

Doing business in the Russian Federation



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Introduction





This guide has been prepared by EY Russia in order to provide a quick overview of the legal framework, tax system, forms of business organization, and business and accounting practices in Russia. Making decisions about foreign operations is a complex task that requires knowledge of a country's commercial climate, bearing in mind that the Russian business and regulatory environment continues to develop on multiple fronts. Detailed advice should be taken before commercial decisions are taken. This guide is no substitute for such advice. This guide reflects information current as of **July 2014** (except where a later date is specified in the text).

In March to September of 2014, economic sanctions were imposed on Russia and certain Russian companies and individuals by the United States, the European Union and a number of other states in connection with events in Ukraine. Russia responded with its own sanctions, including bans on food imports from the European Union, the United States, Canada, Australia and Norway. How long such measures might stay in force and whether further measures might be introduced was unclear when this publication went to press.

Concern regarding the impact of sanctions contributed to uncertainty about the extent to which a range of tax measures proposed by the government in the first half of 2014 and intended to have effect from 1 January 2015 would actually be enacted.

Read more about doing business in Russia and find details of more recent developments in the regulatory and tax environment at www.ey.com/russia.

EY provides assurance, advisory, tax and legal, and transaction advisory services in the principal cities of the world. Additional copies of this brochure may be obtained from EY's Moscow office:

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General business information





Time

Russia has been on daylight saving time from 2011. This will change at 02:00 on 26 October 2014. In the time zone in which Moscow and St Petersburg are located, the clocks will be put back one hour. Ten other time zones will exist (currently, there are only nine in total). Kaliningrad Province will be at Moscow time minus one hour; while at the opposite extreme, Kamchatka Territory and the Chukchi Autonomous District will be at Moscow Time plus nine hours. Daylight saving time will not apply at any time of the year. There will be no seasonal changes. During the winter, Russia's time zones will progress from two hours ahead of Greenwich Mean Time (GMT) in the west to 12 hours ahead of GMT. Moscow, the capital city, will be three hours ahead of GMT.

Time differences between Moscow and some major cities of the Commonwealth of Independent States (CIS) from 26 October 2014 are shown in the following table:

City	Hours ahead of or behind Moscow
Kyiv	-1/0
St. Petersburg	0
Baku	-1/0
Almaty*	+3
Novosibirsk	+3
Vladivostok	+7

* Kazakhstan does not observe daylight saving time.

Flying time between Moscow and some major cities of the world, as well as time differences, are shown in the table below:

City	Time difference	Flying time
London	-3 or -2	3 hours 50 minutes
New York	-8 or -7	8 hours 30 minutes
Paris	-2 or -1	3 hours 45 minutes
Tokyo*	+6	10 hours 25 minutes

* Japan does not observe daylight saving time.

Source: <http://www.timeanddate.com/>

Public holidays

The following days are non-working public holidays in Russia:

Holiday	Date
New Year holidays	1, 2, 3, 4, 5, 6 and 8 January
Russian Orthodox Christmas Defenders of the Fatherland Day	7 January
International Women's Day	23 February
Spring and Labor Day	8 March
Victory Day	1 May
Russia Day	9 May
National Unity Day	12 June
	4 November

In the event that a day of rest and a non-working public holiday coincide, the day of rest is usually carried over to the next working day after the public holiday. If a holiday falls on a Tuesday, the Monday before will serve as a bridge holiday.

In this case, the following Saturday will be a regular working day, making up for the Monday bridge holiday. Those of the New Year holidays that fall on a weekend are now being carried over to later in the year.

Financial system

Overview

Credit institutions, non-governmental pension funds, insurance companies and investment funds are the major pillars of the Russian financial system.

Cash transactions and transfers are carried out by financial institutions within the framework of the national payment system. Organized securities trading is carried out at securities exchanges. Both securities exchanges and over-the-counter transactions with securities often involve financial intermediaries – professional participants in the securities market (brokers, dealers, asset managers, depositaries and registrars).

Since 1 September 2013, the Central Bank of the Russian Federation (the Central Bank) has assumed the role of the single financial regulator responsible for oversight of the entire financial segment of the Russian economy, with authority extending from supervision over financial institutions to regulation of securities placements and securities exchanges. The Federal Financial Markets Service that was previously in charge of regulation of securities markets and acted as investment funds regulator was dissolved on 1 September 2013.

Banking system

Credit institutions

Banking operations in Russia may be carried out only by licensed credit institutions, which include banks and non-banking credit institutions. Banking operations are listed in the statute and include: accepting deposits from legal entities and individuals, placement of attracted funds, opening and maintaining bank accounts of legal entities and individuals, money transfers and electronic money transfers, cash collection services and foreign currency exchange, as well as the issue of bank guarantees (a Russian equivalent to standby letters of credit).

All licensed banks in Russia are entitled to accept deposits from, and open accounts for, legal entities, place funds and perform money transfers. Banks that are able to qualify under a tighter set of requirements may also receive a retail banking license permitting them to attract deposits from and open accounts for individuals. Banks that have been in good standing for at least two years may also apply to the Central Bank for extension of their banking activities and receive a general license, which allows them to conduct almost all types of regular banking operations. The only banking operation excluded from the scope of the general license is attraction of deposits and distribution of precious metals. Non-banking credit institutions are allowed to perform just the limited banking operations listed in their license and may only accept deposits from, and open accounts for, legal entities (and are not allowed to carry out similar operations with individuals).

The Central Bank performs a supervisory function over Russian credit institutions. It enacts mandatory regulations applicable to banking operations and sets financial requirements for their performance, approves the appointment of senior management, holds their mandatory reserves and monitors their compliance with applicable requirements. Since 1 January 2014, Russian credit institutions are required to comply with Basel III capital requirements.

Currently, foreign banks cannot perform banking activities in Russia directly or through their branch offices, but they are allowed to set up Russian banking subsidiaries. Establishment and operations of such subsidiaries are subject to certain additional requirements (e.g., Russian citizens should comprise at least 75% of the overall employee headcount and at least 50% of the management board if the chief executive officer is a foreign national). The other notable restriction, which applies to both Russian and foreign investors, is the requirement to obtain prior approval of the Central Bank when acquiring ownership or control directly or indirectly over 10% (or more) of the shares in a Russian bank.

Foreign banks are also allowed to establish representative offices in Russia, subject to prior approval of the Central Bank. Representative offices of foreign banks may only be established with a view to evaluating the prospects of entering the Russian banking market and providing advisory services to the bank's clients. Representative offices of foreign banks may not perform any banking operations in Russia.

National payment system

Federal Law No. 161-FZ “On the National Payment System” of 27 June 2011 (the National Payment System Law) came into effect in September 2011. It sets the legal and organizational framework for transactions within the national payment system operated by the Central Bank and defines the procedures and mechanisms of cash transfers (wire transfers), both for cash in bank accounts and electronic funds.

Bank account balances are the main source of funds for cash transfer operations. Amendments to the Russian Civil Code that came into effect on 1 July 2014 introduced a few additional types of bank account that may be opened by credit institutions for their clients: in addition to “classic” current (settlement) accounts, banks may open escrow, nominee and pledge accounts, and carry out operations specific to these types of accounts.

The National Payment System Law allows credit institutions to create payment systems managed by private operators that are responsible for processing and clearing payments of the members of the payment system. Private payment systems are subject to supervision and oversight from the Central Bank. A payment system may be recognized as a payment system of national significance if it complies with certain requirements and its operator is beneficially owned by Russian citizens. Operators of private payment systems (other than payment systems of national significance) are required to make and maintain security deposits with the Central Bank.

The National Payment System Law also regulates the operations of banking payment agents, legal entities or individual entrepreneurs engaged by a credit institution to identify customers and to collect or make payments of petty cash or electronic funds on behalf of the credit institution. Operations of non-banking payment agents, responsible for collection of petty cash from individuals on behalf of suppliers of goods, works or services, are subject to similar regulation under a different piece of legislation – Federal Law No. 103-FZ “On Operations of Collection of Payments from Individuals Performed by Payment Agents” of 3 June 2009.

Deposit insurance

To protect individual depositors, Federal Law No. 177-FZ “On Insurance of Deposits of Individuals in the Banks of the Russian Federation” of 23 December 2003 (the Deposit Insurance Law) came into effect at the end of December 2003. It stipulates that a bank may only accept deposits from, or open accounts for, individuals if the bank is a member of the deposit insurance system.

The Deposit Insurance Law provides for the creation of the Agency for Insurance of Deposits (the Agency). The Agency acts as an insurer in the deposit insurance system. Its responsibilities include collecting insurance contributions, managing the funds in the mandatory insurance pools, establishing insurance premiums and monitoring insurance payments. Any bank that has been granted a retail banking license is entered in the Agency’s register as a participant in the mandatory deposit insurance system.

Banks participating in the deposit insurance system are subject to a number of requirements, including compliance with the Central Bank’s monitored mandatory ratios (capital adequacy, liquidity, etc.) and reliability of financial accounts and reports. Failure to meet such requirements may lead to the bank being unable to attract deposits from, or open accounts for, individuals.

Member banks pay a contribution into the deposit insurance fund. These contributions are calculated as a percentage of the average daily balance of individual deposits maintained with a particular bank and are subject to an upper limit.

Insurance companies and non-governmental pension funds

Insurance companies

In Russia, insurance services may be provided only by licensed insurance companies. The types of activities that are subject to licensing include property insurance, liability insurance, accident insurance, health insurance, life insurance and entrepreneurial risk insurance, reinsurance and insurance brokerage.

An insurance company may not simultaneously hold licenses to provide life insurance coverage (life insurance company), on one hand, and property, liability and entrepreneurial risk insurance (property insurance company) on the other hand. However, insurance companies of both types may provide health and accident insurance coverage.

The Central Bank is vested with the authority to regulate and supervise the Russian insurance sector. It sets certain financial requirements related to capital adequacy of, and formation of insurance reserves by, insurance companies. It monitors compliance with regulatory requirements related to operations of insurance companies, their officers and shareholders. The Central Bank is also authorized to pass regulations determining classes of assets that are acceptable for the purposes of investment of insurance reserves.

Foreign insurance companies cannot provide insurance coverage in Russia directly or through their branch offices, but they are allowed to set up Russian insurance subsidiaries. Operations of such subsidiaries are subject to certain additional requirements (e.g., they are not allowed to provide insurance coverage to state authorities and companies and, until 2017, to provide life insurance coverage). Furthermore, foreign entities or their subsidiaries may not control more than 50% of the aggregate amount of share capital of all insurance companies in Russia.

Non-governmental pension funds

Licensed non-governmental pension funds (“pension funds”) are the structures most commonly used to set up pension and retirement schemes in Russia. Pension insurance coverage may also be provided by insurance companies.

Russian legislation on non-governmental pension and retirement schemes has been subject to a number of fundamental changes that, upon the expiration of a

transitional period at the end of 2015, will create a new regulatory environment for non-governmental pension and retirement schemes.

From 1 January 2014, a pension fund may only be established in the form of a joint-stock company. All existing funds (that were organized as non-commercial foundations with no members) need to be transformed into joint-stock companies by the end of a transitional period.

Pension funds operate private pension and retirement schemes. Pension funds that comply with tighter regulatory requirements may also receive a certain part of the employer’s contributions to the mandatory state pension insurance system at the election of the employee for whose benefit such contributions are made. From 1 January 2015, the amounts of such contributions will be insured by the Agency.

The discretion of pension funds (and asset management companies) with respect to the choice of investment strategy for amounts received as contributions to the mandatory state pension insurance system is significantly limited by the long list of restrictions set out in Federal Law No. 111-FZ “On the Investment of Funds for Financing of the Cumulative Part of the Labor Pension in the Russian Federation” of 24 July 2002. Legislation passed in 2014 introduced restrictions on the classes of assets in which a pension fund operating a private pension (retirement) scheme may invest.

The Central Bank acts as the major regulating authority for pension funds. It sets certain financial requirements

related to capital adequacy of, and formation of pension reserves by, pension funds. It also checks compliance of pension funds and asset managers (which may be engaged to manage the assets of the funds) with regulatory requirements.

Investment funds and asset managers

The mutual investment fund is the most common form of professional asset management of financial assets for larger groups of investors in Russia. Private asset management schemes may be set up based on a contract for direct fiduciary management of financial assets by the asset manager.

Mutual investment funds are usually organized as a “shared investment fund” – a pool of assets jointly owned by fund members (whose interests are evidenced by the relevant certificates) that is managed by a licensed asset manager (professional participant in the securities market) based on the fund’s rules. Fund rules are subject to registration with the Central Bank. Mutual investment funds may also be organized as joint-stock companies. Operations of mutual investment funds and their asset managers are heavily regulated by the Central Bank which, among other things, specifies the categories of assets in which the manager is allowed to invest.

“Know Your Customer” Procedures

Anti-Money Laundering Law

Federal Law No. 115-FZ “On the Prevention of Money Laundering and the Financing of

Terrorism” (the Anti-Money Laundering Law) came into effect on 1 February 2002 and has been revised a number of times to reflect global developments in this area. The Anti-Money Laundering Law is the primary legislative act in Russia, aimed at preventing money laundering activities and the financing of terrorism, and is supported by numerous recommendations, binding instructions and regulations of the Central Bank and other authorities.

The Anti-Money Laundering Law requires institutions that deal with cash operations, including all kinds of financial institutions (in particular, credit institutions, pension funds, insurance companies, professional participants in the securities market, mutual fund managers, payment agents, leasing and factoring companies, etc.) and such companies as mobile operators, pawn shops, realtors and consultants (jointly, “the regulated entities”), to establish mandatory internal protocols of client and payment acceptance.

In particular, the regulated entities need to perform due diligence procedures to ascertain the identity of a customer (and its beneficiary in the case of a corporate customer) and monitor transactions for suspicious activity. As a general rule, identification of an individual customer is required unless the amount of an operation is below RUB15,000 (US\$420¹) or the equivalent in foreign currency. Identification of a customer (and its beneficiary) is required in connection

¹ Hereinafter in the text, the values in Russian rubles are translated for illustrative purposes into US dollars at the RUB-US\$ exchange rate 1 US\$ = 35.73 RUB (as of 31 July 2014).

with the opening of an account with a credit institution at all times.

Identification of a beneficiary implies that a regulated entity ascertains the identity of an individual who ultimately holds, directly or indirectly, the shares in, and has predominant participation of more than 25% in the capital of, a corporate customer or who has the ability to control such customer.

The regulated entities must identify and report transactions falling under mandatory control to the Federal Financial Monitoring Service, a designated monitoring authority. These transactions, among others, include petty cash transactions, transactions with bearer’s securities, transfers to anonymous accounts, acquisitions of precious metals and gems with a value of at least RUB600,000 (US\$16,800), and immovable property transactions of at least RUB3 million (US\$84,000), or the equivalent of these amounts in foreign currency. If one of the parties to a transaction is suspected of being connected to terrorist activity, the transaction is subject to mandatory control regardless of the amounts involved.

The Central Bank may undertake preventive or enforcement measures in respect of a regulated financial institution involved in transactions which infringe on the anti-money laundering legislation. Preventive measures may include issuing an order to cease a violation and provide the Central Bank with a program for improvement and establishing additional monitoring measures. Enforcement measures may include the imposition of a fine and the withdrawal of the banking license.

FATCA implementing legislation

The United States Foreign Account Tax Compliance Act (FATCA), which came into force on 1 July 2014, requires foreign financial institutions, among other things, to perform due diligence procedures with respect to their customers and report certain information to the competent authority in the United States.

Russian legislation allows Russian financial institutions to adopt and implement policies and procedures that are required for the purposes of FATCA. Collection of additional information from clients and the reporting of information to foreign competent authorities are allowed with the clients’ consent. In cases when a client fails to consent to the disclosure and reporting of information, the relevant financial institution is authorized under the Russian law to rescind its agreement with such client and close its account.

Fundamentals of Russian securities regulation

Regulation of securities offerings

Federal Law No. 39-FZ “On the Securities Market” of 22 April 1996 (the Securities Law) established a legal framework both for placements of, and for secondary transactions with, securities in Russia.

Russian legislation prohibits public offerings or sales of any instruments other than securities and, in certain cases, foreign securities. The definition of a “security” under the Securities Law is very narrow, including only stocks, bonds, warrants and Russian depository receipts. Subject to compliance with certain requirements, any commercial paper may qualify as a security; however,

Russian law provides an exhaustive list of types of commercial paper, which makes it impractical to issue securities in any form other than those specifically listed in the Securities Law.

All offerings of securities in Russia, both public and private, are subject to mandatory state registration with the Central Bank. In the case of a public offering, simultaneous registration of the prospectus and the securities issue is required. The Securities Law provides for statutory safe harbors for private offerings, which are not subject to the prospectus registration requirement. These safe harbors include offerings for a total amount of less than RUB200 million (US\$5.6 million) and closed subscriptions to fewer than 500 persons.

Professional participants in the securities market, credit institutions, investment funds, pension funds and insurance companies are recognized as “qualified investors” by law. Certain corporations or high net worth individuals may be recognized as qualified investors if they are characterized as such by a broker. An offering of securities to any number of qualified investors is not considered a public offering and does not require registration of the prospectus.

Requirements with respect to the content of the prospectus include information concerning the issuer and its subsidiaries, including the financial statements, as well as information concerning the securities offered. Provisions permitting the issuers to incorporate certain information into the prospectus by reference to prior filings, provide a draft prospectus for

comment prior to submission of the final prospectus for registration and register a shelf prospectus (which will be valid for one year) came into effect in July 2013.

Issuers that have registered a prospectus are subject to continuous disclosure requirements in the form of quarterly reports and the disclosure of significant events that may affect the financial position or business activities of the issuer, which should be placed on an internet site and, in some cases, also disseminated through a newswire. Upon redemption of the issued securities and reduction in the number of shareholders to 500 or less, the issuer may opt out of the mandatory disclosure requirements by filing an application with the Central Bank.

Issuers of bonds are entitled, and on demand of the bondholders required, to convene meetings of bondholders that are authorized to approve amendments to the bond placement terms, grant waivers of bondholders' rights and appoint a bondholder representative (whose functions are similar to those of the indenture trustee). From 1 July 2016, appointment of a bondholder representative will be mandatory for all public bond placements.

Regulation of secondary transactions

Any secondary transactions with securities that are not registered with the Central Bank are prohibited. In cases when securities are registered by the Central Bank, but no prospectus is in place with respect to such securities or the issuer is not subject to continuous disclosure requirements, any public

offerings or sales of such securities are restricted. Other transactions with respect to Central Bank registered securities are permitted, with no mandatory holding periods being prescribed in the Securities Law.

Securities of foreign issuers (as well as a few types of Russian securities that are expressly designated for qualified investors only) are deemed “restricted securities,” in Russia and are subject to much tighter restrictions on secondary transactions than registered securities, for which no prospectus is in place. Secondary transactions with restricted securities are only allowed between entities that are qualified investors or, via a broker, between other qualified investors.

These restrictions with respect to securities of foreign issuers may be lifted at the decision of the Central Bank, made at the request of a Russian stock exchange submitted along with the prospectus prepared by the issuer. Securities of a foreign issuer that are listed on an internationally recognized foreign stock exchange (including the NYSE, NASDAQ and the London Stock Exchange) may receive unrestricted status if they are admitted to listing by a Russian stock exchange. In the latter case, no decision of the Central Bank is necessary, and the foreign issuer will be deemed compliant with the Russian prospectus disclosure and continuous disclosure requirements if it meets the relevant requirements of the internationally recognized stock exchange.

Placement of securities of Russian issuers overseas and the establishment of depositary receipts or a similar program with respect to Russian securities may be performed only with the permission of the Central Bank. The number of shares that may be offered overseas or be deposited into a depositary receipts program may not exceed 25% of the share capital of the Russian issuer.

Securitization

Russian legislation (after 1 July 2014, when the relevant amendments to the Securities Law came into force) establishes the regulatory framework for such forms of securitization as the issuance of mortgage-backed securities, securities backed by a pool of any other financial assets (including credit card debts, retail loans, etc.) and infrastructure bonds backed by claims under contracts pertaining to long-term investment projects.

The Securities Law establishes special rules of corporate governance and bankruptcy for securitization vehicles and sets out procedures for the issuance of different tranches of securities backed by the same collateral.

The title registration system with respect to securities

Generally, Russian securities may be issued in both registered and bearer form. Certain types of securities (for example, stocks) may only be issued in the registered form.

Russia has adopted a two-tier system of title registration with respect to registered securities. Transactions with all such securities are to be recorded in the registry maintained by a licensed registrar. Following the expiration of a transitional period on 1 October 2014, the registries of shares of all joint-stock companies (including companies that are privately held) may only be maintained by a licensed registrar.

Licensed depositaries are free to open nominee securityholder accounts with registrars and are authorized to record transactions in respect of securities held by such depositaries as the nominees. Security holders are then free to choose to have the title to their securities recorded either by the registrar or the depositary.

Russian bonds may be issued in both registered and bearer form. The placement documents with respect to the absolute majority of bonds in bearer form provide for the “centralized storage” of such bonds, with a depositary recording transactions therewith.

The National Clearing Depository CJSC, as the sole Russian licensed central depositary, has the exclusive right to act as nominee securityholder in all registers of securities of issuers that are subject to continuous disclosure requirements. No Russian depositaries other than the central depositary are entitled to open nominee accounts with the registrars of securities of reporting issuers. The licensed central depositary also has the exclusive right to act as a depositary,

recording transactions with respect to publicly placed bonds in bearer form.

Major international and foreign depositaries and clearing systems, including Clearstream and Euroclear, are entitled to open nominee securityholder accounts with respect to Russian securities, but may only do so with the Russian central depositary. Such international and foreign depositaries (clearing systems) are subject to a requirement to disclose the identities of security holders registered with them.

Since November 2013, Russian securities underlying the depositary receipts or similar foreign securities must be held via a “foreign depositary program account” that needs to be opened with a Russian depositary that, in turn, has opened an account with the central depositary. Foreign depositaries (custodians) are allowed to exercise voting rights only with respect to the shares underlying such foreign securities, whose holders have been disclosed to the Russian issuer.

Control and supervision of the Russian securities market

Control and supervision of the securities market is carried out by the Central Bank. It implements government policy on the securities market, regulates the activities of professional participants of the securities market, and protects the rights of investors and shareholders. Its major functions are as follows:

- ▶ Developing a statutory regulatory framework for the securities market, including adopting relevant regulations

- ▶ Determining the key directions for development of the securities market
- ▶ Registering securities offerings, prospectuses and reports on securities offerings
- ▶ Keeping appropriate records and ensuring the disclosure of information on the securities market
- ▶ Licensing and overseeing professional participants of the securities market, including asset managers
- ▶ Performing inspections, issuing mandatory prescriptions, bringing administrative actions and taking other legal action.

In addition, there are a number of self-regulating organizations in the Russian market that unite professional securities market participants and develop uniform standards for their members' activities. There is the Professional Association of Registrars, Transfer Agents and Depositaries (PARTAD); the National Securities Association (NFA) mainly unites banks that are licensed as professional participants of the securities market; and as for the National Association of Stock Market Participants (NAUFOR), its members also include non-banking professional participants of the securities market.

Currency control

General principles

Russian currency control rules distinguish requirements for Russian residents and nonresidents with residency for currency control purposes being defined differently than for tax purposes. The following persons are considered Russian residents:

- ▶ Russian citizens, except for those who live abroad on a permanent or temporary basis for not less than a year (including those with a foreign residence permit, or a work or student visa with a duration of over one year)
- ▶ Foreign nationals and stateless individuals who live permanently in Russia on the basis of a residence permit
- ▶ Legal entities duly registered under Russian law as well as foreign branches, representative offices and other subdivisions of Russian legal entities
- ▶ Diplomatic representatives, consular offices and other official representative bodies of Russia located abroad
- ▶ The Russian Federation, its regions and municipalities

All other persons and entities are deemed nonresidents, including Russian branches, representative offices and other subdivisions of foreign legal entities.

