href="http://www.am.gov.lv/moscow">www.am.gov.lv/moscow</a>	

#### Embassies of Russia abroad

<b>Embassy of Russia in Denmark</b> <a href="http://www.denmark.mid.ru">www.denmark.mid.ru</a>	<b>Embassy of Russia in Lithuania</b> <a href="http://www.lithuania.mid.ru">www.lithuania.mid.ru</a>
<b>Embassy of Russia in Finland</b> <a href="http://www.finland.mid.ru">www.finland.mid.ru</a>	<b>Embassy of Russia in Norway</b> <a href="http://www.norway.mid.ru">www.norway.mid.ru</a>
<b>Embassy of Russia in Estonia</b> <a href="http://www.estonia.mid.ru">www.estonia.mid.ru</a>	<b>Embassy of Russia in Poland</b> <a href="http://www.poland.mid.ru">www.poland.mid.ru</a>
<b>Embassy of Russia in Germany</b> <a href="http://www.germany.mid.ru">www.germany.mid.ru</a>	<b>Embassy of Russia in Sweden</b> <a href="http://www.sweden.mid.ru">www.sweden.mid.ru</a>
<b>Embassy of Russia in Ireland</b> <a href="http://www.ireland.mid.ru">www.ireland.mid.ru</a>	<b>Embassy of Russia in UK</b> <a href="http://www.great-britain.mid.ru">www.great-britain.mid.ru</a>
<b>Embassy of Russia in Latvia</b> <a href="http://www.latvia.mid.ru">www.latvia.mid.ru</a>	

#### Lawyer -Accountant - Consultant

<b>Bech-Bruun International</b> <a href="http://www.bechbruun.com">www.bechbruun.com</a>	<b>Mannheimer Swartling</b> <a href="http://www.mannheimerswartling.se">www.mannheimerswartling.se</a>
<b>PricewaterhouseCoopers</b> <a href="http://www.pwc.com">www.pwc.com</a>	<b>CaRisMa Consulting</b> <a href="http://www.carismaconsulting.dk">www.carismaconsulting.dk</a>

## Danske Bank

<b>Denmark</b> Danske Bank <a href="http://www.danskebank.com">www.danskebank.com</a>	<b>Lithuania</b> Danske Bankas <a href="http://www.danskebankas.lt">www.danskebankas.lt</a>
<b>Estonia</b> Sampo Pank <a href="http://www.sampopank.ee">www.sampopank.ee</a>	<b>Northern Ireland</b> Northern Bank <a href="http://www.northernbank.co.uk">www.northernbank.co.uk</a>
<b>Finland</b> Sampo Pankki <a href="http://www.sampobankki.fi">www.sampobankki.fi</a>	<b>Norway</b> Fokus Bank <a href="http://www.fokus.no">www.fokus.no</a>
<b>Germany</b> Danske Bank <a href="http://www.danskebank.com/de">www.danskebank.com/de</a>	<b>Poland</b> Danske Bank <a href="http://www.danskebank.com/pl">www.danskebank.com/pl</a>
<b>Ireland</b> National Irish Bank <a href="http://www.nationalirishbank.ie">www.nationalirishbank.ie</a>	<b>Russia</b> ZAO Danske Bank <a href="http://www.danskebank.com/ru">www.danskebank.com/ru</a>
<b>Latvia</b> Danske Banka <a href="http://www.danskebanka.lv">www.danskebanka.lv</a>	<b>Sweden</b> Danske Bank <a href="http://www.danskebank.se">www.danskebank.se</a>

## General Information

<b>Central Bank of the Russian Federation</b> <a href="http://www.cbr.ru">www.cbr.ru</a>	<b>Moscow Stock Exchange (MSE)</b> <a href="http://www.mse.ru">www.mse.ru</a>
<b>Ministry of Finance</b> <a href="http://www.minfin.ru">www.minfin.ru</a>	<b>Moscow Interbank Currency Exchange</b> <a href="http://www.micex.com">www.micex.com</a>
<b>Ministry of Economic Development and Trade</b> <a href="http://www.economy.gov.ru">www.economy.gov.ru</a>	<b>Association of Russian Banks</b> <a href="http://www.arb.ru">www.arb.ru</a>
<b>Federal Financial Markets Service</b> <a href="http://www.fcsr.ru">www.fcsr.ru</a>	<b>Russian Chamber of Commerce and Industry</b> <a href="http://www.tpprf.ru">www.tpprf.ru</a>
<b>RTS Stock Exchange</b> <a href="http://www.rts.ru">www.rts.ru</a>	

Danske Bank  
Holmens Kanal 2-12  
DK-1092 Copenhagen K

Tel. +45 45 12 00 00  
[www.danskebank.com](http://www.danskebank.com)