Foreign currency operations between Russian residents are prohibited (i.e., payments between them should be made in Russian rubles, which is the official

currency in Russia), although there are some exceptions specified by law. Residents may use foreign currency to determine the contract price, but the payment should be made in rubles. This can lead to exchange rate differences that can arise between the date the transaction is entered into and the payment date.

Between nonresidents, payments in foreign currency are generally permitted without restrictions (purchase and sale of securities between nonresidents are also permitted, although they can be subject to Russian securities and antitrust regulations). Payments between nonresidents in Russian rubles are permitted through accounts opened in Russian banks only.

Currency control restrictions for Russian residents

Transactions between residents and nonresidents involving payments in rubles and foreign currency or securities denominated in rubles and foreign currency can be concluded without any limitations, unless special regulation is imposed by the Government or the Central Bank.

The main requirements for such operations are:

- ▶ Residents must document currency operations with nonresidents with a transaction passport, which is a special document to be opened with the assistance of a Russian bank. Via the transaction passport, the bank reports the receipt and repayment of the currency to the Central Bank.

Currently (in July 2014), the transaction passport is not required if the sum of the contract (unless it is a credit agreement) does not exceed US\$50,000.

- ▶ Foreign currency and checks (including traveler's checks) in foreign currency can be purchased and sold only through banks that have obtained a special license for carrying out operations with foreign currencies.
- ▶ Individuals must declare currency in the event of exporting it from Russia in excess of certain thresholds.
- ▶ Residents must repatriate ruble and foreign currency export proceeds from export transactions and return currency paid to a foreign party under import transactions that were not completed.
- ▶ Russian residents must notify the tax authorities about opening overseas bank accounts with foreign banks. They are also required to present notices on opening or closing bank accounts and regular cash flow reports on such accounts (currently applies to legal entities only, but will also apply to individuals from 1 January 2015) to the tax authorities.

The operation of an overseas bank account by a Russian resident is subject to significant restrictions: a resident can receive money on such an account only in a limited number of cases specifically prescribed by Russian currency control regulations. However, amendments to the Currency Control Law, which came into effect on 2 August 2014,

significantly extended the list of such cases. This has made the operation of foreign bank accounts by individual residents, including Russian personnel on assignment to foreign affiliates of Russian employers, much easier. Among the additions to the list of amounts that may now be credited to an individual resident's foreign bank account are:

- ▶ The minimum deposit required to open an account
- ▶ Salary and other payments made by a non-resident under an employment contract in connection with the resident's performance of employment duties outside Russia
- ▶ Interest on the balance of such accounts
- ▶ Cash deposits
- ▶ Cash from currency exchange transactions using funds on the account
- ▶ Pensions, stipends, alimony and other social payments
- ▶ Insurance payments made by non-resident insurers
- ▶ Funds repayable to resident individuals, including mistakenly transferred funds and money refunded to a resident individual for goods purchased from a non-resident and returned or for paid services provided by such non-resident

The following may also be credited by nonresidents to resident individuals' accounts in banks of OECD and Financial Action Task Force (FATF) member countries:

- ▶ Income from the rental (subrental) to nonresidents of a resident individual's real estate and other assets located outside the Russian Federation
- ▶ Grants
- ▶ Accumulated interest (coupon) income payable under the terms of issue of foreign securities owned by a resident individual
- ▶ Other income from foreign securities (dividends, payments on bonds and bills of exchange, and payments in connection with a reduction in the capital of a foreign security's issuer)

Liability for violation of currency law

The Federal Financial and Budgetary Supervisory Service (Rosfinnadzor) is a Russian state agency in charge of controlling and monitoring the financial and budgetary sphere, including currency control.

It is important to note that the penalties for violating currency regulations can be very significant. The Code of Administrative Offenses states that unlawful currency operations and non-compliance with currency repatriation limitations are subject to an administrative fine of 75%-100% of the amount of the non-compliant currency operation. Moreover, for certain offenses, additional criminal liability can be imposed on the executives of the legal entity violating such regulations, including imprisonment. Non-compliance of Russian banks with currency control regulations may result in revocation of their licenses.



Examples of violation of Russian currency control rules (please note that only Russian residents are liable for such offenses):

- ▶ A foreign contractor does not pay its Russian supplier on time, or does not deliver goods to its Russian customer and does not return advance payments for those goods on time (i.e., the Russian resident cannot comply with the repatriation obligation).

- ▶ A Russian resident is employed outside Russia and receives salary from the non-resident employer on an account in a non-Russian bank.

- ▶ A Russian resident has entered into a currency forward transaction, swap or option with any party other than a Russian bank.

Therefore, in any situation in which a Russian entity is involved in any debt forgiveness, net-off or other similar operation with a foreign company, it is

strongly recommended that currency control be given due attention in advance of concluding any material transactions.

Reform of the Civil Code

Important amendments were introduced to the Civil Code in 2013 and the first seven months of 2014, and further developments are expected as part of an ongoing initiative to reform Russian civil legislation and bring it closer to the civil law concepts that are commonly used in standard business practice.



Most of these amendments may be divided into two main categories: (1) some legal characterizations and clarifications that had already been formulated and systematically used in Russian court practice have now been introduced in the Civil Code; and (2) some civil law concepts that are commonly used in standard business practice were introduced in Russian civil law for the first time.

The amendments already in force affect general civil law principles and the regulation of areas of civil law such as

legal entities and corporate governance, powers of attorney, the validity of transactions, the law of conflicts, intellectual property, pledges, securities, and loans and credits.

The specific regulations and legislation concerning these matters, other than the amended provisions of the Civil Code, were not amended in the same way, which may lead to problems of interpretation in practice. Therefore, we expect the relevant legislation to be

revised to conform with the amended Civil Code by the end of 2015.

A further set of amendments to the Civil Code is expected to be enacted later in 2014 or in 2015, covering the general regulation of transaction law. We expect that some of the M&A instruments that are commonly used in business practice will be recognized and regulated in Russian civil legislation.

Companies





Legal entities

Russian corporate legislation provides a wide range of forms of legal entity which can be generally divided into two categories: (1) commercial legal entities, and (2) non-commercial legal entities.

Commercial legal entities include, but are not limited to, companies, partnerships and commercial cooperatives. Non-commercial legal entities include funds and associations, etc.

The most frequently used forms of legal entity in business in practice are the limited liability company (LLC) and the joint-stock company (JSC).

LLC

The charter capital of an LLC is divided among its participants in proportion to their contributions. Each participant may hold only one participation interest, with a nominal value in proportion to the participant's contribution to the charter capital.

The statutory minimum charter capital is RUB10,000 (US\$280).

The charter capital may be contributed in cash or in-kind. The list of in-kind contributions permitted is limited. It includes shares in JSCs, participation interests in LLCs, equity interests in

partnerships, public and municipal bonds and other objects. Intellectual property can also be contributed as an in-kind capital contribution subject to some limitations. In-kind contributions must be valued by a Russian authorized independent appraiser.

An LLC's charter capital may be increased by decision of the participants by means of additional contributions to the capital of either the participants or a third party.

During an increase in the charter capital, additional capital can also be paid in by offsetting monetary claims of the participants and/or a third party against contributions receivable based on a unanimous decision of all participants.

The participants are also entitled to take a decision to make contributions to an LLC's assets. Such contributions to assets do not affect the amount of the charter capital or the proportions of the participants' participation interests.

An LLC is required by law to maintain the value of its net assets at a level greater than or equal to the amount of its charter capital. Should net assets fall below the charter capital, the participants are required to take a decision to decrease the charter capital to remedy the situation subject to the charter capital not being lower than the statutory minimum.

If a decision to decrease the charter capital and/or to carry out a reorganization is taken by the participants, the creditors of the company are entitled to claim early settlement of amounts due to them from the LLC. In practice, the company may agree with each creditor on due protection of its interests during the decrease in the charter capital or reorganization, by signing a waiver letter.

An LLC is regarded as established when it is registered by making the relevant entry in the Unified State Register of Legal Entities (USR). The USR is maintained by the tax authorities. General information about the company, including information about its participants and the actual nominal value of their participation interests, recorded in the USR is available at the request of any third party in the form of an extract. An extract from the USR can be obtained by submitting a request to the tax authorities and paying a small fee (less than US\$20). More detailed information about an LLC, including personal data about each participant, can be received only at the request of a participant or the company. An extract from the USR is an official document for the purpose of confirming the status of a company, including the amount of the participation interest of each participant.

The initial charter capital must be paid in within four months of state registration. The charter capital may be increased only if the initial and each additional capital increase (if any) have been paid up.

A participant is entitled to sell or transfer by any other means its participation

interest or part of its participation interest to another participant unless the prior consent of all other participants and the company is required under the LLC's charter.

A participant is entitled to sell or transfer by any other means its participation interest or part of its participation interest to a third party unless this is directly prohibited by the charter. All other participants and/or the company have a preemptive right to acquire the participation interest or the relevant part of the participation interest at the purchase price the third party has agreed to pay or at the price that is provided by the charter for such circumstances.

A sale and purchase agreement or any other agreement formalizing the transfer of a participation interest or a part of a participation interest must be notarized.

If directly provided by the charter, a participant is entitled to withdraw from an LLC at any time by submitting an application to do so to the company. In this case, the company is obliged to repurchase such participation interest within three months at its current value.

The maximum number of participants in an LLC is 50. An LLC cannot have as its sole participant a person that is itself held only by one person (company or individual).

JSC

The charter capital of a JSC is divided into shares with equal nominal value, and each participant in a JSC (shareholder) is entitled to hold one or more (up to 100%) shares.

Shares in the charter capital of a JSC are securities. Therefore, each issue of shares must be registered with the Central Bank as described in the "Stock Exchange and Securities" section.

A JSC can issue both ordinary and preferred shares. Various types of preferred shares are allowed, but the total nominal value of preferred shares cannot exceed 25% of the JSC's charter capital. During the initial placement, the shares are distributed among the shareholders and/or third parties either by closed or by open subscription. Some JSCs may also distribute shares via the stock exchange.

The type of JSC that is allowed to distribute shares via open subscription and/or via the stock exchange is a public joint stock company² (PJSC). To obtain the status of PJSC, the shareholders must specify "public" in the name of the company and in its charter. All JSCs that do not comply with the above requirements are non-public joint stock companies³ (NPJSCs).

The minimum capital requirement for incorporation is currently RUB 10,000 (US\$ 280) for an NPJSC and RUB 100,000 (US\$ 2,800) for a PJSC.

Three quarters of the initial charter capital must be paid in by the shareholders prior to state registration of a JSC and the remainder within one year of state registration.

² Prior to 1 September 2014, such companies were called open joint stock companies in the Civil Code. At 31 July 2014, the name change had yet to be reflected in the JSC Law.

³ Prior to 1 September 2014, such companies were called closed joint stock companies.

The charter capital may be paid in either in cash or in kind. The list of permitted in-kind contributions is limited. Contributions of shares in JSCs, participation interests in LLCs, equity interests in partnerships, public and municipal bonds and other objects are permitted. Intellectual property also can be contributed with some limitations. In-kind contributions must be valued by a Russian authorized independent appraiser.

The shareholders may decide on an increase in the charter capital either by means of issuing additional shares or by increasing the nominal value of each share. The charter capital may be increased only if the initial share issue and any subsequent issues of additional shares are fully paid up.

A JSC is required by law to maintain the value of its net assets at or above the amount of its charter capital. Otherwise, the shareholders are obliged to take a decision to decrease the charter capital subject to complying with the statutory minimum.

If the shareholders take a decision to decrease the charter capital and/or to carry out a reorganization of a JSC, then the creditors of the company are entitled to claim early fulfilment of their contractual obligations. However, in practice, the company may reach agreement with each creditor on due protection of its interests in the course of a decrease in the charter capital or the reorganization by signing a waiver letter.

During an increase in the charter capital, the additional issue of shares in a NPJSC can be also paid in by offsetting monetary

claims of the shareholders and/or a third party.

General information about a JSC is recorded in the USR, while information about the shareholders is recorded in a special register of shareholders maintained by an authorized registrar. The registrar must be chosen and approved by the shareholders. An extract from the shareholders' register issued by the registrar is the official document required to confirm the status of a shareholder and the actual number of shares held by each shareholder. An extract from the shareholders' register can be obtained by a shareholder or by the company by submitting a request to the registrar.

A shareholder is entitled to sell or to dispose of its shares by any other means to a third party. In the case of a NPJSC, all other shareholders and/or the NPJSC have a pre-emptive right to acquire the shares at the purchase price agreed with the third party.

If a shareholder or a third party through one transaction or a number of related transactions holds in excess of a 30% (or 50% or 75%) threshold of shares in a PJSC, it must issue a public offer to all other shareholders to buy the rest of the PJSC's shares. If the majority shareholder's interest exceeds a 95% threshold in course of this public offer, it is entitled to exercise a squeeze-out right with respect to the remainder of the PJSC's shares, in which case, the remaining minorities are obliged to sell it their shares.

The maximum number of shareholders of an NPJSC cannot exceed 50, but is unlimited for a PJSC. A JSC cannot have as its sole shareholder a person that is itself held by one person only (a company or an individual).

The financial statements of a JSC must be audited annually by an external auditor.

A PJSC must comply with special information disclosure requirements provided by CBR regulations.

Corporate governance in LLCs and JSCs

Corporate governance in LLCs and JSCs has the following elements: (1) General Meeting of participants or shareholders; (2) board of directors; (3) sole executive body; (4) executive board, (5) internal audit committee.

A General Meeting must be held annually. Extraordinary General Meetings may also be convened. General meetings cover fundamental and significant questions of corporate governance such as liquidation and reorganization, the election of a sole executive body and board of directors, the announcement of dividends, and the approval of amendments to the charter.

A board of directors is not obligatory for an LLC or an NPJSC, but must be established for a PJSC. There cannot be fewer than five board members for a PJSC. The board of directors' authority includes, but is not limited to, the approval of large scale and interested party transactions, the election of the sole executive body, etc.

The sole executive body is the only body authorized to act on behalf of the company without a power of attorney and to represent the company in dealings with any third parties. The charter of the company may provide for a sole

executive body composed of a number of individuals acting jointly or separately. The sole executive body can also be a legal entity (management company).

The establishment of an executive board is optional. Where such a board exists,

it performs a consulting function for the sole executive body.

An internal audit committee is obligatory for a JSC but optional for an LLC.

Joint ventures and subsidiaries

The LLC and NPJSC are the most frequently used forms of legal entities for incorporation of JVs and subsidiaries. For convenience, we summarize some basic differences between an LLC and NPJSC as follows:

LLC	Closed JSC
Standard registration procedures	Standard registration procedures plus registration of shares with the Central Bank
The charter capital must be paid within four months of state registration	At least three-quarters of the charter capital must be paid in within three months before the state registration and the rest within one year of the state registration
A participant can be excluded from an LLC by a court decision if guilty of major violations	A shareholder cannot be excluded
If expressly provided by the charter, a participant may withdraw from the company at any time and receive the actual value of its participation interest	A shareholder is not allowed to withdraw from a company (other than by selling its shares)
When a preemptive right to acquire shares is exercised, the purchase price of the participation interest may be specified by the charter in advance or the price offered to the buyer	When a preemptive right to acquire shares is exercised, the purchase price of the shares is the price offered to the buyer
Information on each participant and the amount and nominal value of their participation interest is recorded in the USR maintained by the tax authorities	Information on each shareholder and the amount and nominal value of their shares is recorded in the shareholders' register maintained by the authorized registrar
Transfer of title to a participation interest is usually subject to notarization by a Russian notary	Transfer of title to a share is formalized by making the appropriate entry in the shareholders' register
Contributions to a company's assets are permitted. Such contributions do not affect the total amount of the charter capital or the nominal value of each participation interest	Contribution to a company's assets is not provided for in applicable law
In-kind contributions to the charter capital are permitted. Such contributions do not change the size of the charter capital or nominal value of equity shares	An in-kind contribution without increasing the charter capital is not expressly provided for by the law. It is possible to apply analogy of law, but the validity of such method is uncertain

Branch and representative office

Foreign companies may also operate in Russia without creating a legal entity by establishing a branch or a representative office. The main advantages of operating through a branch or representative office, compared with a JSC or an LLC, are that a branch or representative office has fewer administrative, tax and accounting obligations, and is considered to be non-resident for currency control purposes.

Branch

The branch of a legal entity is a separate subdivision of a legal entity whose headquarters are in another location, possibly in another country. A branch may perform all the functions of a legal entity, including representative functions. The branch should have a manager or head of the branch who acts on the basis of a power of attorney issued by its parent company. Since the branch is not considered to be a separate legal entity, all duties and rights will apply to the legal entity that is behind that branch. A branch may be inappropriate for certain activities, such as those that require licenses that are issued only to Russian legal entities. In addition, a branch is not recommended if it is expected that significant import activity will take place, since it is easier to manage customs procedures as a Russian legal entity.

The branch of a foreign company must be accredited and registered with the State Registration Chamber. The accreditation must be renewed every five years (whereas the registration of a JSC or LLC is usually for an indefinite period of time).

In addition, a branch of a foreign company must be registered with the tax authorities, social funds and other state bodies. The nature of the activities performed will determine whether the activities are subject to Russian taxation. Generally, tax filings must be made even if no taxable activities are performed or if no income is generated.

Representative office

A representative office is generally understood to be a subdivision of a foreign legal entity (FLE) that represents the company's interests in Russia. Representative offices are not allowed to undertake commercial activity under the Civil Code. Their main purpose is generally to promote commercial relations between the FLE and Russian enterprises, and to gather information about the Russian market. In practice, many representative offices in Russia do engage in commercial activity.

If a license or other permit is required in order to engage in a particular commercial activity, the relevant Russian authority may refuse to issue the required license or permit to a representative office on the grounds that it is prohibited from carrying out commercial activities.

Another point to take into consideration when deciding on the form of establishing a legal presence in Russia is that a representative office may not be the most appropriate form for foreign entities that plan to hire a significant number of expatriates prior to 31 December 2014, since the favorable status of Highly Qualified Specialist (HQS) is not available for foreigners working for representative offices of FLEs in that period. HQSs

benefit from significantly more favorable work permit and work visa procedures and less restrictive tax residency rules. From 1 January 2015 representative offices of FLEs will be also allowed to engage foreign nationals under the HQS regime. Please see the "Immigration" section on page 62 for further details.

A representative office should be accredited with the State Registration Chamber or with the Chamber of Commerce and Industry (or, for example, with the Ministry of Education and Science in the case of educational activity) and registered with the State Registration Chamber, as well as with the tax authorities, social funds and other state bodies. The maximum accreditation term is three years, but can be renewed.

Registration of businesses in Russia

Russian companies, as well as branches and representative offices of FLEs, must be registered with several state authorities. Companies must be registered with the state registration authority (currently the tax authorities), which takes care of both the state and tax registrations, with the state statistics service, and with three social benefit funds (pension, social and obligatory medical insurance). Branches and representative offices must be registered and accredited with the State Registration Chamber (see above) and registered with a designated tax inspectorate for foreign companies, as well as with the State Statistics Service and the three abovementioned funds.

The establishment of a commercial legal entity may also require obtaining the prior approval of the Federal Antimonopoly Service when certain thresholds are reached in terms of balance sheet value of the assets or revenue, or if the charter capital of a commercial legal entity is paid by shares or property of another commercial legal entity.

Foreign investors should be prepared to face a very formal and time-consuming process. As a preliminary step, significant time is necessary to gather and draft the documents to be filed with the competent authorities (notarized and legalized or apostilled corporate documents of the foreign company, constitutional documents of the newly created Russian company or business, etc.). As far as the registration itself is concerned, the average registration of a Russian legal entity, branch or representative office takes approximately two weeks from the date of filing of the necessary documents with the authorities.

If any documents filed in connection with a registration are considered unsatisfactory by a registration authority, such documents may need to be re-filed. Furthermore, certain registrations must take place in a prescribed sequence; thus, a delay at one stage of the process can impact subsequent stages.

Additional steps are necessary for the entities to be fully operational, e.g., opening of bank accounts, manufacture of a corporate seal and registration of the issuance of shares (for JSCs only) with the Central Bank.

Companies need not wait until the end of the entire registration process before starting their activities. They can begin operations after their state and tax registrations, production of a company seal and opening of permanent bank account(s); branches and representative offices can begin operations after their accreditation with authorized bodies, registration with the tax authorities, production of a seal and opening of permanent bank account(s).

Mergers and acquisitions

Antimonopoly control

Certain transactions (including mergers, acquisitions, establishment of new companies, purchase and sale of shares and assets) are subject to antimonopoly control. The prior approval or post-transaction notification of the Federal Antimonopoly Service (the FAS) is required if certain thresholds are reached in terms of balance sheet value of the assets or revenue or market share of the companies involved in the transaction. Generally, FAS approvals have been routinely granted. However, there have been situations when the FAS used its authority to prevent foreign companies from acquiring certain assets or enterprises.

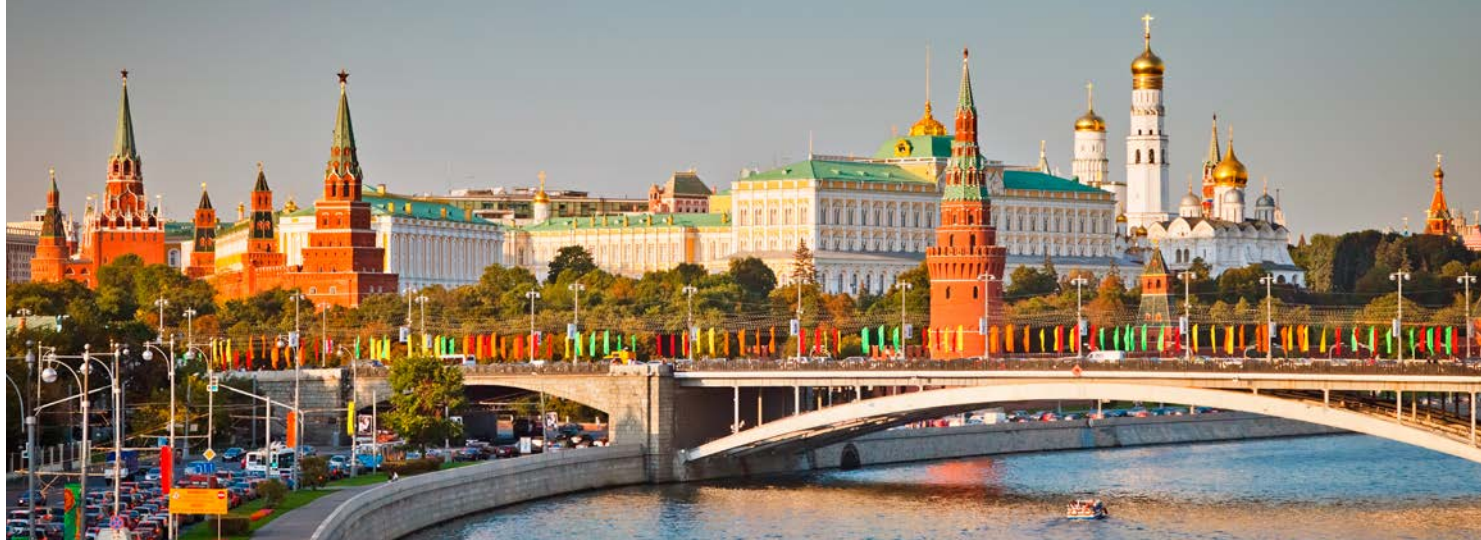
The FAS is entitled to inspect the compliance of any business entity with antimonopoly regulations. Scheduled inspections are to be conducted regularly every three years. Unscheduled inspections may be held more frequently if the FAS receives information on any violations of antimonopoly legislation

from various sources. Companies present in Russia must be prepared for potential FAS inspections ahead of time, since companies may receive notification of an upcoming FAS inspection as late as three working days in advance for a scheduled inspection and only 24 hours in advance for an unscheduled inspection. If an organization fails to present the documents to the FAS or is late in presenting them, it may be fined up to RUB500,000 (US\$16,300).

A number of rules and regulations of great importance for business and law enforcement practice were introduced into antimonopoly legislation in 2011 (the third antimonopoly package). In particular, the third antimonopoly package introduced more detailed definitions of actions that are prohibited as restraints of competition and a clearer demarcation between different kinds of competition-restricting agreements. One of the more material innovations provided by the third antimonopoly package relates to the application of merger control regulations to foreign entities. These regulations must be taken into account by parties intending to enter the Russian market.

Restrictions on strategic companies

Russian legislation sets certain limits for foreign investments in specified areas of the Russian economy, which, according to the state, have strategic significance and therefore require a special regime of protection. There is a list of 42 types of activity (sectors) with strategic significance. Foremost among them are the environmental sector, nuclear industry, military equipment and



industrial explosives sector, aviation and space sectors, mass-media activities, operations of natural monopolies, etc. The law limits or provides for a special regime for foreign investors to obtain control over Russian companies conducting activity in these strategic sectors.

Currently, the leading trend in the regulation of investments in strategic companies is liberalization of the respective legislation. In particular, recent amendments introduced into the law on strategic investments excluded from the list of strategic companies nearly all banks and some entities using x-ray equipment. However, in general, the law on strategic investments still has much to be improved, and relevant amendments are currently being developed by the Russian Government.

Shareholders' agreements

Shareholders' agreements can be concluded between the participants

in an LLC and between the shareholders in a JSC. By entering into a shareholders' agreement, the parties may undertake to vote in a particular manner at general meetings, to agree on voting options with other shareholders, to acquire or dispose of shares at a pre-determined price and upon the occurrence of certain events, to refrain from share transfers subject to certain conditions, and/or to perform other actions related to the management of the company and its activities in a coordinated fashion.

A shareholders' agreement can be concluded between all the participants or shareholders or between some of them. Creditors and other third parties can also be parties to a shareholders' agreement.

A shareholders' agreement is a confidential document. The law provides that some general information must be disclosed only with respect to shareholders' agreements relating to PJSCs.

Tax system

Russian taxes are listed and regulated by the Russian Tax Code. The list of Russian taxes includes the following taxes and levies:

- ▶ Federal taxes and levies – value-added tax (VAT), excise duty, personal income tax, profits tax, mineral extraction tax, water tax and levies for the use of fauna and for the use of aquatic biological resources, and state duty
- ▶ Regional taxes – assets tax, gambling tax and transport tax (it is likely that regions will be able to levy a sales tax from 1 January 2015)
- ▶ Local taxes – land tax and assets tax on individuals (introduced by a federal law of 9 December 1991 and not included in the Tax Code)

Tax rates

Tax rates on corporate income and capital gains are summarized below:

Corporate profits tax rate	20% (a)
Capital gains tax	20% (b)
Branch remittance tax	0%
Withholding tax	
Dividends	0%/9%/15%/30% (c)(g)
Interest on certain types of state and municipal securities, mortgage-backed bonds and certain income from certificates of participation in a mortgage pool	0%/9%/15%/30% (d)(g)
Other interest paid to foreign companies	20%/30% (g)
Income from the rental or sublease of ships and aircraft and/or means of transport and containers used in international traffic	10%
Rental income derived from property used in Russia	20%
Royalties from patents, know-how, etc. paid to foreign companies	20%
Income from the sale of Russian immovable property or shares (and derivatives thereof) of qualifying property-rich companies	20%
Fines and penalties	20%, 40% (e)
Payments of other similar Russian-source income to foreign companies	20% (f)

(a) The basic corporate profits tax rate consists of 2% payable to the central government and 18% payable to the regional government. Regional governments have the power to reduce the regional element by up to 4.5% (establishing the regional rate as 13.5%), giving a minimum overall rate of 15.5%. Exceptions include certain educational and medical activities taxed at a 0% rate and profits subject to a special tax regime for new offshore hydrocarbon deposits, enacted with effect from 1 January 2014, which are taxed at a fixed rate of 20% payable entirely to the federal budget.

(b) Capital gains of Russian companies are taxed at the corporate profits tax rate of 20% of the gain. However, in certain circumstances, the 20% rate applies to the gross income (see "Capital gains and losses" on page 32).

(c) Dividends paid to foreign companies (that do not have a permanent establishment in Russia) are subject to 15% profits tax withholding, but reduced rates may apply under applicable double tax treaties. Dividends received by Russian companies are taxed at 9% unless they qualify for the participation exemption regime. Under this regime, dividends received by Russian companies from qualifying participations in Russian and foreign companies are tax-exempt ("Dividend income" on page 31).

(d) Interest on certain types of state and municipal securities, mortgage-backed bonds, and certain income from certificates of participation in a mortgage pool are subject to tax at reduced rates.

(e) The standard penalty is 20% (which may be increased to 40% in the case of a deliberate violation). The transfer pricing legislation establishes a 40% penalty effective from 2017; a reduced 20% penalty applies to transactions concluded in 2014-2016 (see "Transfer pricing" on page 45).

(f) Items of "active" income such as income from sale of goods, other property (except for Russian immovable property or shares and derivatives thereof of qualifying property-rich companies) or property rights, conducting work or rendering services in Russia are generally exempt from income tax withholding in Russia.

(g) A "punitive" withholding tax rate of 30% could apply to interest, dividends paid on Russian securities (including ADRs and GDRs on the Russian securities) held through foreign nominee accounts at Russian custodians where no aggregated information on the beneficial owners of such securities is provided to the Russian custodians.

The withholding tax rates indicated above apply to payments to FLEs that do not carry out activities in Russia through a permanent establishment.

Corporate profits tax

Taxpayers

Taxpayers for profits tax purposes are (i) Russian legal entities (RLEs) and (ii) FLEs that carry out activities in Russia through permanent establishments and receive income from sources in Russia.

A significant change has been proposed in 2014, whereby from 1 January 2015, FLEs which are recognized as tax resident in Russia will be subject to the same profits tax treatment as RLEs. At the time of writing, the legislation had not been enacted and remained subject to change. Consequently, it was unclear what the final criteria for determining whether an FLE is tax resident in Russia will be.

Russian legal entities

RLEs are taxed on their worldwide income.

Consolidated groups of taxpayers

A consolidated group of taxpayers is a voluntary association of profits taxpayers for the purposes of calculation and payment of profits tax based on the aggregate financial results of all group participants. The agreement establishing the group must be registered and accepted by the tax authorities.

Only Russian companies can participate in groups. The minimum period for which a group may be established is two years. A group may be established by companies if one company directly or indirectly holds at least a 90% share in the others. In practice, this rules out most Russian

companies in foreign-owned groups, which typically structure investments in Russia such that Russian group companies have foreign shareholders.

The group of companies should satisfy the following main criteria on applying to establish a group:

- ▶ At least RUB10 billion (US\$280 million) in federal taxes must have been paid in the preceding calendar year.
- ▶ The total revenue of the group in the preceding calendar year should comprise at least RUB100 billion (US\$2.8 billion).
- ▶ The aggregate value of assets of the group as of the preceding 31 December should comprise at least RUB300 billion (US\$8.4 billion).

These thresholds are the main barrier for companies wishing to form a group.

The law includes other criteria. For example, the companies should not be undergoing reorganization, insolvency proceedings or liquidation, and their net assets should exceed charter capital.

A group's profits tax base is based on the group participants' income and expenses. The methodology for determining the profits tax base for a group allows current losses of group participants to be offset against any current profits of other group participants. The consolidated profit may not be reduced by any tax losses accumulated by the participants prior to the establishment of the group.

Tax accounting, tax calculation and tax payment responsibilities for the entire group will be imposed on one participant,

which is designated the "responsible participant." The responsible participant files a consolidated tax return and pays profits tax. This is intended to reduce administrative expenses related to tax reporting for the group as a whole. Should this company fail to discharge its liabilities, all members of the group will be responsible jointly and individually for any tax underpayment, corresponding penalties and late payment interest.

Transactions among the participants of a consolidated group are not subject to control under transfer pricing rules.

Tax audits are to be performed with respect to all companies in a particular group at the same time.

Permanent establishments of foreign legal entities

A permanent establishment (PE) of an FLE in Russia is a branch, representation, subdivision, bureau, office, agency, or any other economically autonomous subdivision or other place of business through which the entity regularly carries out entrepreneurial activities in Russia. Such entrepreneurial activities include, for example, the use of subsurface resources, construction, assembly, the sale of goods from warehouses located in Russia, the performance of work and the rendering of services.

With effect from 1 January 2014, activities of an FLE in Russia are deemed to include activities carried out by an FLE that is the operator of a new offshore hydrocarbon deposit involving hydrocarbon extraction at the new offshore hydrocarbon deposit. This gives rise to an exception to the rule that activities must be within

Russian territory in order to give rise to a PE subject to tax in Russia, since such deposits may be outside Russia's territorial waters.

A PE is considered to be formed from the moment when entrepreneurial activities begin to be regularly carried out through a division of an entity. The provision of any kind of services to third parties, including representative activities and support services for affiliates, is treated as an entrepreneurial activity for this purpose. The term "regularly" is not expressly defined and the determination of whether a PE is created as a result of an entity's activities depends on each particular situation, but is commonly understood as recurring and not one-off business activities. The existence of a PE does not depend on whether or not the FLE has registered its place of activity with the tax authorities, or indeed whether the place of activity is registered as a branch or a representative office. The tax treatment of a representative office carrying out regular commercial activities is exactly the same as that of a branch.

A PE of an FLE can also be created through activities of a dependent agent in Russia. A dependent agent is defined as a person who, on the basis of contractual relations with that FLE, represents its interests in Russia, acts in Russia in the name of that FLE and has, and habitually exercises, an authority to conclude contracts or to negotiate significant conditions of contracts in the name of that legal entity, thereby creating legal consequences for that FLE.

The following activities do not result in the creation of a PE in Russia: carrying

out activities of a preparatory and auxiliary nature for the head office; the possession of securities, share interests and other assets in Russia; the mere conclusion of a simple partnership agreement to be carried out in Russia; the secondment of personnel to work for another entity in Russia; or the export and import of goods from or into Russia.

Rates

The profits tax rate is 20%. This rate is split into two components paid to different budgets:

Federal	2%
Regional	18%

The regional authorities may reduce their component of the tax rate to 13.5%, making the lowest possible total tax rate 15.5%. Some regions have effectively adopted a reduced tax rate for certain categories of taxpayers under certain conditions (e.g., Leningrad region, Vologda region, Kaluga region, Krasnoyarsk territory and Khanty-Mansiysk region).

Exceptions to the above include certain educational and medical activities taxed at a 0% rate and profits subject to a special tax regime for new offshore hydrocarbon deposits, enacted with effect from 1 January 2014, which are taxed at a fixed rate of 20% payable entirely to the federal budget.

Different rates apply also for specific types of income such as dividends (see "Dividend income" on page 31), income paid to an FLE and certain specific types of interest.

Tax base

Taxable profit of Russian companies is determined as gross taxable income earned minus tax-deductible expenses incurred.

Taxable profit of an FLE is defined as (i) income received through a PE reduced by expenses incurred by the FLE in relation to the PE's activities and (ii) certain types of income received from other sources in Russia.

From 1 January 2015, some FLEs may be treated as tax resident in Russia and subject to the same profits tax treatment as Russian companies. The relevant legislation is likely to be enacted by the end of 2014. The criteria for determining whether an FLE is tax resident had not been settled when this book went to press. The locations at which management activity takes place are expected to be relevant, but other criteria were also included in draft legislation published in the first half of 2014.

Taxable income

Gross income includes income from sales of goods (work and services), and non-sales income such as income in the form of interest received under loan agreements, income from leased properties, dividends and other income.

Taxable income is reduced by tax-deductible expenses.

Exempt income

The Tax Code provides a list of income that is not taken into account in determining the tax base.



The most significant exemption provided by the Tax Code is for funds received by an RLE without consideration (i) from its parent (an entity or a physical person), if the parent owns more than 50% of charter capital of the RLE, or (ii) from its subsidiary, if the RLE owns more than 50% of this subsidiary. This exemption applies unless the assets received are transferred to third parties within one year from the day of receipt (this exception does not apply to monetary resources received). Additionally, if the parent transfers to its subsidiary property, property rights or non-property rights for the purpose of increasing its net assets, the transfer is not subject to taxation.

Deductible expenses

Generally, expenses are considered to be deductible for profits tax purposes if they are “economically justified” and supported by proper documentation (drawn up in accordance with Russian law or documents drawn up in accordance with customary business practices applicable in the foreign state in which the expenses in question were incurred),

unless specifically disallowed by the Tax Code. The Tax Code contains a list of tax-deductible expenses, but this list is explicitly open and is secondary to the primary business purpose criteria. However, it is more difficult in practice to take a deduction for expenses that are not explicitly listed in the Tax Code.

In practice, form over substance has been the standard approach by the tax authorities, and the inability to support an expense by contract and invoice (plus other supporting documentation for certain expenses) tends to result in a nondeductible expense.

Interest

The deductibility of interest is subject to arm’s length and thin capitalization tests.

Until 31 December 2014, interest on any type of loan taken out to finance business-related expenses is, in principle, fully tax-deductible, provided the interest charged is at an arm’s length rate, i.e., does not deviate by more than 20% from the interest charged for comparable loans as defined by the Tax Code. In the absence of comparable loans obtained by

the company, or at the company’s choice, the maximum amount of interest that may be deducted from taxable income should be taken to be equal to the Central Bank refinancing rate multiplied by a factor of 1.8 in the case of ruble loans and multiplied by a factor of 0.8 in the case of loans in foreign currency.

From 1 January 2015, new rules will apply to the recognition of interest, whether as income or an expense. In the case of transactions recognized as controlled under the transfer pricing rules, those rules should be taken into account in determining the interest recognized for profits tax purposes. An exception to this general rule is where one of the parties to a controlled transaction is a bank. In this case, the lender will have the right to recognize the actual interest on the debt as income if the rate exceeds the lowest value of the range of threshold values that is established by the Tax Code (see table below), whereas the borrower will have the right to recognize the actual interest on the debt obligation as an expense if the rate is lower than the highest value of this same range of threshold values.

Currency of indebtedness	Lower threshold	Upper threshold
Rubles in 2015	75% of the CBR rate	180% of the CBR rate
Rubles from 1 January 2016	75% of the CBR rate	125% of the CBR rate
Euro (€)	EURIBOR (€) + 4 percentage points	EURIBOR (€) + 7 percentage points
Chinese yuan (CNY)	SHIBOR (CNY) + 4 percentage points	SHIBOR (CNY) + 7 percentage points
Pounds sterling (GBP)	LIBOR (GBP) + 4 percentage points	LIBOR (GBP) + 7 percentage points
Swiss francs (CHF)	LIBOR (CHF) + 2 percentage points	LIBOR (CHF) + 5 percentage points
Japanese yen (JPY)	LIBOR (JPY) + 2 percentage points	LIBOR (JPY) + 5 percentage points
Other	LIBOR (USD) + 4 percentage points	LIBOR (USD) + 7 percentage points

In all other cases of controlled transactions where one of the parties is a bank, the interest recognized as income or expenditure by a taxpayer will be determined with account taken of the transfer pricing provisions.

The thin capitalization test restricts deductibility of interest on loans to RLEs that are issued either by (i) a foreign company that owns (directly or indirectly) more than 20% of the Russian company's share capital or by (ii) a Russian company that is a related party to a foreign company mentioned above, or in respect of which (iii) the foreign company itself or a Russian related party (mentioned above) acts as a guarantor or otherwise undertakes to guarantee the repayment of the loan by the RLE. The debt-to-equity ratio, above which restrictions apply, is generally 3:1, but is 12.5:1 for banks and leasing businesses. Excess interest, which is the amount of interest on loans in excess of the 3:1 or 12.5:1 ratio, is nondeductible and is treated as a dividend paid to the organization in relation to which controlled indebtedness exists and is taxed accordingly.

It should be noted that, despite previous numerous positive court rulings with respect to this issue based on the "form over substance" principle, in recent years, the Russian courts have changed their approach. In accordance with current court practice, formal compliance with thin capitalization rules does not necessarily protect companies from the tax authorities' claims. Negative trends in court practice mainly relate to the tax authorities successfully challenging the application of the nondiscrimination principles of double tax treaties and applying thin capitalization rules to loans received from foreign sister companies.

Depreciation

Depreciable or amortizable assets are fixed tangible and intangible assets with a useful life of more than 12 months and a historical cost of more than RUB40,000 (US\$1,120). Taxpayers are allowed to pool assets into 10 groups, depending on the type of asset and their useful life, and to apply depreciation rates to the assets within each pool. Taxpayers may choose between straight-line and

reducing-balance depreciation methods, and should apply the same method to all depreciable assets. The reducing-balance method cannot be applied to certain long-life assets or assets of a license holder or operator used exclusively in carrying out hydrocarbon extraction activities at a new offshore hydrocarbon deposit. The exact depreciation groups are determined in a governmental decree that sets out the allocation of various types of assets. The majority of technological equipment is subject to depreciation over a period from 7 to 10 years, while buildings are depreciated over more than 30 years.

Fixed assets classified as highly energy-efficient facilities and assets that were entered in accounting records before 1 January 2014 and used for work under conditions of an aggressive environment and/or on a multi-shift basis can be tax-depreciated at up to twice the normal tax depreciation rate.

Fixed assets used in scientific and engineering activities, assets subject to a leasing agreement, and assets of a licence-holder or operator used

exclusively in carrying out hydrocarbon extraction activities at a new offshore hydrocarbon deposit may be depreciated at up to three times the usual rate. In the last case, a change in use of an asset can trigger a claw-back of the accelerated depreciation deducted if the tax book value exceeds 20% of historic cost when it begins to be used in carrying out activities that are not connected with hydrocarbon extraction at a new offshore hydrocarbon deposit.

An asset cannot be subject to accelerated depreciation on more than one of the above bases at a time.

Taxpayers that incur capital expenditures have the right to expense an “accelerated capital allowance” calculated on the historical value of the fixed assets. The accelerated capital allowance is generally 10% of the historical value of the fixed asset, and for assets belonging to the third to seventh depreciation groups (which correspond to assets with a useful life from 3 to 20 years), it comprises 30%. The deduction applies to the acquisition of fixed assets and to extension, further equipping, reconstruction, modernization, retooling, and partial dismantling of fixed assets. The accelerated capital allowance should be reversed and included in the profits tax base if the fixed assets are sold to a related party less than five years after they were brought into use. Prior to 1 January 2013, the accelerated capital allowance was reversed following any sale within the five-year period.

Companies performing activity in the area of information technology are allowed to treat expenses for the acquisition of electronic and computer equipment as

material expenses and deduct them in full when this equipment is placed into use rather than through depreciation (subject to certain conditions).

Intangible assets are subject to amortization within the terms of their useful life, established by taxpayers depending on the features and the type of intangible, otherwise the amortization term is fixed at 10 years.

Other expenses

Advertising expenses such as mass-media advertising (TV, radio, telecommunication networks, etc.), outdoor advertising (billboards, illuminated signs, etc.), participation in exhibitions and fairs, maintenance of showrooms, and preparation of advertising brochures and catalogs are fully tax-deductible. Expenses for prizes awarded during advertising campaigns and expenses for other types of advertising are deductible up to a cap equal to 1% of the taxpayer's sales revenue.

Training expenses incurred by a taxpayer for the professional training of its employees are deductible for tax purposes in full if the training or education is provided by a licensed Russian or foreign educational institution, and provided to employees or future employees.

Eligible R&D expenses are generally deductible irrespective of whether the research succeeded or failed to yield a positive result. Certain listed R&D expenses are deductible at cost plus a 50% uplift.

Loss carried forward

Tax losses may be carried forward for 10 years on a first-in, first-out basis. Tax losses may not be carried back or surrendered to related companies. A change in ownership of a Russian company does not restrict the future relief available for losses arising prior to the change in ownership.

Special rules apply to losses on securities transactions and losses of operators and licence-holders arising from activities related to new offshore hydrocarbon deposits.

Dividend income

Dividends received by Russian companies are subject to a 9% tax rate.⁴ In order to prevent double taxation of dividends, the tax base on domestic dividends paid is determined as the difference between dividends paid to RLEs by the taxpayer and dividends received from RLEs; i.e., further distribution of dividends received by RLEs from other RLEs to their own RLE investors is not taxable.

A participation exemption regime applies to dividends received by RLEs in relation to investments meeting certain conditions. Dividends received by an RLE are tax-exempt if the RLE receiving the dividends has continuously owned for at least 365 calendar days a stake of at least 50% of the capital of the organization distributing the dividends as of the date of the decision to pay dividends.

⁴ In August 2014, the Ministry of Finance published a draft law including a proposal to increase this rate to 13%. If enacted, the new rate could apply from 1 January 2015.



There is an additional participation-exemption condition for dividends paid by foreign subsidiaries to their Russian parent companies: the state of tax residence of this FLE must not be included in a list approved by the Ministry of Finance of countries that provide preferential tax treatment and do not require the disclosure of information when financial operations are carried out (in offshore zones). Dividends received by RLEs from non-qualifying participations are taxed at 9%.

See Appendix 5 for the blacklist of jurisdictions approved by the Ministry of Finance.

Capital gains and losses

Gains on the sale of capital assets are taxed at the standard profits tax rate. Capital gains are computed as gross proceeds minus net tax book value (for depreciable assets) or acquisition cost (for other assets and property rights). Incidental costs of disposal are also deductible. Capital losses on the disposal of assets and property rights are deductible. For depreciable assets, the deduction should be taken evenly over the residual useful life of the property.

Gains of FLEs on sales of immovable property and on sales of non-exchange traded shares (and derivatives thereof) in RLEs, more than 50% of whose assets consist of immovable property situated

in Russia, are considered to be income of an FLE from a Russian source, except for shares realized through foreign exchanges). Such income is taxed at the rate of 20%.

Capital gains on the disposal of securities are subject to profits tax at the standard tax rate. Specific rules regulate the computation of capital gains on quoted and unquoted securities. Until 31 December 2014, capital losses are available for deduction and carryforward only against gains on the securities from the same category (i.e., quoted or unquoted). From 2015, losses on disposals of exchange-traded securities may be included in the general profits tax base and the tax bases relating to



non-exchange traded securities and non-exchange traded derivatives are to be merged into a single tax base. Gains of FLEs on sales of securities (other than shares and derivatives thereof in RLEs, more than 50% of whose assets consist of immovable property situated in Russia) are not subject to tax in Russia unless the gains are attributable to a Russian PE.

A 0% profit tax rate can be applied to capital gains received from sales or other disposal of certain types of shares of Russian companies that meet the following condition: as of the date of disposal, such shares were owned by the taxpayer for a period exceeding five years. This provision is applicable:

1. To shares acquired and contributions to charter capital made starting from 2011
2. In the Russian companies of an innovative sector of non-exchange traded shares

This means that taxpayers will be able to enjoy this benefit in 2016.

Tax reporting and payment

Taxpayers must submit monthly or quarterly tax returns for each reporting period and annual returns for the calendar year. Quarterly returns are due within 28 days of the end of the reporting quarter. Annual returns are due by 28 March of the year following the reporting year.

Profits tax can be paid on either a monthly or a quarterly basis. If the monthly basis is used, the profits tax is paid 28 days after the end of the month based on actual profit. Quarterly payments are due 28 days after the end of the quarter based on actual profit; however, monthly advance payments, which are due on the 28th day of each month of the quarter and are equal to one-third of the total advance payments for the preceding quarter, are still required.

Under the quarterly payment system, certain types of taxpayers, including PEs of FLEs, companies with sales income of less than RUB10 million (US\$280,000) per quarter on average for the last four

quarters, production sharing agreement investors, participants in simple partnerships and investment partnerships, and beneficiaries of asset management agreements, are exempt from the obligation to make monthly advance payments each quarter and, hence, make quarterly advance tax payments only.

Economically autonomous subdivisions of Russian companies with premises in more than one location have to register a subdivision and file a copy of corporate tax declarations in each tax district in which they have permanent workplaces. They must also allocate taxable profits among the head office and the separate subdivisions in different regions. The apportionment should be based on (i) the net book value of fixed assets and (ii) at the discretion of the taxpayer, either the number of employees or the payroll.

If a Russian company has several subdivisions in one region, it may choose the one that will submit the profits tax declaration for all of them.

Where an FLE has multiple PEs in Russia, each is typically treated as a separate taxpayer for profits tax purposes. Losses arising from the activities of one PE generally cannot reduce taxable profit on activities of another. There are two exceptions. One is where an FLE carries out activities through multiple PEs within the framework of a unified technological process or in other similar cases, for example, during the construction of a single object, such as a bridge, pipeline or road, spanning multiple tax districts. Such an FLE may be able to obtain approval to calculate profits tax for a group of such PEs as a whole, provided

that all the divisions included in the group apply the same accounting policies for taxation purposes. The other exception applies only to FLEs that are operators of new offshore hydrocarbon deposits and allows profits tax to be calculated on the aggregate result of activities at multiple locations relating to the same deposit subject to certain conditions.

Tax accounting

When accounting ledgers contain insufficient information to determine the profits tax base, taxpayers are required to maintain separate tax accounting ledgers. The tax base is calculated based on tax accounting data in relation to income and expenditure. The system of tax accounting should be organized by the taxpayer independently, based on the principle of consistent application of the norms and rules of tax accounting. The procedures for the maintenance of tax records should be formally established in a taxpayer's accounting policy.

Value added tax (VAT)

Taxpayers

Taxpayers for VAT purposes are (i) organizations, (ii) private entrepreneurs or (iii) persons that are deemed to be taxpayers of VAT in connection with the importation of goods into the territory of Russia and other territories under its jurisdiction.

The territory of Russia and other territories under its jurisdiction mean the territory of Russia and the territories of artificial islands, installations and structures over which Russia exercises

jurisdiction in accordance with the legislation of Russia and provisions of international law.

Since 18 March 2014, the Russian Government has treated the territory of the Republic of Crimea, including the Federal City of Sevastopol, as part of the territory of the Russian Federation.

A special transitional period (from 18 March 2014 until 1 January 2015) has been established for synchronization of Crimean VAT legislation with that of Russia. The VAT rules for this transitional period have been revised many times, especially those concerning the VAT rates applicable to particular supplies and operations and VAT recovery.

Registration

There is no separate registration for VAT purposes. All Russian VAT payers are subject to tax registration, which covers all taxes, including VAT.

Rates

VAT is levied at a general rate of 18% on taxable supplies, which include the majority of domestic sales of goods and services. Certain basic food products, children's goods, medical products, medicines, drugs, newspapers and magazines are subject to a reduced rate of 10%.

Export of goods; provision of certain types of works and services associated with the export and import of goods; goods (works, services) supplied for official use by diplomatic missions; works and services directly connected with the carriage or transportation of goods placed

under the customs transit procedure performed by Russian taxpayers within the territory of Russia, and transportation of passengers and luggage from a place within to a place outside Russia are subject to a zero VAT rate (i.e., exempt with credit for input VAT).

Taxable operations

The following operations are VATable: (i) sales of goods (work, services), transfer of property rights in the territory of Russia, (ii) transfer of goods (work, services) in the territory of Russia for one's own needs, expenses of which are not deductible for profits tax purposes, (iii) performance of construction and installation work for one's own consumption and (iv) importation of goods into the territory of Russia and other territories under its jurisdiction.

The transfer of goods (or the results of work or services) without consideration is regarded as a sale for VAT purposes.

Place of supply of goods and services

Goods are deemed to be sold in Russia if either (i) the goods are situated in the territory of Russia and other territories under its jurisdiction and are not shipped or transported or (ii) the goods are situated in the territory of Russia and other territories under its jurisdiction at the time of the commencement of shipment or transportation.

Services are deemed to be provided in Russia in the following situations:

- (i) the services (work) are directly connected with immovable property situated in Russia

- (ii) the services (work) are connected with movable property situated in Russia
- (iii) the services are actually rendered in Russia in the sphere of culture, art, education, tourism, leisure or sport
- (iv) the purchaser of certain types of services (work) carries out activities in Russia
- (v) transportation services and related services provided by Russian organizations or private entrepreneurs, where the point of departure and/or destination point are in the territory of Russia, or by foreign organizations that are not registered with the Russian tax authorities, where the point of departure and destination point are in the territory of Russia (except for the services related to transportation of passengers and cargoes provided by foreign organizations not through its PE)
- (vi) services (work) which are directly connected with transportation of goods placed under the international customs transit procedure and are provided by organizations or private entrepreneurs whose place of activity is deemed to be the territory of Russia;
- (vii) services of an organization of natural gas transportation by means of pipeline rendered by Russian organizations;
- (viii) works (services) aimed at the performance of geological study, exploration and production of hydrocarbons that are provided in the territory of the continental shelf

and the exclusive economic zone of Russia and

- (ix) the activities of the organization or a private entrepreneur that performs the work (renders the services) are carried out in the territory of Russia with respect to the performance of work (rendering of services) not envisaged in points (i) to (ix).

Point (iv) above relates to the following types of services: the transfer and licensing of intangible property; the provision of consulting, legal, accounting, audit, advertising, marketing, engineering and information processing services; the provision of personnel secondment services (where the staff work in Russia); the rent of movable property (with the exception of land motor vehicles); the provision of services related to the development of computer programs and databases (computer software and information products) as well as their adaptation and modification; provision of emission reduction units granted under the Kyoto Protocol; and certain other types of services.

The place of activity of services provided by a Russian organization or private entrepreneur where means of transport such as aircraft, seagoing vessels or inland vessels are provided for use for transportation purposes under a lease agreement (time charter) with a crew is not deemed to be Russia if the mentioned vessels are used outside the territory of Russia for the purpose of harvesting aquatic biological resources or scientific research or if transportation occurs between ports that are situated outside the territory of Russia.

When tax arises upon a sale

Output VAT should be calculated under a quasi-accrual method. It is accrued on the earliest of the following dates:

- ▶ The day on which goods (work and services) or property rights are dispatched (transferred)
- ▶ The day on which payment or partial payment is received in respect of future supplies of goods (performance of work, rendering of services) or transfer of property rights

However, prepayments received for the delivery of goods or services subject to a zero VAT rate or exempt from VAT are excluded from the VAT tax base

Non-taxable supplies

Exempt supplies include the provision of financial, insurance, educational, cultural or medical services, and the provision of certain medical equipment, prosthetics and facilities for disabled persons.

The list of VAT-exempt transactions also includes the provision of exclusive rights on inventions, utility models, industrial designs, software, databases, integrated circuit topographies and production secrets (know-how), and provision of such rights under a license agreement. The exemption is not applicable to trademark royalties.

Certain activities aimed at the development and modernization of innovative products and technologies are also exempt from VAT in order to support companies engaged in innovative and R&D activities.

There is no right to offset input VAT on VAT-exempt supplies.

Imported goods

Imported goods are subject to import VAT levied at the customs border. VAT on imports is generally collected at customs and is payable on the total value of the goods, including import duty and excise tax where applicable.

In practice, import contracts may envisage not only the import of goods, but also the provision of services related to those goods. Such cases may be variously treated from a VAT standpoint, i.e., the whole value under the contract may be treated as VATable at customs or the value of goods may be treated as VATable at customs, and the VAT status of services may be required to be separately determined. Contracts covering both the import of goods and provision of services should therefore be carefully drafted.

Certain goods are exempt from customs VAT. For example, certain listed technological equipment (including spare parts for such equipment) for which no analogs are made in Russia are exempt from import VAT. See the “Customs” section on page 42 for further information on this import VAT exemption.

Calculation of VAT

Generally, VAT due to the state is calculated as the difference between output VAT charged to customers of goods, work or services sold and input VAT incurred upon supplies.

VAT charged by suppliers is generally recoverable by a customer, as long as the underlying costs relate to its taxable

business activity and VAT invoices properly drawn up by suppliers are in place. VAT refunds are permitted only for tax-registered persons making taxable supplies in Russia. Russia does not operate with a cross-border VAT refund mechanism. In this regard, any Russian VAT charged to a customer that is not tax-registered in Russia would represent an additional cost for the customer.

If a taxpayer carries out both VAT-exempt and taxable supplies, it is obliged to account for those operations separately. Input VAT directly related to taxable supplies is recoverable in full, while amounts of input VAT directly related to the exempt supplies is not recoverable and should be expensed. Input VAT that may not be directly attributed to taxable or VAT-exempt supplies (such as VAT on general and administrative expenses) must be apportioned. If certain purchased goods (works, services) are used in the production and/ or selling of both taxable and VAT-exempt supplies, associated input VAT can be recovered pro rata to the share of taxable supplies in total sales revenue.

Special rules for input VAT allocation apply to operations with derivatives.

If input VAT on supplies exceeds the amount of output VAT charged to customers, the difference can be reimbursed to taxpayers either through a refund or through offset against the taxpayer’s future obligations to the state (future payments of VAT, other federal taxes or accrued tax fines (penalties)), subject to certain procedures and conditions. This difference is first investigated by the tax authorities during

an in-house audit within three months of the submission date of the tax return.

Subsequently, if they do not identify any discrepancies in the VAT reported, the tax authorities should adopt a decision for the excess input VAT to be reimbursed. If the taxpayer has tax arrears due to the state, the tax authorities should independently credit the amount of VAT that is reimbursable against the tax due. If the taxpayer does not have any tax arrears due to the state, the amount of VAT that is reimbursable should be refunded upon the taxpayer's application. Alternatively, the taxpayer can request a credit of the refundable amount of VAT against future tax payments.

Under certain conditions, the reimbursement (offset or refund) of VAT can be granted to taxpayers "in advance," i.e., before the completion of an in-house tax audit of the returns submitted. An "accelerated refund" may be granted to (i) taxpayers who have existed for more than three years and whose gross total amount of tax paid for the three previous calendar years is not less than RUB10 billion (US\$280 million) and (ii) taxpayers who have submitted a bank guarantee to the tax authorities for the corresponding amount.

In practice, obtaining refunds of input VAT takes a significant amount of time. Delay in the recovery or offset of excess input VAT often occurs.

Withholding of VAT on acquisitions from FLEs

When RLEs acquire goods, work or services from FLEs that are not registered for tax purposes in Russia, and the place of supply of the goods (work, services) is in Russia, the tax base is determined by the purchaser, acting as a tax agent. The tax agent should withhold the VAT from the payment made to the FLE, and pay it to the state.

VAT withheld from payments to FLEs is recoverable by the Russian purchaser under the VAT recovery provisions stipulated by law.

To deal with this withholding mechanism, foreign suppliers usually gross up fees under agreements for Russian VAT and therefore remain "whole" when the VAT is withheld.

Tax reporting and payment

Taxpayers file VAT returns on a quarterly basis (by the twentieth day of the month following the calendar quarter). Payments should be made in equal installments by the twentieth day of each of the three months following the tax period that has ended.

Since 1 January 2014 VAT payers (including tax agents) have been required to submit VAT returns in electronic form via telecommunication channels.

Branches of a legal entity do not have to compute and pay VAT; all VAT compliance can be centralized.

Assets tax

Taxpayers

Assets tax is paid by the following taxpayers:

- ▶ RLEs
- ▶ FLEs carrying out activities in Russia through a PE or owning immovable property in Russia

Tax base

For RLEs and FLEs carrying out activities in Russia through a PE, assets tax is levied on immovable property (and movable property received by taxpayers before 1 January 2013), which is recorded as fixed assets in their accounts maintained under Russian accounting principles.

The tax base is the average annual value of the assets, calculated on the basis of the net book value of the fixed assets period by period (the first three months, six months and nine months of a year, and the calendar year).

With effect from 2014, for certain items of immovable property, asset tax is calculated based on cadastral value (close to the market value). Since 1 January 2014 the tax base may be determined by the regional authorities as the cadastral value for the following types of immovable property:

- ▶ Administrative-business centers and shopping centers
- ▶ Non-residential premises designed or actually used for offices, retailing, public catering facilities and consumer services

- ▶ property owned by FLEs without PEs in Russia or which is not related to their activities through a PE

In order to enact cadastral value as the tax base for asset tax, the regional authorities must approve the results of the determination of the cadastral value of the relevant items of immovable property and amend the relevant regional laws accordingly. In 2014, the new rules of taxation based on cadastral value have been only partially enacted in certain Russian regions, e.g.:

- ▶ In Moscow, the new rules were enacted for business centers and shopping centers, and for immovable property owned by FLEs without a PE in Russia.
- ▶ In the Moscow region, the new rules were enacted for shopping centers and for immovable property owned by FLEs without a PE in Russia.
- ▶ In most other regions, the new rules were enacted for 2014 only for immovable property owned by FLEs without a PE in Russia.

It is expected that assets taxation based on the cadastral value will be further developed and become more widespread during the next few years.

If a property is not recorded in the official cadastral valuation report as of 1 January of the tax period (year), the assets tax base for such property in that year is to be determined based on the net book value under the old rules. If immovable property without a cadastral valuation is owned by an FLE and the property is not related to activity of a PE in Russia, the tax base for such property is taken to be equal to zero.

Tax rate

The assets tax rate for movable and immovable property not taxed on the cadastral value is determined by the regional authorities, but cannot exceed 2.2%.

The tax rate for objects taxed at their cadastral value is also determined by the regional authorities, but cannot exceed the following levels:

- ▶ For property located in Moscow:
 - ▶ In 2014 – 1.5%
 - ▶ In 2015 – 1.7%
 - ▶ From 2016 – 2%
- ▶ For property located elsewhere:
 - ▶ In 2014 – 1%
 - ▶ In 2015 – 1.5%
 - ▶ From 2016 – 2%.

Tax exemptions

Certain assets are excluded from the tax base, in particular, land plots and other natural resource sites, certain historical and cultural monuments. Certain regions provide full exemptions from assets tax to taxpayers performing certain investment projects. Significant amendments to the tax base for assets tax were introduced with effect from 1 January 2013. The list of assets that are not subject to assets tax was significantly expanded. Additions include:

- ▶ Movable property received after 1 January 2013
- ▶ Nuclear plants, spacecraft, ships registered in the Russian International Register of Vessels and assets recognized as cultural heritage objects.

At the same time, since 2013, certain items of infrastructure such as public-access railroads, trunk pipelines, power lines and objects related to them have been included in the assets tax base. Before 2013, such infrastructure objects included in a special list issued by the Russian Government were exempt from assets tax. A transitional period was implemented for 2013 to 2018, during which tax rates applicable to the assets in question are subject to special limits (0.4% in 2013 and increasing by 0.3% each year until the maximum rate allowed reaches the standard rate of 2.2% in 2019).

From 2014, FIFA and related entities are excluded from the list of taxpayers of asset tax.

Tax reporting

Taxpayers should complete quarterly tax returns estimating the cumulative tax due for the current calendar year, less quarterly settlements already made. The quarterly returns should be submitted to the tax authorities along with any additional settlement due.

A taxpayer with branches possessing a separate balance sheet should pay tax to the budget at the location of each branch.



Other taxes

Excise duty

Excise duty is payable on domestic sales of certain goods produced in Russia and on imports thereof. The list of goods subject to excise duty includes alcohol, beer, tobacco, cars, motorcycles, petrol, diesel fuel, motor oil and straight-run petrol. The rates are ordinarily established in rubles per unit or in percentages of value and vary significantly. Imported alcohol and tobacco are cleared through customs only if they carry excise stamps. With some exceptions, export sales are exempt from excise duty. Excise duty is deductible for profits tax purposes.

During 2014, rates for many types of excisable goods (cigarettes, petrol, diesel fuel and motor oil) were increased.

Transport tax

Transport tax applies to both legal entities and physical persons who register vehicles. For most types of land vehicle,

tax rates established in the Tax Code vary from RUB2.5 to RUB15 (US\$0.07 to US\$0.42) per horsepower of the engine capacity of the vehicle. Regional authorities are entitled to increase or decrease the tax rates, but not by more than tenfold. Since 1 January 2014, the tax on passenger cars with an average value of RUB3 million (US\$84,000) or more (according to a list published for this purpose) is increased by multiplying the tax rate by a coefficient of between 1.1 and 3, depending on the value.

Mineral extraction tax

Tax rates for oil and gas represent fixed-duty rates based on physical volume or quantity, but are subject to variation in line with changes in global prices. Tax benefits in the form of tax holidays and coefficients to reduce the tax rate have been introduced to stimulate extraction in the cases of difficult-to-recover oil, new offshore hydrocarbon deposits and other designated subsurface sites. Other minerals are subject to tax based on the value of extracted commercial minerals.

Other taxes

Other taxes payable by companies include personal income tax, social contributions (see section on “Individuals” on page 54), water tax, gambling tax, land tax and various licensing fees.

International taxation matters

Taxation of Russian-source income of FLEs without a PE in Russia

Withholding tax

The source taxation regime is relatively similar to OECD principles. Russian-source income that does not relate to the business activities of the FLE in Russia through a PE is subject to profits tax in Russia at the source of payment. The payer of income is responsible for withholding and remitting the tax to the state.

Russian-source income

Russian-source income includes the following:

- ▶ Dividends and other forms of profit distribution from Russian entities
- ▶ Interest income from all types of debt obligations, including profit-sharing and convertible bonds
- ▶ Royalty payments in respect of copyrights, patents, trademarks, industrial designs and secret formulas or processes used within Russia
- ▶ Income from the sale of shares (share interests) in Russian entities if more than 50% of the assets of such entities consists of immovable property situated in Russia, and of financial instruments derived from such shares (share interests), with the exception of quoted shares or shares disposed of through a foreign stock exchange
- ▶ Gains from the sale of immovable property located in Russia
- ▶ Rental and lease payments relating to assets used in Russia
- ▶ Income from international transportation
- ▶ Fines and penalties for the violation of contractual obligations by Russian entities and state bodies
- ▶ Other similar income

Tax rates

The withholding tax rate applicable to income paid to foreign companies depends on the nature of the income:

Type of income	Tax rate
Interest	20% (*)
Income from operation, maintenance or lease of vessels, planes or other means of transport or containers in international traffic	10%
Dividends	15%
Capital gains from disposal of immovable property and capital gains from disposal of shares of Russian entities, if more than 50% of the assets of such entities consists of immovable property	20%
Rental income	20%
Royalties	20%
Other types of income	20%

* Interest on certain types of state and municipal securities, mortgage-backed bonds and certain income from certificates of participation in a mortgage pool are subject to tax at reduced rates.

With respect to payment of interest income relating to Eurobonds, Russian borrowers will not be required to act as a tax agent if the following conditions are met concurrently:

1. Debt instruments in respect of which interest is paid arise in connection with the issuance of Eurobonds (the law uses the term "circulated bonds"), and this connection is indicated in the respective agreement and terms of issue of Eurobonds and the prospectus, or the connection is verified by the actual movement of funds.
2. Eurobonds have been listed and/or admitted for trading on one or more foreign exchanges, and the rights to them are registered in foreign

depository or clearing organizations, provided that such foreign exchanges, foreign depository and clearing organizations are included in the list approved by the Central Bank in cooperation with the Finance Ministry.

3. The foreign organizations that are issuers of circulated bonds, or the foreign organizations that are authorized to receive interest income payable on circulated bonds, or the foreign organizations to which there have been ceded rights and obligations in respect of issued circulated bonds whose issuer is another foreign organization, and to which interest income on debt obligations is paid by Russian organizations, are, as at the date on which the interest income is paid, residents of states that have a double tax treaty with Russia, as confirmed by a tax residency certificate.

This exemption from tax agent functions also applies:

- ▶ To interest income on State securities of the Russian Federation, State securities of constituent entities of the Russian Federation and municipal securities
- ▶ To income that is paid by Russian organizations on circulated bonds issued by those organizations in accordance with the legislation of foreign states
- ▶ To income paid by a Russian organization on the basis of guarantees or other security arrangements relating to the debt obligation to foreign organizations or on Eurobonds
- ▶ To other income paid by a Russian organization and stipulated under the terms of the respective debt instrument or the terms of issue of Eurobonds (e.g., payments upon early repurchase and/or redemption of Eurobonds)

A “punitive” withholding tax rate of 30% could apply to interest and dividends on Russian securities (including ADRs and GDRs on Russian securities) held through foreign nominee accounts at Russian custodians where no aggregated information on the beneficial owners of such securities has been provided to the Russian custodians.

Treaty relief

Double tax treaties, including those concluded by the Russian Federation and those to which the former USSR was a party, may provide relief in the form of reduced or zero rates of withholding tax. Tax treaties to which the former

USSR was party are honored by Russia, unless the other party to the treaty has renounced the treaty or it has been replaced by a new treaty. In the last 20 years, Russia has entered into many new treaties based on the OECD Model Convention, and now has an extensive treaty network. As of July 2014, Russia has in force double tax treaties with more than 80 countries.

A double tax treaty between Russia and Malta is the most recently ratified. It will come into force on 1 January 2015.

A foreign company wishing to claim an exemption from Russian withholding tax or a reduced rate based on a treaty must provide the Russian payer of the income with a tax residency certificate issued by the foreign tax authority confirming that the company is a tax resident in the relevant treaty country.

One of the key directions of Russian tax policy in 2014 is towards narrowing the application of tax benefits under international treaties. Proposed legislative changes in this respect cannot enter into force until 2015 at the earliest. However, the Ministry of Finance issued guidance to tax authorities and taxpayers in April 2014 setting out a stricter approach to the application of treaty benefits that the ministry views as based on existing law and hence having immediate effect. Tax inspectors auditing amounts of tax withheld by tax agents or considering applications for refunds of excess tax withheld from foreign companies are to consider whether or not the recipient of income is its beneficial owner, taking into consideration the functions performed and risks assumed

by the recipient and whether the income is subsequently paid to another person that would not have been entitled to concessions under the tax treaty in question.

See Appendix 4 for treaty withholding tax rates.

Foreign tax relief

As previously indicated, RLEs are taxed in Russia on their worldwide income. Therefore, both Russian and foreign-source income are taken into account when determining the tax base.

To avoid double taxation, amounts of tax paid in accordance with the legislation of foreign countries by an RLE are creditable against the Russian tax payable by the RLE. The amount of the tax credit may not exceed the amount of tax payable in Russia on the income taxed in the foreign jurisdiction. Foreign tax on foreign-source dividends, however, can be credited against Russian tax on dividends only if such credit relief is envisaged by an applicable double tax treaty (often the case). For other types of income, a tax credit is granted regardless of whether a treaty exists.

The main tax reforms under consideration in 2014

So-called “deoffshorization” of the Russian economy became the main goal of Russian tax policy development at the end of 2013, and the Government had already presented several initiatives by July 2014.

Some of the key initiatives proposed have been developed in a Draft Law,

according to which the following are to be introduced in Russian tax law:

- ▶ Controlled foreign company (CFC) rules extending the scope of Russian tax to profits of such companies
- ▶ The beneficial ownership concept to limit the availability of treaty benefits
- ▶ A Russian tax residence concept for foreign companies based on some form of place of effective management test
- ▶ Taxation of indirect transfers of ownership in Russian property-rich companies

By the August of 2014, the Draft Law had been published and substantially amended a number of times, with alternative drafts published by interested parties. Given the pressure on the economy caused by economic sanctions and other factors, it is conceivable that the government will decide now is not the time for some of the measures proposed, in which case, they may be removed from the draft prior to enactment. Alternatively, the new rules might be introduced with a certain transition period, which would provide taxpayers with more time to adapt to them. Currently, the Draft Law is under consideration by the government and is expected to be finalized by the end of 2014.

Taxation of reorganizations of companies in Russia

Reorganizations of companies (in the form of a merger, upstream merger (absorption), transformation, spin-off or demerger) in Russia are generally tax-neutral. A reorganization of companies should not give rise to any tax charge in Russia for the shareholders of the reorganized company or companies.

In addition, the reorganization of Russian companies does not give rise to any taxation for the resulting companies with respect to the assets, accounts receivable and obligations transferred by the reorganized company. Generally, there is no change of control limitations. If a taxpayer ceases its activity as a result of its reorganization, the legal successor is able to use the loss carry forwards transferred from the reorganized company.

Customs

Overview

Customs regulation in Russia is generally based on international standards, and the Russian customs legislation contains provisions that are similar to the provisions of the EU Customs Code. The Russian Federation is a member of the World Customs Organization, the International Convention on Harmonized Commodity Description and Coding System (Brussels, 1983), the Convention on Temporary Import (Istanbul, 1990), the Convention on Simplification and Harmonization of Customs Procedures (Kyoto, 1973) and many others. Russia joined the World Trade Organization in August 2012.

Import duties

Imported goods are generally subject to import customs duties and import VAT. Certain categories of goods (such as alcohol, tobacco, personal cars and gasoline) are also subject to excise duties (see "Other taxes" on page 39).

Customs duty rates vary from 0% to 20% of the customs value of the goods. Import VAT is generally 18% (subject to certain exceptions) and is calculated on the basis of the sum of the customs value and the customs duty. Import VAT paid by the importer is generally offsettable against its output VAT.

Current customs tariffs set zero duty rates for books, certain types of medicines and some other goods. Humanitarian aid, goods that are needed to rectify the consequences of natural calamities, accidents and disasters, as well as diplomatic goods, are exempt from customs duties and VAT.

Import of technical equipment

Certain categories of manufacturing equipment (including components and spare parts) for which there are no equivalent produced in Russia (according to a list approved by the Russian Government) are exempt from VAT on importation into Russia. Certain types of technological equipment are also exempt from customs duty (i.e., are subject to 0% customs duty).

In addition, any equipment imported as a contribution in kind to the charter capital of a Russian company from a foreign shareholder can be exempt from customs duty under certain conditions.

Export duties

Certain categories of goods (e.g., oil, natural gas and timber) are subject to export customs duties.

Customs value

Customs valuation in Russia is based on the GATT or WTO rules. The customs value of imported goods is usually determined as the value of the goods as indicated in the invoice plus certain other costs associated with the importation of the goods but not included in the transaction price. These additional costs are typically the cost of delivery of the goods to the border (e.g., transportation and insurance costs), royalties or other payments for use of intellectual property, the cost of materials provided free of charge by the purchaser to the seller, etc. This method of calculation of the customs value of imported goods is called the transaction value method.

Normally, the customs value is based on CIP delivery terms (Incoterms 2010 – Carriage and Insurance Paid To). If the customs value cannot be estimated with the transaction value method, other methods may apply: the price of a transaction involving identical or similar goods, the deduction cost method, the summation cost or the reserve method.

Customs coding

The Unified Customs Nomenclature of the Customs Union is applicable in Russia. This nomenclature is based on the Harmonized Commodity Description and Coding System of goods. Therefore, the first six digits of the commodity code should be identical in Russia and in the

EU, although there are some differences in practice. It is possible to obtain a binding decision from the customs authorities concerning the classification of goods.

Customs procedures

All cross-border transfers of goods and vehicles in Russia are carried out under one of the customs procedures prescribed by customs legislation of the Customs Union. Each customs procedure provides different terms for clearance, which have a considerable effect on the tariff and non-tariff barriers under import and export transactions. Below is a summary of the main customs procedures.

Release for domestic consumption

The customs procedure of release for domestic consumption is used when goods are imported into Russia without the intention of their being re-exported. This is the most frequently used and most straightforward procedure. Under this procedure, after the payment of customs duty, import VAT and fulfillment of other necessary formalities, the goods are considered to be in free circulation in Russia.

Bonded warehouse

When goods are imported under the bonded warehouse customs procedure, the imported goods are kept in a special warehouse under supervision of the customs authorities (customs bonded warehouse) until their sale to the final customers, their final use in Russia, or their re-exportation outside Russia. The payment of customs duties and import

VAT is postponed until removal of goods from the customs bonded warehouse.

Goods kept in a customs bonded warehouse must remain in unchanged condition; i.e., it is prohibited to manufacture, assemble or transform goods stored in a customs bonded warehouse.

The period of storage of goods in a customs warehouse cannot exceed three years. After the expiration of the storage period, the goods should be placed under another customs procedure. If the goods are released for domestic consumption, customs duties and VAT are due. If the goods are re-exported to a country outside the Customs Union, no customs duty or import VAT are due.

Temporary importation

The temporary importation procedure is the customs procedure under which the use of goods in Russia is permitted with full or partial exemption from customs duties and import VAT.

The time period for temporary importation cannot exceed 2 years (or 34 months for leased fixed assets).

A full exemption is granted in limited cases for goods that are intended to be used in non-sales operations. Typical examples of temporary importation with full exemption are importations of goods for an exhibition or for testing in Russia.

A partial exemption is granted in other situations when, at the moment of the importation of the goods to Russia, it is intended that the goods will be maintained in Russia for a limited period of time and will be re-exported afterward.

Under the partial exemption, the importer has to pay customs payments in monthly installments of 3% of the total amount, calculated as if the goods were released for free circulation. These amounts are not refunded if the goods are re-exported.

Once the period of temporary importation has expired, the goods can be either re-exported out of Russia or released for free circulation in Russia. If the goods are finally released for free circulation, the outstanding amount of customs payments should be paid together with late payment interest.

This procedure is widely used in practice, in particular, in the case of importation for leasing operations in Russia.

Customs procedures of processing

There are three different procedures of processing:

- ▶ Processing of goods in Russia for export. Under this procedure, companies whose business involves processing of goods in Russia can, under certain conditions, import goods into Russia for their processing without payment of customs duty and import VAT. A bank guarantee may be required to secure the payments of customs duties and taxes that can be due in case of violation of the conditions for this procedure.
- ▶ Once the goods have been processed into finished products, they should be exported. If the finished products are released for free circulation in Russia, customs duty and import VAT are due

on the value of the raw materials, as well as late payment interest.

- ▶ Processing of goods for domestic consumption. Under this customs procedure, customs duties are due only once the finished products are released for free circulation in the Russian market. Thus, customs duties apply to the finished goods. Imported raw materials for processing are exempt from customs duties but are subject to import VAT. The procedure is applicable only to the goods under the list established by the Government. It is possible that the list could be extended upon application of the interested party(parties).
- ▶ Processing of goods outside Russia. The procedure of processing of goods outside Russia allows exportation of goods for their processing and subsequent re-importation into Russia. Customs duties and import VAT are due only on the value added by the processing operations but not on the value of imported goods. This procedure is useful for goods that need to be exported for repair outside Russia.

CIS free-trade regime

According to the free-trade regime among CIS countries, goods originated and imported into Russia from one of the CIS countries are exempt from customs duties. In order to qualify for this exemption, the goods should be imported under a contract concluded between CIS residents, and the goods should be shipped directly from the territory of a CIS country. An additional requirement

is that the seller should be the owner of the goods. VAT and excise duties (if applicable) are due.

Customs Union of Russia, Belarus and Kazakhstan

Russia has formed a Customs Union with Belarus and Kazakhstan. The unified customs legislation of the Customs Union, the Customs Code of the Customs Union, international agreements and Decisions of the Customs Union Commission, the Unified Customs Tariff and unified system of non-tariff measures (licensing requirements on importation) are directly applicable in Russia. The Customs Union implies the free movement of goods within the Customs Union country members.

The Agreement on the Eurasian Economic Union (EEU) signed by the leaders of Russia, Belarus and Kazakhstan in 2014 will begin to operate from 1 January 2015. It represents the next stage of integration among these countries following the creation of the Customs Union and the Unified Economic Space. Customs regulation within the EEU will continue to be governed by the Customs Code of the Customs Union and international agreements between the member states prior to the adoption and entry into force of the Customs Code of the EEU.

Transfer pricing

The current transfer pricing legislation (the TP Law)⁵ has applied since 1 January 2012. Even though Russia is not a member of the OECD, the provisions of the TP Law are, in large part, consistent with OECD principles, but are subject to some specific Russian considerations. The rules are driven by the arm's length principle and focus on a consideration of the substance of the transaction rather than the form.

Among several significant conceptual changes, one of the major reforms introduced by the new TP Law is the requirement for TP documentation and TP notification for controlled transactions.

It will take time to understand how, in practice, the TP Law will be interpreted and applied by the Russian tax authorities. The first audits under the new TP Law commenced in 2014 and there was little court practice concerning the interpretation of the new TP Law in the period to 31 July 2014. There are signs that the intention of the Russian tax authorities is to develop an OECD-like practice. However, companies should closely monitor the practical development of Russian TP legislation in order to comply with Russian-specific requirements, which may differ from the OECD approach.

⁵ Enacted by Federal Law No. 227-FZ and incorporated in Part I of the Tax Code, mainly in articles 105.1 to 105.25.

Scope of TP control

The Russian TP rules primarily focus on related-party transactions, but certain third-party transactions are also subject to TP control. All cross-border transactions with related parties are subject to TP control. Third-party transactions subject to TP control include transactions involving goods traded on global commodity exchanges (such as certain types of oil and oil products, ferrous metals, nonferrous metals, fertilizers, precious metals and precious stones) and transactions with a counterparty located in certain blacklisted jurisdictions,⁶ if the annual income, as a result of all transactions between the parties, exceeds RUB60 million (US\$1.7 million) subject to transitional provisions in the TP Law.

In the domestic market, only related party transactions can be subject to transfer pricing control. However, a materiality threshold applies in the domestic market and generally only transactions in excess of a threshold of RUB3 billion in 2012 (US\$84 million), RUB2 billion (US\$56 million) in 2013 and RUB1 billion (US\$28 million) for 2014 and subsequent years are subject to TP control. It is worth noting that this threshold is lowered to RUB60 million (US\$1.7 million) for the following transactions:

- ▶ Transactions involving an object of assessment to mineral extraction tax calculated at an ad valorem tax rate
- ▶ Transactions where one of the parties is exempt from paying profit tax, or pays the tax at a 0% rate

⁶ Please refer to Appendix 5 for a list of these locations.

- ▶ Transactions where one of the parties is registered in a special economic zone (SEZ) (such transactions have been subject to control since 1 January 2014)
- ▶ Transactions where one of the parties is the operator or licence holder in relation to a project involving hydrocarbon extraction activities on Russia's continental shelf (such transactions became subject to control from 2014 subject to certain conditions)

As an exemption, certain domestic transactions are not subject to TP control:

- ▶ Transactions between members of a domestic consolidated group of taxpayers
- ▶ Transactions where both parties are registered within the same region of Russia, where none of the parties have economically autonomous subdivisions in other regions of Russia nor pay income tax to the budgets of other regions, where none of the parties have tax losses and there are no other grounds for the transaction to be controlled
- ▶ Transactions involving loans and financial guarantees agreed upon before 1 January 2012 (unless substantial changes to the terms have been made since then).

For the purposes of the TP Law, the main condition for two entities to be regarded as related parties is a 25% ownership threshold, i.e., if one party directly or indirectly controls more than 25% of the other party. There are numerous

other conditions, and the courts can also declare companies and individuals to be related on any other grounds, if it is proven that the relationship between the parties influenced the terms and the results of transactions.

TP methods

The TP Law generally follows the principle set forth in the July 2010 OECD Guidelines for Multinational Enterprises and Tax Administrations. In particular, it allows for the use of one of the five OECD methods, including comparable uncontrolled price (CUP), resale minus, cost plus, transactional net margin method and profit split method. The CUP method has first priority, whereas the profit split method is regarded as the method of last resort. The resale minus method is regarded as the second priority method for activities of distribution of goods in Russia.

Documentation requirements

Notification of controlled transactions: information about controlled transactions should be submitted annually to the tax authorities via a TP notification. This information should be presented to the tax authorities no later than 20 May of the year following the year when the controlled transactions took place. For 2013, this requirement applied only where the amount of income from all controlled transactions concluded by the taxpayer within a calendar year with one person (a few of the same persons being parties to the controlled transactions) exceeds RUB80 million (US\$2.2 million). Starting from 2014, all controlled transactions need to be reported in the TP notification.

TP documentation: transactions subject to TP control should be documented. The tax authorities may request TP documentation proving that the transfer prices are established at arm's length. This documentation should be presented to the tax authorities within 30 business days from the tax authorities' request, which cannot be earlier than 1 June of the year following the reporting year. Generally, Russian TP documentation will need to contain similar information as recommended by the OECD TP Guidelines. A comparability analysis based on Russian data (also in line with the search strategy prescribed in domestic law) is a must where the tested party is located in Russia. Foreign comparable data will be accepted only in the absence of reliable information within Russia. The TP documentation must be submitted to the tax authorities in Russian.

As an exception, TP documentation is not required for third-party transactions, transactions where the prices conform to a regulated price or a price that is prescribed by the anti monopoly authorities, transactions with securities and derivatives traded on an organized equity market and for transactions covered by an advance pricing agreement.

Advance pricing agreements

The TP Law provides the opportunity to conclude an advance pricing agreement (APA) with the Russian tax authorities. Only Russian entities are eligible to conclude an APA and they also have to qualify as large taxpayers. An APA can be unilateral (with the Russian tax

authority only) or multilateral (with the tax authorities of several countries).

Penalties

The TP Law establishes a 40% penalty in case a taxpayer's income is adjusted as the result of a TP audit (based on the amount of unpaid tax). However, no penalty can be charged by the tax authorities if the taxpayer submitted TP documentation or concluded an APA.

In addition, the 40% penalty will be applied only to transactions concluded in 2017 and subsequent years. No penalty will apply to transactions concluded in 2012 and 2013 and a reduced 20% penalty will apply to transactions concluded in 2014, 2015 and 2016.

Special economic zones

SEZs are defined territorial areas with a special regime for carrying out entrepreneurial activity and special business incentives, in particular, certain tax and customs privileges. Exemptions from customs duties and VAT are provided under the customs procedure of free customs zone.

Four types of zones are now envisaged by the law:

- ▶ Industrial production SEZs
- ▶ Technological and innovative SEZs
- ▶ Tourism and recreational SEZs
- ▶ Port SEZs

Type of special economic zone	Location of zones
Industrial production	Lipetsk region, the Republic of Tatarstan (Alabuga), the Pskov region, Sverdlovsk region, Samara region and Kaluga region
Technological and innovative	Moscow (Zelenograd), Moscow region (Dubna), Tomsk and St. Petersburg and the Republic of Tatarstan
Tourism and recreational	The Republic of Altai and Altai region, the Republic of Buryatia, Stavropol territory, Irkutsk region, Primorsky territory and North-Caucasus tourism cluster
Port	Ulyanovsk (airport), Khabarovsk Territory and Murmansk region (seaports)

Finished goods produced in a free economic zone and sold in the domestic market (in Russia or Customs Union member countries) are exempted from customs duty and VAT if certain conditions are met. The principal condition is that the finished goods be recognized as Customs Union goods (if they meet the relevant criteria of sufficient processing). Currently, however, the law does not regulate the use of this exemption by companies that were not registered as residents of a free economic zone before 1 January 2012.

SEZs are created at the initiative of the executive body of the region and the municipality in whose territory the SEZ is intended to be formed, but the decision on the effective creation of an SEZ is made by the Russian Government (Ministry of Economic Development).

To enjoy the benefits of an SEZ, it is necessary to be a resident of this SEZ, i.e., to be registered within the territory of the SEZ, to conclude a special agreement with the SEZ managing bodies and to fulfill certain conditions in terms of activity and level of investment in the SEZ.

The major tax and customs privileges are the following:

- ▶ Accelerated depreciation, general rates may be increased by a factor of two (only for industrial production and tourism and recreation SEZs)
- ▶ Provision of work and services by port SEZ residents on the territory of a port SEZ are not subject to VAT
- ▶ Reduced social contribution rates (for industrial, technological and innovative, tourism and recreation SEZs)
- ▶ Ten-year exemptions of assets tax
- ▶ Five-year exemptions of land tax (10 years for shipbuilding organizations in industrial SEZs)
- ▶ Profits tax rate is not higher than 15.5% for all SEZs, for industrial production SEZs and for tourism and recreation SEZs which have been combined in cluster by a government decision the maximum tax rate is 13.5%
- ▶ Guarantee against unfavorable changes in tax legislation

- ▶ Foreign goods placed (imported) and used in a free economic zone are exempted from customs duties and VAT
- ▶ When Customs Union goods (goods produced in or previously imported into Russia, Belarus and Kazakhstan) are imported from another part of Russia to be used in producing finished goods, customs duties are not charged and a 0% rate of VAT applies
- ▶ The applicability of export duties to finished goods exported from a free economic zone to countries outside the Customs Union also depends on the degree of processing. Customs Union goods are subject to duties (if duties have been established), while foreign goods are not

The SEZs in the Kaliningrad and Magadan regions are regulated by separate laws and have different incentives than other SEZs. It is worth noting, however, that according to Russian WTO assessment agreements, these separate laws will be in force only until 2016 (in respect to Kaliningrad region) and until 2014 (in respect to Magadan region).

Offshore Oil and Gas Developments

Since 1 January 2014, special tax and customs regimes have applied to certain offshore hydrocarbon development projects. Concepts such as “an operator,” “an offshore hydrocarbon deposit” and “hydrocarbon extraction activities” are now incorporated in the Tax Code and customs legislation, allowing special profits tax, mineral extraction tax and customs regimes to be established for qualifying

activities. Such activities, when performed by the holder of the relevant mineral licence or a qualifying operator, are subject to special ring-fencing rules that prevent losses from other activities from reducing taxable income from a new offshore hydrocarbon deposit and limit the extent to which losses from one such deposit can reduce taxable income from others.

Financial reporting and auditing

Sources of accounting principles

Regulatory bodies

Regulatory bodies overseeing Russian accounting principles include the Ministry of Finance, the Central Bank, the Federal Service on Financial Markets and the Federal Tax Service.

Accounting regulations for Russian legal entities are based on the Civil Code, the Federal Law On Accounting, the Federal Law On Consolidated Financial Statements, the Statutes on Accounting and Reporting in Russia (namely accounting standards (PBUs)), and other laws and accounting regulations issued by the Ministry of Finance. With the adoption in 2010 of the Federal Law On Consolidated Financial Statements, International Financial Reporting Standards (IFRS) were introduced into Russian legislation for the purposes of consolidated financial reporting by certain companies (see the next section for further details).

The Chart of Accounts for Bookkeeping for the Financial and Economic Activity of Enterprises and the Instruction for Its

Application describes the bookkeeping methodology in detail.

Accounting standard PBU No. 1/2008 Accounting Policies of an Organization prescribes the possibility of developing an appropriate method on the basis of Russian accounting standards and IFRS if accounting methods do not exist in the current accounting legislation.

Most PBUs are based in large part on IAS and IFRS. Some IFRSs, however, have no comparable PBU standard, and some PBUs that are based on IFRS have not been updated for recent changes to the comparable IFRS. Therefore, the Russian accounting system continues to differ from the IFRS, as well as from accounting principles generally accepted in the US (US GAAP).

Financial accounting and reporting is separate and distinct from tax accounting and reporting. Twenty-four accounting standards have been issued by the Ministry of Finance, which offers guidance on accounting matters. Also, several new accounting standards are currently under development.

Books and records

The general provisions of the accounting standards, including PBU No. 4/99 Statute on Accounting and Reporting in Russia, envisage that the main aim of accounting records is to provide full and accurate information on the activity of an enterprise and its assets and liabilities. Financial reports are to be used by the company internally – by managers, shareholders and owners, as well as by external investors, creditors and other users of accounting reports. The Federal Law on

Accounting requires that the company draw up its accounting policy based on Russian legislation, including the Law on Accounting and accounting standards.

The Federal Law On Accounting applies to all companies located in Russia and to branches and representative offices of foreign companies, unless otherwise stipulated in international treaties to which Russia is a party.

Fundamental concepts

Accounting principles include the concepts and principles of accruals, going concern, prudence, completeness, timeliness, relevance, substance over form, matching revenues and expenses, comparability, consistency and rationality. However, the application of these principles may differ from practices common in other countries. For example, in practice, Russian accounting tends to focus on form rather than substance; the laws are very specific as to the documents required to support a transaction, and this emphasis on the legal form may override the application of other accounting principles.

Applicability of IFRS for consolidated financial statements of public companies in Russia

Federal Law No. 208-FZ On Consolidated Financial Statements was adopted on 27 July 2010 (Law No. 208-FZ). Thus, Russia introduced a legislative requirement concerning the mandatory application of IFRS by all public-interest entities and certain other companies for the preparation of consolidated financial statements.

In accordance with the amendments to Law No. 208-FZ adopted in 2014, its scope was broadened to include public-interest entities such as: non-state pension funds; management companies of investment funds, mutual funds and non-state pension funds; clearing institutions; federal state unitary companies of significant public interest (as determined by the Government); and PJSCs, whose shares are in federal ownership (as determined by the Government). Further amendments clarified that IFRS financial statements must also be prepared by those companies that have no subsidiaries. At the same time, amendments explicitly exclude from the scope of Law No. 208-FZ medical insurance companies that are engaged solely in mandatory medical insurance activities, as well as public entities such as budget or municipal companies. Furthermore, the amendments stipulate a change in the time line for the obligatory preparation, presentation and publication of consolidated financial statements under IFRS for issuers of listed bonds. Such companies are required to prepare, present and publish their consolidated financial statements under IFRS, starting with the financial statements for 2014. The amendments also clarify that, for the purposes of Law No. 208-FZ, the consolidated financial statements are the statements that present the financial position, financial results and changes in the financial position of a company or combination of companies, including foreign companies, that forms a group as this term is defined in IFRS. The amendments also confirmed that entities that have no subsidiaries may nevertheless be within the scope of the Law On Consolidated Financial Statements.

Companies for which publication of IFRS consolidated financial statements is mandatory

According to Law No. 208-FZ, the following companies must publish their consolidated financial statements prepared in accordance with IFRS:⁷

- ▶ Credit institutions
- ▶ Insurance companies (except for medical insurance companies engaged only in mandatory medical insurance activities)
- ▶ Non-state pension funds
- ▶ Management companies of investment funds mutual funds and non-state pension funds
- ▶ Clearing institutions,
- ▶ Federal state unitary companies of significant public interest (as determined by the Government)
- ▶ Public joint-stock companies, whose shares are in federal ownership (as determined by the Government)
- ▶ Other listed companies

Where other federal laws require the preparation, the presentation and/or the publication of consolidated financial statements or where the constitutive documents of a company that does not fall within the scope of Law No. 208-FZ require the preparation, the presentation and/or the publication of consolidated financial statements, those statements must be prepared in accordance with Law No. 208-FZ.

⁷ Initially only credit institutions, insurance companies and other companies with listed securities were included in the scope of Law No. 208-FZ.

From 1 January 2013, for example, under Federal Law No. 325-FZ “On Organized Trading” of 25 November 2011, trade institutors must prepare their annual consolidated financial statements in accordance with the requirements of Law No. 208-FZ. Also, according to Federal Law No. 39-FZ “On the Securities Market” of 22 April 1996, an issuer that has registered an offering memorandum must make available to the public its consolidated financial statements under IFRS.

Endorsement of IFRS in Russia

Law No. 208-FZ states that IFRS and Interpretations of IFRS issued by the IFRS Foundation and endorsed by the Russian Government in consultation with the Central Bank must be applied in Russia. A decision to endorse an individual IFRS or Interpretation of an IFRS in Russia is made with regard to such a standard or interpretation as a whole. If certain provisions of a standard or interpretation are recognized as not suitable for application in Russia, such standard or interpretation will be adopted in Russia with such provisions “carved out.”

Procedure of endorsement of IFRS in Russia

According to Law No. 208-FZ, IFRS are to be applied in Russia based on a Russian translation. Government Regulation No. 107 On approval of the Regulation on the Endorsement of IFRS and Interpretations of IFRS to be Applied in Russia, of 25 February 2011, set out the requirements of the Law in greater detail and established the procedure for the endorsement of IFRS in Russia.

The IFRS Foundation assigned to Russia the right to use the Russian translation of IFRS in Russia. Although the Russian Government reserves the right to carve out certain provisions of the IFRS prior to their approval for application in its jurisdiction, it is expected that, as a rule, IFRS will be applied in Russia in the wording approved by the IASB.

A not-for-profit organization, the Foundation National Organization for Financial Accounting and Reporting Standards (NOFA Foundation), is the expert body for providing endorsement advice to the Ministry of Finance about the suitability of individual IFRS and interpretations thereof for the Russian financial reporting system. In March 2012, Order No. 148 of the Ministry of Finance established an Interdepartmental Working Group for IFRS Implementation. Among other things, the group summarizes the practice of application of Law No. 208-FZ and prepares recommendations on issues arising during the implementation of IFRS in Russia. By July 2014, the Group had issued four recommendations that have been published on the Ministry of Finance's official website.

On 25 November 2011, the Ministry of Finance issued Order No. 160n, endorsing a set of 63 standards and interpretations with mandatory application as of 1 January 2012 as issued by IASB, i.e., without any carve outs. These standards came into effect for the purposes of Law No. 208-FZ in December 2011. On 3 August 2012, a second set of standards and amendments to them were endorsed for application in Russia, which included IFRS 10 Consolidated Financial Statements. It is noteworthy that the

Ministry of Finance decided that credit institutions and insurance companies should not be entitled to apply the exemption from preparing consolidated financial statements in the circumstances specified in paragraph 4 (a) of IFRS 10 Consolidated Financial Statements. Accordingly, such companies must publish their IFRS consolidated financial statements even if they meet the criteria in IFRS 10.4(a). The endorsement process continues and, currently, most standards and interpretations effective from 1 January 2014 have been endorsed by Russia as issued by the IASB. The first part of IFRS 9 has also been endorsed and, therefore, may be adopted early by Russian companies.

Procedure of IFRS and interpretations of IFRS coming into effect in Russia

An endorsed IFRS or interpretation of an IFRS comes into effect in Russia in stages, unless otherwise provided by such standard or interpretation.

Stage 1 An endorsed IFRS or interpretation of an IFRS comes into effect for voluntary application by entities on the date provided by the standard or interpretation, but no earlier than its official publication.

Stage 2 An endorsed IFRS or interpretation of an IFRS comes into effect for mandatory application by entities on the date provided by the standard or interpretation.

If an endorsed IFRS or interpretation of an IFRS does not state the date and/or the procedure for its coming into effect, or if it is recognized for application after the date stated therein, such standard or interpretation will come into effect in Russia as of the date of its official publication.

Time frame for the requirement to prepare consolidated financial statements under IFRS

The companies subject to the requirements of Law No. 208-FZ must prepare, file and publish IFRS consolidated financial statements beginning with the calendar year following the year in which the IFRS have been endorsed in Russia. Since the endorsement of the first 63 standards and interpretations was completed in 2011, entities have had to file IFRS consolidated financial statements beginning with the financial year 2012 (except for entities for which a special time frame has been set, including those included within the scope of the Law by amendments made in 2014).

In practice, the effect of officially adopting IFRS in Russia will differ from company to company. Those companies that have been preparing and publishing their IFRS financial statements on a voluntary basis will now only have to publish such financial statements in Russian and submit them to their shareholders and file them with appropriate government authorities on a mandatory basis. Other companies that also fall under the scope of Law No. 208-FZ but that have not published their IFRS consolidated financial statements in the past will have to apply IFRS 1 and prepare their first financial statements in accordance with IFRS, presenting the appropriate reconciliation of equity items with the most recent combined financial statements prepared in accordance with Russian GAAP (PBUs). This is equally applicable to those subsidiaries, associates and joint ventures of large holding companies that may have

been preparing IFRS-compliant reporting packages for consolidation purposes, but never published IFRS consolidated financial statements.

Special time frame for presenting IFRS consolidated financial statements set for certain categories of companies

The companies listed below should present and publish their IFRS consolidated financial statements as follows:

- ▶ Companies with listed bonds – no later than calendar year 2014; companies with listed securities which prepare their consolidated financial statements under internationally recognized standards other than IFRS⁸ – no later than calendar year 2015
- ▶ Non-state pension funds, management companies of investment funds, mutual funds and non-state pension funds and clearing institutions – no later than calendar year 2015
- ▶ State unitary companies of significant public interest and public joint-stock companies, whose shares are in federal ownership – from the year following the year in which they are included in special lists approved by the Government

⁸ There is no official list of such standards, however, an interpretation of the Interdepartmental Working Group for the purposes of Federal Law "On Consolidated Financial Statements" explains that internationally recognized standards other than IFRS in this context means US GAAP.

Presenting annual IFRS consolidated financial statements: deadlines and addressees

Annual consolidated financial statements should be presented to the company's participants (including shareholders) prior to a general meeting, but no later than 120 days from the end of the year for which the consolidated financial statements have been prepared. Annual consolidated financial statements should also be filed with the Central Bank.

Audit of IFRS consolidated financial statements

Annual IFRS consolidated financial statements are subject to mandatory audit. An audit opinion must be presented and published together with the consolidated financial statements.

Publication of IFRS consolidated financial statements

Companies must publish their annual consolidated financial statements within 30 days of the date when they were presented to the company's participants. Consolidated financial statements are considered published if:

- ▶ They have been placed in information networks available to the general public (e.g., the internet)
- ▶ They have been published in the mass media available to those interested in such financial statements
- ▶ Other actions have been performed with regard to such financial statements that make them available to any interested party

Significant accounting concepts for investors

Since the official endorsement of IFRS in Russia, consolidated financial statements of public companies have been prepared under IFRS. Combined Russian financial statements (when required in certain cases) and single company financial statements will continue to be prepared under PBU. Accounting principles for specified accounts and business transactions under PBU are discussed below.

Foreign currency transactions

All bookkeeping entries must be recorded in rubles, which is also the reporting currency. Although Russia is not considered a highly inflationary economy, due to its inflationary past, the ruble amounts require analysis in order to better understand the financial position and results of operations. Foreign currency transactions are converted to rubles using the exchange rate specified by the Central Bank at the date of the transaction. Monetary assets and liabilities, except for advances and prepayments recorded in rubles, but denominated in hard currency, are revalued at the exchange rate on the reporting date or at the rate agreed by the parties.

Fixed assets

Fixed assets are recorded at their historical cost. These assets are depreciated using four allowed methods, with the straight-line method being used more frequently than the others. The useful life of a fixed asset is determined at the acquisition date and is equal to the period of expected use. Revaluations of fixed assets to market value are allowed

(but not required) once a year as at the end of the reporting year. A company can revalue groups of similar (homogeneous) fixed assets not more often than annually. Land and natural resources are not subject to revaluation.

Companies may or are sometimes required to apply different useful lives for accounting and tax purposes.

Inventory

Inventory is carried at cost. Inventory should be written down at the year-end if the realizable value is lower than cost. The realizable value is measured without deduction of selling costs.

The allowed accounting methods for determining cost are:

- ▶ Average cost
- ▶ Individual cost (specific identification)
- ▶ First-in, first-out (FIFO)

The most commonly used method is average cost. The cost of manufactured inventory must include direct costs and allocated indirect manufacturing costs.

Investments

Investments are recorded in the amount of the actual expenditure. Investments with determinable current market value should be recorded at market value. Investments without determinable current market value should be recorded at cost and an impairment test performed.

Bank transactions

A company's cash balance reflects only the activity recorded by the bank. Since the bank statement and its supporting documents are the source for the entries

in the enterprise's books, there is no need to perform a reconciliation of the enterprise's books to the bank statement.

Tax liability

PBU No. 18 Accounting for Deferred Income Taxes addresses accounting for deferred taxes and the identification of temporary and permanent differences between tax and book bases.

Capital and reserves

Shareholders' capital is the entire amount authorized by the charter. Any uncontributed portion of the registered shares is recorded as a receivable from shareholders and included in current assets. Treasury shares are shown as a negative amount in the capital and reserves section of the balance sheet.

Companies may set up a reserve fund from retained earnings. The purpose of the reserve fund is to cover accumulated losses or buy back the company's shares. JSCs must create such a reserve fund amounting to not less than 5% of the authorized capital.

Net income

Although it is based on the accruals method, Russian accounting can differ from IFRS in regards to recognition of revenue and expenses.

Financial statements approved by shareholders are not subject to revision, and any material errors pertaining to prior periods for which financial statements have already been approved are corrected in the financial statements for the current period retrospectively.

If a material error was found after the year-end, but before approval by the annual shareholders' meeting, it is corrected in the accounting records for December of the year in which it occurred.

For tax purposes, companies need to resubmit the previously filed tax returns to correct the effects of any past errors.

Disclosure, reporting and filing requirements

Disclosure requirements

All statements must be prepared in the Russian language and use rubles as the reporting currency.

The annual financial statements in Russia consist of the following:

- ▶ A balance sheet including three columns for the current reporting year and two previous years
- ▶ A statement of financial results
- ▶ Appendices to the balance sheet and statement of financial results

The formats of the balance sheet, statement of financial results and appendices to them are prescribed by PBU No. 4/99, the Accounting Reports of an Organization. Appendices to the financial statements must include the following information:

- ▶ Cash flow statement
- ▶ Statement of changes in shareholders' equity
- ▶ Notes to the financial statements
- ▶ Summary of accounting policies in the notes to the financial statements

- ▶ A description of all departures from mandatory accounting requirements when a fair presentation cannot be achieved through their application
- ▶ Additional details on significant accounts (intangible assets, fixed assets, investments, debtors, creditors, shareholders' equity, revenues, costs and expenses over 5% of total income or total expenses)
- ▶ Disclosure of commitments, contingencies, important subsequent events, guarantees, related parties, beneficial owners, earnings per share and operating segment information
- ▶ Disclosure for environmental activity of company
- ▶ Disclosure of the innovations and modernization
- ▶ Disclosure of risks of activities of company
- ▶ Supplementary information

Quarterly financial reports must include a balance sheet and statement of financial results.

Reporting and filing requirements

The reporting year for all enterprises is from 1 January to 31 December. For newly established legal entities, the first accounting year is the period from the date of their state registration until 31 December of the same year or, for enterprises established after 1 October, until 31 December of the following year. Annual financial statements (balance sheet, statement of financial results, appendices to balance sheet and statement of financial results) must be submitted to shareholders, to the Tax Inspectorate and

the statistical body within 90 days of the year following the reporting year.

Financial statements must be signed by the company's general director.

Public companies, banks, insurance companies and investment funds must present their annual reports to the general public by 30 June after the close of the fiscal year.

All companies listed on the Russian Stock Exchange should submit quarterly financial statements (balance sheet, statement of financial results and required disclosures) and additional information to the Federal Service on Financial Markets within 30 days of the close of the quarter. At present, such companies are permitted to file their IFRS or US GAAP-based financial statements.

Audit requirements

Federal Law No. 307-FZ "On Audit" prescribes criteria for compulsory audits of:

- ▶ Public JSCs
- ▶ Banks, insurance companies, stock exchanges and investment institutions
- ▶ State municipal, unitary enterprises
- ▶ Companies with revenues and/or total assets exceeding a certain limit as at the end of year preceding the reporting period (currently, revenue for the year more than RUB400 million (US\$11 million) and total assets more than RUB60 million (US\$1.7 million))
- ▶ Other cases when federal laws stipulate mandatory audit

Differences between IFRS and Russian accounting principles

The major differences are as follows:

- ▶ Definition of reporting and functional currency
- ▶ The mandatory existence of supporting documentation prepared in accordance with the prescribed rules
- ▶ The inflation concept is not recognized
- ▶ There is no concept for business combinations and purchase price allocation
- ▶ The goodwill concept is not properly prescribed and is not applied
- ▶ The fair value concept is not applied; non-current assets and non-current liabilities are stated at the historical values with few exceptions
- ▶ The impairment concept is not applied to fixed assets
- ▶ Differences in the accounting for the capital and reserves

Individuals



Income tax

General

Russia currently has a flat 13% personal income tax rate (for tax residents), one of the lowest personal tax rates of any non-tax haven country in the world. The low rate, however, is somewhat offset by continuing difficulties faced by taxpayers in dealing with the tax administration system: even paying tax can be logistically challenging in Russia.

Who is liable?

Payers of Russian individual income tax are defined as tax residents of Russia and non-resident individuals who receive income from Russian sources.

Definition of resident

For tax purposes, individuals are considered resident if they are present in the country for 183 days or more in a period of 12 consecutive months. However, the Ministry of Finance and the Federal Tax Service insist that an individual must also spend at least 183 days in Russia in a calendar year to be considered tax resident, although this requirement is not stated in the Tax Code.

Non-residents are those individuals who do not meet the aforementioned test.

The current position of the tax authorities is that days of both arrival and departure count as days in Russia for purposes of the Russian tax residency test.

Object of taxation

Russian tax residents are taxed in Russia on their worldwide income.

Individuals who are not tax residents are taxed on their Russian-source income, which includes but is not limited to the following:

- ▶ Remuneration for the performance of employment duties, services and actions in Russia (regardless of where paid)
- ▶ Dividends and interest paid by a Russian organization
- ▶ Insurance payments made by a Russian organization
- ▶ Income from the sale of property in Russia and income from the sale of securities in Russia.

Tax rates

There are currently five flat rates of 9%, 13%, 15%, 30% and 35%, applicable to different types of income.

Type of income	Flat tax rate
Dividend income (both Russian and non-Russian source) received by residents	9%
All types of income for which another rate is not specified, including salary and other income earned by tax-resident individuals; and employment income* earned by any foreign individuals who qualify as "Highly Qualified Specialists (HQSs)" for immigration purposes, regardless of tax residency status	13%
Dividend income received by nonresidents	15%
All taxable income (except for dividends or employment income received by the individuals qualifying as Highly Qualified Specialists under immigration rules) received by individuals who are not tax residents in Russia	30%
Interest income on bank deposits in excess of the refinancing rate of the Central Bank plus 5% on ruble deposits (or exceeding 9% on non-ruble deposits), certain prizes and deemed income from certain loans extended at a rate of the lesser of two-thirds of the refinancing rate for ruble loans or 9% for loans denominated in foreign currency	35%

Example of calculation of taxable income for most individuals

Income earned by	Russian tax residents	Russian tax nonresidents (except for those qualifying as Highly Qualified Specialists for immigration purposes)	Russian tax nonresidents who qualify as Highly Qualified Specialists for immigration purposes
Employment income*	10,000	10,000	10,000**
Other income received in Russia***	2,000	2,000	2,000
Other income received outside Russia	200	n/a	n/a
Deductions	****	n/a	n/a
Taxable income	12,200	12,000	12,000
Tax rates applicable	13%	30%	13% is applied to 10,000 (employment income) and 30% is applied to 2,000 (other income) received in Russia)
Tax	1,586	3,600	1,900

* Employment income consists of compensation, whether received in cash or in kind, including but not limited to salary, bonuses and expatriate allowances.

** In accordance with the current position of the Ministry of Finance, employment income of HQSs (to which a 13% tax rate is applied) is limited to

base salary, bonuses or remuneration received under Russian employment or civil agreements from the Employer sponsoring HQS work permit. Therefore, taxation of other income received or income received by HQSs from any other employer (e.g., outside Russia for work or services performed by an HQS in Russia) at a 13% tax rate may be challenged by the authorities.

*** Rental income, capital gains, etc.

**** The Russian Tax Code envisages the following categories of deductions from the taxable base: standard, social, property-related and professional. Standard deductions are very insignificant and are relevant only to taxpayers with low levels of income.

Tax collection procedure

Tax, for most taxpayers, is payable through withholding at source. Any individual who has received income subject to tax in Russia where the tax was not withheld at source is obliged to file a tax return. Individual filing obligations typically arise in one of the following situations:

- ▶ A Russian tax resident has received income from sources outside Russia.
- ▶ An individual has received "Russian source" income that was not subject to withholding at source. An individual has received Russian-source income from another individual under a civil agreement (e.g., rental or sales agreements).

An individual may also file a tax return on a voluntary basis, where there is no technical requirement to do so. In particular, this may be required in order to claim certain tax deductions that cannot be granted through the payroll or in order to claim a refund of excess tax withheld, for example, due to a change of tax residency status from non-resident to resident.

Annual tax returns are due no later than 30 April of the year following the reporting (calendar) year; the corresponding tax self-assessed in the declaration must be paid no later than 15 July of said following year. Foreign nationals permanently leaving Russia are required to file a tax return one month prior to their permanent departure and

pay the corresponding tax within 15 days of filing the return.

Although the law stipulates self-assessment, many tax authorities continue to issue formal notifications of a taxpayer's liability.

A penalty of 5% of the tax due per each full or partial month of delay is imposed for the submission of a tax return after the established deadline. The penalty is capped at 30% of the tax due and cannot be less than RUB1,000 (US\$28). Criminal sanctions could also be applied in rare cases. The late payment of tax is subject to interest at a rate of 1/300 of the annual refinancing rate of the Central Bank for each day of late payment.

Underpayment or incomplete payment of tax leads to the imposition fine of 20% (40% in the case of a deliberate violation) of the relevant amount of tax.

A foreign citizen may not be allowed to enter the territory of the Russian Federation if he or she has an outstanding Russian tax liability. The entry ban lasts until the foreign citizen has fully paid the outstanding tax liability.

Capital gains and losses

The capital gain on operations with securities is generally calculated as the difference between the proceeds from the sale of securities and the documented acquisition costs and expenses (including fees for services connected with the purchase or sale of securities). The tax is either withheld at source by the payer of income or otherwise paid by the taxpayer upon filing the tax return. Losses from the sale of securities can be offset against gains from securities of the same class. Certain losses can be carried forward for up to 10 years from the tax period in which they arose.

The taxation of stock options and other equity-based compensation is not dealt with specifically in the Tax Code. Therefore, careful analysis of the Russian tax implications in respect of this type of income is needed.

Tax deductions

Tax-resident taxpayers are entitled to the following tax deductions:

- ▶ Educational fees in respect of the taxpayer up to a maximum of RUB120,000 (US\$3,360) per annum

and their dependent children up to a maximum of RUB50,000 (US\$1,400 per annum per child in total for both parents; this deduction is only available if the expenses are paid to a licensed educational establishment (typically, only Russian institutions will have such a license).

- ▶ Expenses for medical services, medication and medical insurance contributions in respect of the taxpayer, spouse, parents and children, limited to RUB120,000 (US\$3,360) per annum in total, given that the services are provided by a Russian licensed medical institution; certain medical expenses, connected with expensive types of medical treatment, a list of which is established by the Government, are tax deductible without limitation.
- ▶ Pension insurance contributions to licensed Russian non-state pension funds in respect of taxpayer, spouse, parents, children and additional insurance contributions for the accumulative component of the state labor pension paid by the taxpayer (up to a maximum of RUB120,000 (US\$3,360) per annum).
- ▶ The aggregate amount of the above so-called social tax deductions cannot exceed RUB120,000 (US\$3,360) (except for expenditure on children's education and on expensive types of medical treatment).
- ▶ Property purchase expenses on the construction or acquisition of living premises in Russia (up to RUB2 million (US\$55,975)), increased by mortgage

interest or certain other bank interest paid on a loan to fund such an acquisition or such construction, are deductible. The property deduction can be applied to several property items until the whole amount of the RUB2 million deduction is used. The amount of deductible mortgage interest is limited to RUB3 million (US\$75,220). If a residential property is owned by several individuals (so-called shared ownership), each individual can claim the property tax deduction in the amount of RUB2 million.

- ▶ The first RUB1 million (US\$28,000) of income from the disposal of immovable property that has been owned by the taxpayer for less than three years is fully deductible against the sale proceeds (alternatively, the taxpayer can elect to pay tax on the actual taxable gain, if any, equal to gross proceeds minus documented expenses).
- ▶ The first RUB250,000 (US\$7,000) of income from the disposal of movable property (except securities) that has been owned by the taxpayer for less than three years is fully deductible against the sale proceeds (alternatively, the taxpayer can elect to pay tax on the actual taxable gain, if any, equal to gross proceeds minus documented expenses).
- ▶ Charitable contributions to scientific, cultural, educational, health care, religious and social security organizations financed by the state, limited to 25% of the taxpayer's annual income.



- ▶ Income from the disposal of any property (except securities) that has been owned by a taxpayer, who is Russian tax resident for the year of the transaction, for more than three years is exempt from tax.

Deductions for property purchase expenses, expenses related to pension insurance contributions to Russian non-state pension funds and professional tax deductions can be obtained through the payroll. Other deductions can only be claimed by the taxpayer through the submission of a tax return.

Individual entrepreneurs and other individuals performing work or rendering services on a contractual basis may deduct associated business expenses. Property tax paid by these taxpayers is deductible if the property is directly used in carrying out entrepreneurial activities. Taxpayers who cannot document expenses incurred in connection with their entrepreneurial activities are allowed a standard professional tax deduction at a rate of 20% of total income received from entrepreneurial activities. The deduction may be obtained

through a tax agent or upon filing a tax return (in the absence of the tax agent).

Taxpayers are also entitled to a variety of standard deductions. For example, taxpayers who have a child are entitled to a standard child deduction (RUB1,400 (US\$39) for the first and the second child and RUB3,000 (US\$84) for the third and each subsequent child), which fully phases out in the month in which the taxpayer's cumulative year-to-date income exceeds RUB280,000 (US\$7,837). Deductions in the amount of RUB500 (US\$14) and RUB3,000 (US\$84) per month are envisaged for certain disabled individuals, veterans and victims of natural disasters (without income cap).

Exemptions

Taxpayers are entitled to the following exemptions:

- ▶ State allowances (e.g., maternity leave allowance), except for sickness allowances
- ▶ Severance payment of up to three months' average earnings
- ▶ State pensions
- ▶ Payouts from certain insurance policies, including, in particular, obligatory insurance, life insurance policies, insurance covering damage to life or health and voluntary pension insurance
- ▶ Contributions to most medical insurance policies made by companies for the benefit of individuals
- ▶ Certain gifts received from physical persons and legal entities (depending on specific circumstances such as the nature of a gift and its value)
- ▶ Income and items received by way of inheritance in most situations
- ▶ Specific types of material aid



Social security

Social contributions in Russia are the sole responsibility of the employer. There are no “matching” employee contributions. Employer contributions cover obligatory pension, medical and social insurance. On a voluntary basis, additional pension contributions may be paid by individuals or by their employers (e.g., as a part of a social package) to non-state funds or insurance companies.

Social contributions include contributions to the:

- ▶ Pension Fund
- ▶ Social Insurance Fund
- ▶ Federal Fund of Compulsory Medical Insurance

Social contributions must be accrued on remuneration provided to individuals in the context of employment relations and civil-legal agreements on performance of work or rendering of services (except for individual entrepreneurs), and copyright agreements. Generally, the tax base includes remuneration as well as most benefits provided to employees.

The legislation also sets out a closed list of payroll items that are exempt from social contributions. This list includes the majority of social allowances, certain types of payments to employees of a compensatory nature (e.g., per diems, hotel costs and travel expenses), severance payments, voluntary medical insurance if an insurance agreement is concluded for a period over one year, certain types of material assistance to employees, etc.

Exemptions

The following payments and benefits are not subject to social contributions:

- ▶ State allowances, including maternity leave allowance and sick leave allowance
- ▶ Severance payments (up to statutory limits and subject to certain rules), except compensation for unused vacation
- ▶ Fees for additional professional education, training and retraining of employees (subject to certain conditions)
- ▶ Reimbursement of business trip-related expenses

- ▶ Reimbursement of employees' expenses on the payment of interest on loans for the acquisition or construction of a dwelling (subject to certain conditions)
- ▶ Expenses incurred by an individual for work performed or services rendered under civil-legal agreements
- ▶ Contributions paid under voluntary medical insurance agreements concluded in respect of employees for at least one year either with an insurance company or directly with licensed medical institutions
- ▶ Contributions paid under voluntary insurance agreements (on specific types of insurance) concluded in respect of employees
- ▶ Pension insurance contributions paid in respect of employees under the non-state pension security agreements
- ▶ Additional contributions to the accumulative part of the state labor pension paid in respect of employees (up to a maximum of RUB12,000 (US\$336) per annum for each employee)
- ▶ Specific types of material assistance

Social contributions rates

In 2014, the following rates of social contributions were established for all categories of payers (except those who are entitled to the beneficial social security regime):

Individual cumulative year-to-date income subject to social contributions	Pension Fund	Social Insurance Fund	Medical Insurance Fund	Total
Up to RUB624,000 (US\$15,650)	22.0 %	2.9 %	5.1 %	30.0 %
Over RUB624,000 (US\$15,650)	10.0%	0%	0%	10%

Payments made with regards to expatriate employees temporarily staying in Russia who have concluded employment agreements for a period not exceeding six months, and to expatriate employees whose immigration status is Highly Qualified Specialist, are not subject to accrual of social contributions (except for workplace accident insurance), as these categories of individuals are not considered insured with the Russian social security system. Payments made with regards to other categories of expatriate employees (e.g., those who hold temporary or permanent resident permits) are subject to accrual of social contributions in accordance with special provisions envisaged for each category of employees.

The Russian social security system foresees additional pension contributions that should be paid by organizations that have employees eligible for early retirement (i.e., employees working in unsafe and hazardous conditions). Based on the results of a special procedure for evaluation of working conditions, certain job positions may be classified as work performed in unsafe and/or hazardous conditions. In this case, the employer must pay additional pension contributions

due in relation to employment income of these special categories of employees. Depending on the class of professional risk assigned to employees, employers are obliged to pay additional pension contributions at rates ranging from 2% to 8%.

The legislation also stipulates certain categories of organizations entitled to apply lower rates of social contributions. These are organizations conducting certain specific types of economic activity including, but not limited to, the following:

- ▶ Certain types of IT companies
- ▶ Certain types of mass media companies
- ▶ Participants in the Skolkovo project
- ▶ Companies rendering engineering services

Information on accrued and paid medical and pension contributions, as well as individual reporting with respect to the amount of income delivered to individuals should be submitted to the Pension Fund. Information on accrued and paid social insurance contributions should be reported by employers to the Social Insurance Fund.

These reports must be submitted on a quarterly basis (the reporting periods are the first quarter, six months, nine months and the full calendar year). The reports should be submitted to the authorities electronically if the number of individuals in respect of whom social contributions were paid (i.e., insured persons) exceeds 50.

Workplace accident insurance

In addition to the aforementioned social contributions, all employers are required to pay into the Social Insurance Fund, which pays out compensation in the event of workplace accidents or occupational illnesses.

The rate of these contributions depends on a company's economic activity and may vary from 0.2% to 8.5%. The rate is generally 0.2% for most employers that predominantly or only employ office workers. The applicable rate is levied on the contributions base without any cap.

The contributions are to be accrued on all payments to individuals under employment agreements. Notably, employment income payable to foreign nationals is not exempt from these contributions. Otherwise, items exempt from these contributions are very similar to those envisaged for obligatory social contributions and are outlined in detail above.

Russian labor law

The Russian Labor Code forms the basis of labor relations in Russia, establishing procedures for hiring and dismissing employees, as well as regulations concerning working time, vacations, business trips, salary payment and so on. The Labor Code continues to be very protective of employees. If a conflict arises, an employee would be able to demand the application of any relevant protective provisions of the Labor Code, which will prevail over any conflicting provision of the individual's labor agreement. Moreover, the Labor Code establishes certain guarantees for some categories of employees that should be fulfilled by employers, even if they are not specifically set out in the employment agreements.

Labor law applies to all employees working in Russia, regardless of their nationality or the country of incorporation of their employer. In other words, Russian labor law covers not only Russian citizens, but also expatriates working in Russia, regardless of where employment agreements were concluded. It is worth mentioning that Russian immigration rules and their practical administration, which have become increasingly complex, oblige employers to conclude local employment agreements with expatriates in order to obtain work permits.

Standard daily working hours are determined by the employer. The generally accepted standard is a five-day week with an eight-hour working day. Thus, the standard week is 40 working hours. A shortened work week is foreseen for specific categories of employees,

for example, women working in the Far North. Overtime work should not exceed 4 hours within 2 consecutive days and 120 hours within a year. Under Russian labor law, overtime work may only be required in exceptional cases with the written agreement of the employee. Certain employees may also work under an irregular working regime, in which case, they must be compensated for this by at least three calendar days of additional paid vacation per year.

Employees must be granted at least 28 calendar (as opposed to working) days of paid vacation a year. Additional vacations are foreseen for certain categories of employees, i.e., those working under an irregular working hours regime, in harmful and hazardous conditions, in the Far North and locations equated to the Far North. According to Russian labor law, the monthly salary paid to an individual cannot be less than the minimum salary established by the regional agreement at the level of a constituent entity of Russia or, in the absence of such an agreement, by federal legislation.

As of 1 January 2014, the minimum monthly salary established by federal legislation amounted to RUB5,554 (US\$155). The minimum monthly salary in Moscow as of 1 January 2014 was set at RUB12,600 (US\$353) and increased to RUB12,850 (US\$360) with effect from 1 July 2014. This amount is periodically adjusted. The minimum salary is far below salaries offered in the market. In practice, it is actually more a factor for the calculation of state social compensatory payments, rather than a real minimum subsistence level.

In accordance with the requirements of Russian labor legislation, salary should be paid no less frequently than twice a month and paid in Russian rubles.

In addition to the conclusion of a written employment agreement with an employee (which should be in Russian or bilingual), recruitment must be documented internally by the employer through the issuance of a formal hiring order stating the name, position and date of hiring of the new employee in addition to other HR documents.

The statutory guarantees and rights of the employees may not be contractually limited, even at an employee's initiative. Under the labor law, the employment agreement should generally be concluded for an indefinite term, since fixed-term employment agreements can be used only in limited cases.

An employer hiring an employee may wish to establish a probation period, which can have a maximum duration of three months for all employees except for a general director and chief accountant, for whom the probation period may be up to six months.

To comply with Russian labor law, each employer is obliged to maintain a large number of HR documents aimed at documenting various HR events (hiring, vacation, business trips, termination, etc.). These documents are subject to audit by the authorities. Russian labor legislation also prescribes the maintenance of a number of obligatory internal HR policies.

The Russian Labor Code envisages various grounds for termination. The following grounds are the most frequently used:

- ▶ At the employee's initiative
- ▶ At the mutual consent of the employer and the employee
- ▶ At the initiative of the employer

Mutual consent agreement is the most commonly used ground for termination, as it enables termination of the agreement at any agreed date and on conditions agreed by both parties. Such type of termination is also considered the most favorable option by employers, as it helps to mitigate the risks of subsequent disputes with a former employee.

An employee may terminate the employment relationship on their own initiative at any time with two weeks prior written notice to the employer.

Termination by the employer is restricted to a specific list of reasons. Termination without a specific, expressly stated and valid reason is null and void. A termination may also be considered invalid because the employer has not complied with the procedure for termination set out by the labor law. A court may reinstate an employee illegally dismissed in their former position with payment of salary with interest for the period of exclusion from the workplace, and possibly levy further liability for moral damages as well.

In certain limited circumstances, an employer is allowed to dismiss an employee without a notice period or any severance pay. In all other cases, an employee is entitled to a notice period and severance pay, the duration and amount respectively depending on the

circumstances of the employment and the termination.

Various post-employment restrictive covenants (confidentiality, non-competition, non-dealing with customers or suppliers, non-solicitation of remaining employees, etc.) are hard or impossible to enforce.

Among the recent developments in the Russian employment law system is the introduction of a remote work concept, which allows employers to hire individuals to perform employment duties away from the location of the employer (i.e., where the employer does not have a registered presence). Under this concept, all HR documents may be exchanged electronically, including agreements to revise the terms of an employment agreement. An employment agreement with a remote employee may be terminated not only under general provisions foreseen by the Labor Code, but also at the employer's initiative on the grounds stipulated in the employment agreement.

Sanctions for non-compliance

Currently, the fine for non-compliance with labor legislation is outlined in the Code of Administrative Violations and is imposed on responsible executives (i.e., the general director, the chief accountant and the HR director) in amounts of RUB1,000 to 5,000 (US\$28 to US\$140). With regard to legal entities, the fines range from RUB30,000 to 50,000 (US\$840 to US\$1,400). If a violation leads to underpayment of salary, the employer is likely to be obliged to repay the underpaid amount plus potentially

the interest for each day of delay. The interest is calculated as 1/300 of the Central Bank's refinancing rate for each day of delay (1/200 for Moscow).

An alternative sanction may be applied, which is the suspension of the activity of the organization for up to 90 days (in practice, this happens extremely rarely). Violation of labor laws and labor protection laws by a person who has been administratively penalized for a similar administrative offense in the past may entail disqualification for a period from one to three years. Cases of suspension of a company's activity and disqualification of company executives may be enforced only through a court decision.

Labor law in Russia is complicated and contains a lot of rules and conditions that are obligatory for all the employers and companies operating in Russia.

From 1 January 2015, sanctions for violation of Russian Labor Law will become more severe. Please contact us for more details.

Immigration

If a company intends to use foreign personnel in Russia, it should be prepared to deal with the complexity of the Russian immigration regime.

As a prerequisite to starting many work permit application processes, companies should be registered with the local employment service and, in any event, should be complying with the requirement under employment law to submit monthly information on all current vacancies (including positions intended for both Russian and foreign citizens).

If an employer is not in compliance with the above, there is a high risk that any future applications for work permits for expatriate employees will be rejected by the authorities.

Highly Qualified Specialists (HQS)

The term “Highly Qualified Specialist” was introduced in Russian immigration legislation with effect from 1 July 2010. An HQS is a foreign citizen earning not less than RUB2 million (US\$55,975) per annum from an employer in Russia.

A simplified quota-free one-step application procedure for work permits and visas is established for HQSs intending to work in Russia for Russian legal entities or branches of foreign legal entities. From 1 January 2015, representative offices of foreign legal entities will be also allowed to engage foreign nationals under the HQS regime. Such HQSs may apply for work permits and work visas valid for three years, with the opportunity to extend their validity for subsequent three-year periods. By contrast, work permits and visas available to other foreigners have a maximum one-year term.

Companies have to provide HQSs and their accompanying family members (if any) with private medical insurance. Immigration legislation also establishes a requirement for employers engaging HQSs to submit quarterly reports to the immigration authorities on salaries or remuneration paid to HQSs, and notification forms in cases of termination of employment agreements with HQSs and in cases of provision of unpaid leave exceeding one month.

Submission of foreign labor needs forecasts (quota applications)

Under the current regulations, companies must report annually, before 1 June, the number of foreign employees (including both actual employees and civil or legal contractors, but excluding HQSs) they anticipate needing to engage in the following calendar year (including CIS citizens), including the precise positions and citizenships of those anticipated foreign employees. This effectively constitutes an application for quota, whereby quota must first be obtained before it is possible to launch a work permit application for any foreigner who is not an HQS and not to occupy a limited list of specific quota-free job positions.

Work permits

All expatriates working in Russia (except for some specific categories) must hold valid work permits. A company planning to engage expatriates to work in Russia should assume responsibility for the work permit application process and take into consideration that, with the possible exception of HQSs (see above), it will be time- and resource-consuming, often complex and contradictory, and not without risk. It should be noted that most organizations do, in due course, manage to achieve something workable.

Note that most CIS citizens apply for their own work permits under a simplified procedure. The further discussion focuses on the longer procedure applicable to citizens of other countries who are not HQSs.

The application process (possible only after any necessary quota has been obtained by the employer) consists of three key steps. First, an employer submits to the Employment Center the latest information on job vacancies foreseen for expatriate employees. At the second stage, the employer applies to the Migration Service for a permit to engage foreign labor (corporate permit). Finally, once a corporate permit has been issued, an individual work permit should be applied for.

Russia is a party to treaties with France and Korea simplifying the Russian work permit application process.

From 1 January 2015, foreign nationals who apply for a work permit, patent, temporary residence permit or permanent residence permit will be obliged to present a certificate confirming knowledge of Russian language and history, and the basics of Russian law. This requirement will not apply when processing work permits and permanent residency permits for highly qualified specialists.

Work visas

Once an individual's work permit is issued, the employer should arrange for a work visa invitation. A single-entry work visa is initially issued by the Russian Consulate abroad and is valid for up to three months. Once the foreign individual arrives in Russia under this single-entry work visa, it should be replaced by a multiple-entry visa valid for the term of an individual's work permit, but not more than one year (unless an HQS).

In the case of accredited representative offices, it may be possible to apply for work visas on a schedule independent of the work permit process.

Notifications

Companies are required to notify various state authorities regarding the engagement of foreign employees. The tax authorities monitor compliance with the notification procedures and often request copies of such notifications when accepting corporate reporting documents, including payroll-related tax reporting.

Enrollment/De-enrollment

The enrollment procedure involves the responsible hosting party notifying the respective territorial office of the Federal Migration Service within seven business days of a foreign citizen's arrival at the place of his/her stay in Russia, or arrival at a new location in Russia where this individual will stay for seven days or more.

The enrollment procedure for those foreign individuals who obtained their work permits under the Russia-France agreement should be performed within 10 business days of the individual's arrival at the place of stay in Russia.

The enrollment procedure for citizens of Kazakhstan and Belarus should be performed within 30 days of entering Russia. The enrollment procedure for citizens of Ukraine, except for those who work in Russia, should be performed within 90 days of entering Russia.

HQS individuals and their accompanying family members are allowed to enter and stay in Russia without obligation of being enrolled for 90 calendar days from entering Russia. Furthermore, they have no obligation to enrol if traveling to other regions of Russia from the one in which they are enrolled in accordance with the current regulations, provided that the period of stay in this other region does not exceed 30 calendar days.

The responsible hosting party will generally be the hotel, if the foreign citizen is staying at a hotel, or otherwise, the employer or other hosting party.

Highly Qualified Specialists who own accommodation in Russia are given the right to act as a hosting party for their accompanying family members.

The de-enrollment procedure should be completed at the Russian border where foreign citizens are supposed to leave their enrollment coupons or by a new hosting party at the time a foreign citizen is enrolled at a new place of stay in Russia (domestic trip).

Sanctions for non-compliance with the immigration legislation

Russian legislation envisages severe sanctions for companies, their executives and foreign citizens for non-compliance with the immigration legislation. The upper end of financial sanctions applied to a company can reach RUB1 million (US\$28,000) (per foreign individual per violation); the worst-case scenario can include deportation of the individual

from the country and suspension of the employer's business activities for up to 90 days and/or a company being banned from engaging any foreigners under the simplified HQS regime for up to two years. Financial sanctions, and even deportations, are increasingly being applied. In addition, a foreign citizen may not be allowed to enter the Russian Federation if he/she have been held liable for an administrative offense in Russia two or more times within three years. The entry ban lasts for three years from the date when the last decision on the imposition of administrative sanctions came into force.

Punishment measures for violations incurred in the cities of federal significance (Moscow, St. Petersburg, the Moscow Region and the Leningrad Region) are even more severe.

Mandatory Notification of Second Citizenship

According to the Federal Law on Citizenship of the Russian Federation and Certain Legislative Acts, Russian citizens are obliged to notify the Federal Migration Service (FMS) if they have:

- ▶ Another citizenship
- ▶ A residence permit
- ▶ A permit to reside permanently in a foreign state

The overall time limit for submitting the notification is 60 days from the day when a Russian citizen receives a second citizenship or a permit to reside permanently in a foreign state.



Liability

Administrative and criminal charges will be brought against an individual who fails to comply with the notification requirements.

Administrative liability in the form of a fine amounting to RUB1,000 (US\$25)

is imposed for violating the notification procedure (for failing to meet the 60-day deadline or for providing incomplete or inaccurate information), while criminal liability is imposed for failing to make the notification.

Criminal liability for failing to make the notification is quite substantial: the fine may amount to the violator's income for up to one year, while the alternative is punishment in the form of compulsory work (up to 400 hours).

Appendices



Appendix 1: Useful addresses and telephone numbers

When calling from an international location, the caller must use the international telephone country code for Russia, 7, as a prefix.

Major business and commercial organizations

American Chamber of Commerce

Dolgorukovskaya st., 7,
14th floor
Moscow, 127006
Russia

Tel: + 7 495 961 2141

Fax: + 7 495 961 2142

Email: info@amcham.ru

Website: <http://www.amcham.ru>

Association of European Businesses

Krasno proletarskaya st., 16, bld. 3,
Entrance 8, 4th floor
Moscow, 127473
Russia

Tel: + 7 495 234 2764

Fax: + 7 495 234 2807

Email: info@aebrus.ru

Website: <http://www.aebrus.ru>

Deutsch-Russische Auslandshandelskammer (Russo-German Chamber of Commerce)

Pervy Kazachi pereulok, 7
Moscow, 119017
Russia
Tel: + 7 495 234 4950
Fax: + 7 495 234 4951
Email: ahk@russland-ahk.ru
Website: <http://russland.ahk.de>

Russo-British Chamber of Commerce

Galereya Aktyor Business Centre
Tverskaya st., 16/2, 4th floor
Moscow, 125009
Russia
Tel: + 7 495 961 2160 (ext. 100)
Fax: + 7 495 961 2161
Email: infomoscow@rbcc.com
Website: <http://www.rbcc.com>

Chambre de Commerce et D'Industrie Française en Russie

Novoslobodskaya st., 23
5th floor, office 560
Moscow, 127055
Russia
Tel: + 7 495 721 3828
Fax: + 7 495 721 1995
Email: info@ccifr.ru
Website: <http://www.ccifr.ru>

Russian ministries, agencies and services

Government of the Russian Federation

Krasnopresnenskaya nab., 2
Moscow, 103274
Russia
Tel: + 7 495 605 5329
Website: <http://www.government.ru>,

Ministry of Internal Affairs

Zhitnaya st., 16
Moscow, 119049
Russia
Tel: + 7 495 667 4579
Website: <http://www.mvd.ru>

Ministry of Health Care

Rakhmanovsky pereulok, 3/25
Moscow 127994
Russia
Tel: + 7 495 627 2944
Website: <http://www.rosminzdrav.ru>

Ministry of Foreign Affairs

Smolenskaya-Sennaya ploshad, 32/34
Moscow, 121002
Russia
Tel: + 7 499 244 1249
Email: ministry@mid.ru
Website: <http://www.mid.ru>

Ministry of Communications and Mass Media

Tverskaya st., 7
Moscow, GSP-4 125375
Russia
Tel: + 7 495 771 8100
Fax: + 7 495 771 8121
Email: web@minsvyaz.ru
Website: www.minsvyaz.ru

Ministry of Education and Science

Tverskaya st., 11
Moscow, GSP-3, 103905
Russia
Tel: + 7 495 629 7062
Fax: + 7 495 629 0891
Website: www.mon.gov.ru

Ministry of Natural Resources and Environment

Bolschaya Gruzinskaya st., 4/6
Moscow, 123995
Russia
Tel: + 7 495 254 4800
Fax: + 7 495 254 4310/6610
Email: admin@mnr.gov.ru
Website: www.mnr.gov.ru

Ministry of Industry and Trade

Kitaygorodskiyi proezd, 7
Moscow, 109074
Russia
Tel: + 7 495 539 2187
Fax: + 7 495 539 2172
Email: okt@minprom.gov.ru
Website: www.minpromtorg.gov.ru

Ministry of Regional Development

Krasnaya Presnya st., 3,
Moscow 123242
Russia
Tel: + 7 495 980 2547
Fax: + 7 495 699 3841
Email: info@minregion.ru
Website: www.minregion.ru

Ministry of Agriculture

Orlikov pereulok, 1/11
Moscow, 107139
Russia
Tel: + 7 495 607 8000
Fax: + 7 495 607 8362
Email: info@gov.mcx.ru
Website: www.mcx.ru

Ministry of Transport

Rozhdestvenka st., 1/1
Moscow, 109012
Russia
Tel: + 7 495 626 1000
Fax: + 7 495 626 9128
Email: info@mintrans.ru
Website: www.mintrans.ru

Ministry of Finance

Ilyinka st., 9
Moscow, 109097
Russia
Tel: + 7 495 987 9101
Website: <http://www.minfin.ru>

- ▶ Federal Tax Service
Neglinnaya st. 23, 127381
Moscow,
Russia
Tel: +7 495 913 0000
Website: <http://www.nalog.ru>
- ▶ Federal Insurance Monitoring
- ▶ Federal Finance and Budget
Monitoring
- ▶ Federal Treasury Service

Ministry of Economic Development

Pervaya Tverskaya-Yamskaya st., 1/3
Moscow, A-47, GSP-3, 125993
Russia
Tel: + 7 495 694 0353
Fax: + 7 499 251 6965
Email: mineconom@economy.gov.ru
Website: www.economy.gov.ru/minec/main

Federal Customs Service

Novozavodskaya st., 11/5
Moscow, 121087
Russia
Tel: + 7 495 449 7235
Fax: + 7 495 449 7235
Website: www.customs.ru

**Federal Service for State Registration,
Land Cadastre and Cartography**

Vorontsovo Pole st.4a
Moscow, 109028
Russia
Tel: + 7 495 917 5798
Fax: + 7 495 917 4852
Website: <http://www.rosreestr.ru>

**Federal Agency for Management
of Federal Property**

Nikolsky pereulok, 9
Moscow, 109012
Russia
Tel: + 7 495 698 7562
Fax: + 7 495 698 7583
Website: <http://www.rosim.ru>

Ministry of Justice

Zhitnaya st., 14
Moscow, GSP-1, 119991
Russia
Tel: + 7 495 955 5999
Website: www.minjust.ru

Federal Antimonopoly Service

Sadovaya-Kudrinskaya st., 11
Moscow, D-242, GSP-5, 123995
Russia
Tel: + 7 499 252 2323
Fax: + 7 499 254 7521
Email: international@fas.gov.ru
Website: www.fas.gov.ru

Federal Tariff Service

Kitaygorodskiy proezd, 7 building 1
Moscow, 109074
Russia
Tel: + 7 495 620 5069
Fax: + 7 495 620 5041
Email: interco@fstrf.ru
Website: www.fstrf.ru

**Federal Meteorology and Environment
Monitoring Service**

Novovagankovskiy pereulok, 12
Moscow, 123995
Russia
Tel: + 7 499 252 5504
Email: garkina@mcc.mecom.ru
Website: www.meteorf.ru

Federal State Statistics Service

Myasnitckaya st., 39, bld. 1
Moscow, 107450
Russia
Tel: + 7 495 607 4902
Email: stat@gks.ru
Website: www.gks.ru

**Federal Service of Ecological,
Technological and Nuclear Monitoring**

A. Lukyanova st., 4, bld. 1
Moscow, 105066
Russia
Tel: + 7 495 411 6045
Fax: + 7 495 645 8986
Website: <http://www.gosnadzor.ru>

Federal Space Agency

Schepkina st., 42
Moscow, 107996
Russia
Tel: + 7 495 631 9444
Fax: + 7 495 688 9063
+ 7 499 975 4467
Website: www.federalspace.ru

**The Central Bank of the Russian
Federation**

Neglinnaya st., 12
Moscow, 107016
Russia
Tel: + 7 495 771 9100
Fax: + 7 495 621 6465
Email: webmaster@www.cbr.ru
Website: www.cbr.ru

**Russian Chamber of Commerce
and Industry**

Ilyinka st., 6/1, 1
Moscow, 109012
Russia
Tel: + 7 495 929 0009
Fax: + 7 495 929 0360
Email: tpprf@tpprf.ru
Website: www.tpprf.ru

Appendix 2: Exchange rates (year end)

	2006	2007	2008	2009	2010	2011	2012	2013
RUB/US\$, end of the period (eop)	26.33	24.55	29.38	30.24	30.48	32.20	30.37	32.73
RUB/EUR	34.70	35.80	38.00	43.80	40.30	43.80	40.23	44.97

Source: Central Bank

Appendix 3: Economic performance statistics

	2006	2007	2008	2009	2010	2011	2012	2013
Nominal GDP, US\$ billion	1,022	1,354	1,405	1,283	1,482	1,695	2,053	2,093
Real annual GDP growth, %	8.2	8.5	5.2	-7.8	4.3	4.3	3.4	1.3
Inflation, %	9.0	11.9	13.3	8.8	8.8	6.1	5.7	6.5
Industrial output index growth, %	6.3	6.8	0.6	-9.3	8.2	4.7	2.6	0.4
Unemployment rate, %	6.9	6.1	7.8	8.2	7.2	6.1	5.3	5.5

Source: Russian Federal Statistics Service (Rosstat), Central Bank

Appendix 4: Treaty withholding tax rates

The maximum rates of withholding tax under double tax treaties currently in force are as follows:

	Payee resident in	Signatory	Dividends (%)	Interest (%)	Royalties (%)
1	Albania	Russia	10	10	10
2	Algeria	Russia	5/15 (a)	15 (e)	15
3	Argentina	Russia	10/15 (ab) 15 (e)	15	15
4	Armenia	Russia	5/10 (b)	0	0
5	Australia	Russia	5/15 (c)	10	10
6	Austria	Russia	5/15 (d)	0	0
7	Azerbaijan	Russia	10	10 (e)	10
8	Belarus	Russia	15	10 (e)	10
9	Belgium	Russia	10	10 (e)	0
10	Botswana	Russia	5/10 (n)	10 (e)	10
11	Bulgaria	Russia	15	15 (e)	15
12	Canada	Russia	10/15 (f)	10 (e)	0/10 (g)
13	Chile	Russia	5/10 (zz)	15	5/10 (aaa)
14	China	Russia	10	10 (e)	10
15	Croatia	Russia	5/10 (h)	10	10
16	Cuba	Russia	5/15 (ww) 0/10 (xx)	0/5 (yy)	10
17	Cyprus	Russia	5/10 (i)	0	0
18	Czech Republic	Russia	10	0	10
19	Denmark	Russia	10	0	02
20	Egypt	Russia	10	15 (e)	15
21	Finland	Russia	5/12 (j)	0	0
22	France	Russia	5/10/15 (k)	0	0
23	Germany	Russia	5/15 (l)	0	0
24	Greece	Russia	5/10 (pp)	7	7
25	Hungary	Russia	10	0	0
26	Iceland	Russia	5/15 (m)	0	0
27	India	Russia	10	10 (e)	10
28	Indonesia	Russia	15	15 (e)	15
29	Iran	Russia	5/10 (pp) 7.5 (e)	5	15
30	Ireland	Russia	10	0	0
31	Israel	Russia	10	10 (e)	10
32	Italy	Russia	5/10 (o)	10	0
33	Japan	USSR	15	10 (e)	0/10 (p)
34	Kazakhstan	Russia	10	10 (e)	10
35	Kuwait	Russia	0/5 (q)	0	10
36	Kyrgyzstan	Russia	10	10 (e)	10
37	Latvia	Russia	5/10 (qa)	0/5/10 (e) (ea) 5	10
38	Lebanon	Russia	10	5 (e)	5
39	Lithuania	Russia	5/10 (r)	10 (e)	5/10 (s)
40	Luxembourg	Russia	5/15 (t)	0	0
41	Macedonia	Russia	10	10	0
42	Malaysia	USSR	0/15 (vv)	15 (e)	10/15 (u)
43	Mali	Russia	10/15 (v)	15 (e)	0
44	Malta ¹	Russia	5/10(bbb)	5	5
45	Mexico	Russia	10	10 (e)	10
46	Moldova	Russia	10	0	10

	Payee resident in	Signatory	Dividends (%)	Interest (%)	Royalties (%)
47	Mongolia	Russia	10	10 (e)	20 (x)
48	Montenegro ²	Russia	5/15 (aa)	10	10
49	Morocco	Russia	5/10 (w)	10	10
50	Namibia	Russia	5/10 (h)	10 (e)	5
51	The Netherlands	Russia	5/15 (y)	0	0
52	New Zealand	Russia	15	10	10
53	North Korea (DPRK)	Russia	10	0	0
54	Norway	Russia	10	10 (e)	0
55	Philippines	Russia	15	15 (e)	15
56	Poland	Russia	10	10 (e)	10
57	Portugal	Russia	10/15 (z)	10 (e)	10
58	Qatar	Russia	5	5 (e)	0
59	Romania	Russia	15	15 (e)	
60	Saudi Arabia	Russia	5	5 (e)	10
61	Serbia ³	Russia	5/15 (aa)	10	10
62	Singapore	Russia	5/10 (rr)	7,5 (e)	7,5
63	Slovak Republic	Russia	10	0	10
64	Slovenia	Russia	10	10	10
65	South Africa	Russia	10/15 (bb)	10 (e)	0
66	South Korea (ROK)	Russia	5/10 (cc)	0	5%
67	Spain	Russia	5/10/15 (dd) (ee)	0/5 (ff) (ee)	5(ee)

	Payee resident in	Signatory	Dividends (%)	Interest (%)	Royalties (%)
68	Sri Lanka	Russia	10/15 (gg)	10 (e)	10
69	Syria	Russia	15	10 (e)	4.5/13.5/18(hh)
70	Sweden	Russia	5/15 (ii)	0	0
71	Switzerland	Russia	0/5/15 (jj)	0	0
72	Tajikistan	Russia	5/10 (n)	10 (e)	0
73	Thailand	Russia	15	10 (e)	15
74	Turkey	Russia	10	10 (e)	10
75	Turkmenistan	Russia	10	5	5
76	Ukraine	Russia	5/15 (ll)	10 (e)	10
77	United Kingdom	Russia	10	0	0
78	USA	Russia	5/10 (mm)	0	0
79	Uzbekistan	Russia	10	10 (e)	0
80	Venezuela	Russia	10/15 (ss)	0/5/10 (tt) (e)	10/15(uu)
81	Vietnam	Russia	10/15 (nn)	10	15
82	Non-treaty countries	Russia	15	0/9/15/20 (oo)	20

¹ The treaty with Malta is effective from 1 January 2015.

² Montenegro, as a legal successor of the Federal Republic of Yugoslavia, applies the respective double tax treaty.

³ Serbia, as a legal successor of the Federal Republic of Yugoslavia, applies the Yugoslavia-Russia double tax treaty.

- a) The 5% rate on dividends paid to a company (excluding a partnership) that is a beneficial owner and that holds at least 25% of the capital of the payer.
- (ab) The 10% rate applies to dividends paid to a company that is the beneficial owner of the dividend and holds directly at least 25% of the capital of the payer of the dividends. The 15% rate applies to other dividends.
- (b) The 5% rate applies if the recipient of the dividends has invested at least US\$40,000 or the equivalent in local currency in the payer's charter capital. The 10% rate applies to other dividends.
- (c) The 5% rate applies to dividends paid to companies (other than partnerships) that hold at least 10% of the capital of the payer and have invested in the payer at least AUD700,000 or an equivalent amount in local currency and if the dividends paid by a Russian company are exempt from tax in Australia. The 15% rate applies to other dividends.
- (d) The 5% rate applies to dividends paid to a company (other than a partnership) that is the beneficial owner of the dividend and holds directly at least 10% of the capital of the payer of the dividends and if the participation exceeds US\$100,000 or the equivalent in other currency. The 15% rate applies to other dividends.
- (e) A 0% rate applies in case the interest is paid to, e.g., a state, its political subdivisions or local authorities thereof, the central bank or credit institutions of a state or if the loan is guaranteed or otherwise secured by a state. For each particular case, the respective double tax treaty should be considered.
- (ea) The 5% rate applies to interest on bank loans issued to banks. The 10% rate applies to other interest.
- (f) The 10% rate applies to dividends paid to a company that is the beneficial owner of the dividends and owns at least 10% of the voting stock of the payer or, in the case of a Russian payer that has not issued voting shares, at least 10% of the statutory capital. The 15% rate applies to other dividends.
- (g) The 0% rate applies to royalties for the following: copyrights of cultural works (excluding films and television rights); the use of computer software and the use of patents or information concerning industrial, commercial or scientific experience, if the payer and the beneficiary are not related persons. The 10% rate applies to other royalties.
- (h) The 5% rate applies to dividends paid to companies that hold at least 25% of the capital of the payer and have invested at least US\$100,000 or the equivalent amount in local currency. The 10% rate applies to other dividends.
- (i) The 5% rate applies to dividends paid to shareholders that have invested in the payer at least €100,000 or the equivalent amount in local currency. The 10% rate applies to other dividends.
- (j) The 5% rate applies to dividends paid to a company (other than a partnership) that is the beneficial owner of the dividend and holds directly at least 30% of the capital of the payer of the dividends and the foreign capital invested exceeds US\$100,000 or its equivalent in the national currency of the contracting states at the moment when the dividends become due and payable. The 12% rate applies to other dividends.
- (k) The 5% rate applies if the recipient of the dividends has invested in the payer at least FRF500,000 (€76,224) or the equivalent amount in other currency (as the value of each investment is appreciated as of the date it is made) and if the beneficiary of the dividends is a company that is exempt from tax on dividends in its state of residence. The 10% rate applies if only one of these conditions is met. The 15% rate applies to other dividends.
- (l) The 5% rate applies to dividends paid to companies that hold directly at least 10% of the capital of the payer and such capital share amounts to at least DEM160,000 (€80,000) or the equivalent amount in rubles. The 15% rate applies to other dividends.
- (m) The 5% rate applies to dividends paid to companies (other than partnerships) that hold directly at least 25% of the capital of the payer, and the foreign capital invested exceeds US\$100,000 or its equivalent in national currency. The 15% rate applies to other dividends.
- (n) The 5% rate applies to dividends paid to corporations that hold at least 25% of the capital of the payer. The 10% rate applies to other dividends.
- (o) The 5% rate applies to dividends paid to companies that hold directly at least 10% of the capital of the payer, whereby this share should be at least US\$100,000 or its equivalent in other currency. The 10% rate applies to other dividends.
- (p) The 0% rate applies for royalties received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematograph films and films or tapes for radio or television broadcasting. The 10% rate applies to royalties received as a consideration for the use of, or the right to use, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.
- (q) The 0% rate applies if the recipient of the dividend is the Government, a political subdivision or a local authority of the other contracting state, or Central Bank or other governmental agencies of the other contracting state. The 5% rate applies to other dividends.
- (qa) The 5% rate on dividends paid to a company (excluding a partnership) that is a beneficial owner and that holds at least 25% of the capital of the payer and has invested in the payer at least US\$75,000 or the equivalent in local currency. The 10% rate applies to other dividends.

- (r) The 5% rate applies to dividends paid to companies (other than partnerships) that hold directly at least 25% of the capital of the payer, and the capital directly invested by this beneficial owner is not less than US\$100,000 or the equivalent amount in the national currency. The 10% rate applies to other dividends.
- (s) The 5% rate applies to royalties for the usage of industrial, commercial or scientific equipment. The 10% rate applies to other royalties.
- (t) The 5% rate applies to dividends paid to companies that hold directly at least 10% of the capital of the payer, and the capital directly invested by this beneficial owner is not less than €80,000 or the equivalent amount in the national currency (not yet effective upon the amending protocol come into force). Currently, the lowest rate is 10%; it applies if the recipient of the dividend holds directly at least 30% of the capital of the payer and has invested in the payer at least €75,000 or its equivalent in national currency. The 15% rate applies to other dividends.
- (u) The 10% rate applies to royalties received as a consideration for the use of, or the right to use, any patent, trademark, design or model, plan, secret formula or process, or any copyright of scientific work, or for the use of, or the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial or scientific experience. The 15% rate applies to royalties received for the use of, or the right to use, cinematograph films, or tapes for radio or television broadcasting, as well as any copyright of literary or artistic work.
- (v) The 10% rate applies if the recipient of the dividends has invested more than FRF1 million (€152,449) in the payer. The 15% rate applies to other dividends.
- (w) The 5% rate applies if the beneficial owner of the dividends owns an interest in the capital of the payer of at least US\$500,000. The 10% rate applies to other dividends.
- (x) Royalties are subject to tax in the country of the payer in accordance with domestic law (current rate 20%).
- (y) The 5% rate applies to dividends paid to companies (other than partnerships) that hold directly at least 25% of the capital of the payer and have invested at least €75,000 or its equivalent in the national currencies. The 15% rate applies to other dividends.
- (z) The 10% rate applies if the beneficial owner is a company that, for an uninterrupted period of two years before the payment of the dividends, owned directly at least 25% of the capital of the payer of the dividends. The 15% rate applies to other dividends.
- (aa) The 5% rate applies to dividends paid to companies (other than partnerships) that hold directly at least 25% of the capital of the payer and have invested in the payer at least US\$100,000 or the equivalent amount in local currency. The 15% rate applies to other dividends.
- (bb) The 10% rate applies if the beneficial owner of the dividends owns at least 30% of the charter capital of the payer and has directly invested at least US\$100,000 in the charter capital of the payer. The 15% rate applies to other dividends.
- (cc) The 5% rate applies to dividends paid to companies (other than partnerships) that hold directly at least 30% of the capital of the payer and have invested not less than US\$100,000 or the equivalent amount of local currencies. The 10% rate applies to other dividends.
- (dd) The 5% rate applies if the beneficial owner of the dividends is a company (other than a partnership) that has invested at least €100,000 or its equivalent in the charter capital of the payer and if the country of residence of the beneficial owner of the dividends does not impose taxes on the dividends. The 10% rate applies if one of these conditions is met. The 15% rate applies to other dividends.
- (ee) The reduced tax rate is not applicable to a company resident in one contracting state receiving dividends, interest or royalties from sources in the other contracting state if more than 50% of this company is owned (directly or indirectly) by nonresidents. This restriction does not apply if the establishment of the company and its operating activities in the other contracting state are founded on sound business reasons other than a mere participation in the capital of the other company.
- (ff) The 0% rate applies if the interest is paid on a long-term loan (seven or more years) granted by a bank or other credit institution that is a resident of the contracting states, or if the beneficial owner of the interest is a contracting state, a political subdivision or a local authority thereof.
- (gg) The 10% rate applies if the beneficial owner of the dividends owns at least 25% of the charter capital of the payer. The 15% rate applies to other dividends.
- (hh) The 4.5% rate applies to royalties paid to entities for copyrights of cinematographic films, programs, and recordings for radio and television broadcasting. The 13.5% rate applies to royalties paid to entities for copyrights of works of literature, art or science. The 18% rate applies to royalties paid to entities for patents, trademarks, designs or models, plans, secret formulas or processes and computer software, as well as for information relating to industrial, commercial or scientific experience.
- (ii) The 5% rate applies if the beneficial owner is a company (other than a partnership) that holds directly 100% (at least 30% if the recipient corporation is a part of a joint venture) of the payer and the foreign capital invested exceeds US\$100,000 or the equivalent amount in local currency. The 15% rate applies to other dividends.

- (jj) A 0% rate applies if the dividend is paid to, e.g., a pension fund a state, its political subdivisions or local authorities thereof, the central bank of a state which are beneficial owners. The 5% rate applies to dividends paid to companies (other than partnerships) that hold directly at least 20% of the capital of the payer and if, at the time the dividends become due, the foreign capital invested exceeds CHF200,000 or its equivalent in any other currency. The 15% rate applies to other dividends.
- (ll) The 5% rate applies to dividends paid to corporations that have invested in the payer at least US\$50,000 or the equivalent amount in local currency. The 15% rate applies to other dividends.
- (mm) The 5% rate applies to dividends paid to corporations holding at least 10% of the voting shares of the payer or, in the case of a Russian payer that has not issued voting shares, at least 10% of the statutory capital. The 10% rate applies to other dividends.
- (nn) The 10% rate applies to dividends paid to shareholders that have invested at least the equivalent of US\$10 million in the payer. The 15% rate applies to other dividends.
- (oo) The 0%, 9% or 15% rates apply to interest on certain types of state and municipal securities; the 20% rate applies to other interest.
- (pp) The 5% rate applies if the beneficial owner is a company (other than a partnership) that holds directly at least 25% of the capital of the company paying the dividends. The 10% rate applies in other cases.
- (qq) The 10% rate applies if the beneficial owner holds directly at least 20% of the total capital of the company paying the dividends. The 15% rate applies in all other cases.
- (rr) The 5% rate applies if the beneficial owner is the Government of the other contracting state or is a company that holds directly at least 15% of the capital of the payer company and has invested in it at least US\$100,000 or its equivalent in other currencies; the 10% rate applies in other cases.
- (ss) The 10% rate applies to dividends paid to a company (other than a partnership) that is the beneficial owner of the dividend and holds directly at least 10% of the capital of the payer of the dividends and if the participation exceeds US\$100,000 or the equivalent in other currency. The 15% rate applies to other dividends.
- (tt) The 5% rate applies to interest on bank loans. The 10% rate applies to other interest.
- (uu) The 10% rate applies to fees for technical assistance.
- (vv) The 0% withholding tax rate applies to dividends paid by a company resident in Malaysia to a resident of Russia who is the beneficial owner thereof. Profits of a joint venture accruing to a participant who is a resident of Malaysia, when transferred from Russia, may be taxed in accordance with the Russian law, but the tax charged shall not exceed 15% of such profits transferred from Russia.
- (ww) The 5% rate applies if the beneficial owner of the dividends is a company (other than a partnership) that holds 25% of the charter capital of the payer. The 15% rate applies to other dividends.
- (xx) The 0% rate applies in the case the interest is paid to, e.g., the government of the state, its political subdivision or local authorities thereof, or to a body or financial banking organization that is fully owned or controlled by the contracting state or a political subdivision or local authority thereof; or to other bodies or organizations (including financial institutions) in connection with a loan made within the framework of agreements concluded between the governments of the contracting states. The 10% rate applies to other interest.
- (yy) The 0% rate applies to royalties paid to entities for copyright royalties and other similar payments for the production of a literary, dramatic, musical or artistic work. The 5% rate applies to other royalties.
- (zz) The 5% rate applies to dividends paid to companies that hold at least 25% of the capital of the payer. The 10% rate applies to other dividends.
- (aaa) The 5% rate applies to royalties for the use of, or the right to use, any industrial, commercial or scientific equipment. The 10% rate applies to other royalties.
- (bbb) The 5% rate applies to dividends if the beneficial owner is a company (other than a partnership) that holds directly at least 25% of the capital of the company paying the dividends and this holding amounts to at least €100,000. The 10% rate applies in other cases.

Pending treaties:

Brazil, Estonia, Ethiopia, Georgia, Laos, Mauritius and Oman.

Treaties being negotiated:

Bahrain, Bangladesh, Barbados, Bosnia and Herzegovina, Ecuador, Fiji, Hong Kong, Madagascar, Nigeria, Seychelles, Taiwan and Tunisia.

Appendix 5: Blacklist of jurisdictions approved by the Ministry of Finance

The list of states and territories that grant preferential tax treatment and do not require the disclosure and provision of information in relation to financial operations carried out (offshore zones) is as follows:

1. Anguilla
2. Kingdom of Andorra
3. Antigua and Barbuda
4. Aruba
5. Commonwealth of the Bahamas
6. Kingdom of Bahrain
7. Belize
8. Bermuda
9. Brunei-Darussalam
10. Republic of Vanuatu
11. British Virgin Islands
12. Gibraltar
13. Grenada
14. Commonwealth of Dominica
15. People's Republic of China:
Hong Kong (Xianggang) Special
Administration Region Macau
(Aomen) Special Administration
Region
16. Union of the Comoros: Anjouan
Islands
17. Republic of Liberia
18. Principality of Liechtenstein
19. Republic of Mauritius
20. Malaysia: Labuan Island
21. Republic of Maldives
22. Republic of Malta
23. Republic of the Marshall Islands
24. Principality of Monaco
25. Montserrat
26. Republic of Nauru
27. Netherlands Antilles⁹
28. Republic of Niue
29. United Arab Emirates
30. Cayman Islands
31. Cook Islands
32. Turks and Caicos Islands
33. Republic of Palau
34. Republic of Panama
35. Republic of Samoa
36. Republic of San Marino
37. Saint Vincent and the Grenadines
38. Saint Kitts and Nevis
39. Saint Lucia
40. Isle of Man Channel Islands
(Islands of Guernsey, Jersey,
Sark and Alderney)
41. Republic of Seychelles

⁹ The Ministry of Finance published a draft order amending the above list on its official website in August 2014. This proposes the removal of Malta and replacing "the Netherlands Antilles" with "Curaçao and Sint Maarten (the Dutch part)" with effect from 1 January 2015.



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