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OF THE FOREIGN INVESTMENT
ADVISORY COUNCIL IN RUSSIA**

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**Foreign Investment Advisory Council in Russia
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ATTACHMENTS

1. Overview of investment activities of pharmaceutical companies in Russia (June 2013)
2. Russia attractiveness survey 2013: Shaping Russia's future
3. "Why Russia can still be a good market for your company" (Source: CEEMEA Business Group, Dr. Daniel Thorniley)

1. OVERVIEW OF LEGISLATIVE CHANGES FOLLOWING THE 26th SESSION

Topic	Description	Status in October 2012	Status in October 2013
1. Tax administration	1. The entry into force of legislation on taxes and levies	<p>Legislative acts on taxes and levies that</p> <ul style="list-style-type: none"> - eliminate or reduce liability for violations of tax and levy legislation or introduce additional guarantees to protect the rights of tax and levy payers, tax agents and their representatives, - eliminate obligations of tax and levy payers, tax agents and their representatives or otherwise improve their position <p>may enter into force on their official publication date if this is directly stipulated in such acts.</p>	<p>Legislative acts on taxes and levies that</p> <ul style="list-style-type: none"> - eliminate or reduce liability for violations of tax and levy legislation or introduce additional guarantees to protect the rights of tax and levy payers, tax agents and their representatives, - eliminate obligations of tax and levy payers, tax agents and their representatives or otherwise improve their position <p>may enter into force on the dates directly stipulated in these acts, but not earlier than their official publication dates.</p>
	2. Grounds for recovering arrears from a subsidiary (dependent) company	<p>Article 45. Fulfilment of an obligation to pay a tax or levy</p> <p>2) for the purpose of recovering arrears, which have been owed for more than three months by organizations which are dependent (subsidiary) companies (enterprises) in accordance with the civil legislation of the Russian Federation – from the corresponding parent (predominant, participating) companies (enterprises) when their bank accounts are credited with receipts from sales of goods (work and services) of the dependent (subsidiary) companies (enterprises) as well as by organizations which are parent (predominant, participating) companies (enterprises) in accordance with</p>	<p>Article 45. Fulfilment of an obligation to pay a tax or levy</p> <p>Clause 2 has been amended.</p> <p>On 30 July 2013 new grounds were introduced for recovering a dependent company's arrears from the parent and vice versa. A dependent company's arrears will be recovered from the parent company (and vice versa) if funds or other assets were transferred to the parent (dependent) company after the debtor learned or should have learned that a field tax audit had been scheduled or that an in-house tax audit had begun (paragraphs 4 and 5 of subclause 2.2 of Article 45 of the Russian Tax Code).</p> <p>The procedure for recovering a dependent company's arrears from the parent and vice versa will</p>

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		<p>the civil legislation of the Russian Federation – from dependent (subsidiary) companies (enterprises) when their bank accounts are credited with receipts from sales of goods (work and services) of the parent (predominant, participating) companies (enterprises)</p>	<p>also apply to organizations that are found by the court to be related to the debtor in another way. As a general rule, the status of a company (dependent or parent) is determined in accordance with Russian civil law (paragraph 8 of subclause 2.2 of Article 45 of the Russian Tax Code).</p> <p>(subclause 2 in the version of Federal Law No. 134-FZ of 28 June 2013)</p>
	<p>3. Maximum amount of arrears</p>	<p>Article 48. Recovery of tax, a levy, penalties and fines from assets of a taxpayer (levy payer) – physical person who is not a private entrepreneur</p> <p>Clause 1.</p> <p>The above-mentioned recovery petition shall be filed by a tax authority (customs authority) with a court where the total amount of tax, a levy, penalties and fines which is recoverable from the physical person exceeds RUB1,500, except in the case provided for in paragraph 3 of clause 2 of this Article.</p> <p>Clause 2.</p> <p>If, within a period of three years from the date of expiry of the due date of the earliest demand for the payment of tax, a levy, penalties and fines that is taken into account by a tax authority (customs authority) in computing the total amount of tax, a levy, penalties and fines to be recovered from a physical person, that amount of taxes, levies, penalties and fines has exceeded RUB1,500, the tax authority (customs authority) shall file</p>	<p>Article 48. Recovery of tax, a levy, penalties and fines from assets of a taxpayer (levy payer) – physical person who is not a private entrepreneur</p> <p>Clause 1.</p> <p>The above-mentioned recovery petition shall be filed by a tax authority (customs authority) with a court where the total amount of tax, a levy, penalties and fines which is recoverable from the physical person exceeds RUB3,000, except in the case provided for in paragraph 3 of clause 2 of this Article.</p> <p>(as amended by Federal Law No. 20-FZ of 4 March 2013)</p> <p>Clause 2.</p> <p>If, within a period of three years from the date of expiry of the due date of the earliest demand for the payment of tax, a levy, penalties and fines that is taken into account by a tax authority (customs authority) in computing the total amount of tax, a levy, penalties and fines to be recovered from a physical person, that amount of taxes, levies, penalties and fines has exceeded RUB3,000, the tax authority (customs authority) shall file a recovery petition with a court within six months from the day on which the</p>

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		<p>a recovery petition with a court within six months from the day on which the above-mentioned amount exceeded RUB1,500.</p> <p>If, within a period of three years from the date of expiry of the due date of the earliest demand for the payment of tax, a levy, penalties and fines that is taken into account by a tax authority (customs authority) in computing the total amount of tax, a levy, penalties and fines to be recovered from a physical person, that amount of taxes, levies, penalties and fines has not exceeded RUB1,500, the tax authority (customs authority) shall file a recovery petition with a court within six months from the date of expiry of that three-year period.</p>	<p>above-mentioned amount exceeded RUB3,000.</p> <p>(as amended by Federal Law No. 20-FZ of 4 March 2013)</p> <p>If, within a period of three years from the date of expiry of the due date of the earliest demand for the payment of tax, a levy, penalties and fines that is taken into account by a tax authority (customs authority) in computing the total amount of tax, a levy, penalties and fines to be recovered from a physical person, that amount of taxes, levies, penalties and fines has not exceeded RUB3,000, the tax authority (customs authority) shall file a recovery petition with a court within six months from the date of expiry of that three-year period.</p> <p>(as amended by Federal Law No. 20-FZ of 4 March 2013)</p>
	4. Tax audit procedure	<p>As of January 2012, there is a new type of tax audit: an audit of the fullness of the calculation and payment of taxes with regard to the performance of transactions between interdependent entities (Article 105.17 of the Russian Tax Code). The conformity of prices to market prices can now no longer be checked by a field or desk audit.</p> <p>The new type of audits will be performed by the Federal Tax Service of Russia at its location. The grounds for the Federal Tax Service to check price conformity are the following (Article 105.17.1 of the Russian Tax Code):</p> <ul style="list-style-type: none"> - notification of controlled transactions submitted by the taxpayer, 	

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		<ul style="list-style-type: none"> - notice of the regional tax authority, which during a desk or field audit discovered instances of the performance of unannounced controlled transactions, - revelation of a controlled transaction when the Federal Tax Service conducted a field audit again. The verification of the correctness of applying the prices does not obstruct the performance of field and desk audits for the same period. <p>Generally, an audit should not be longer than six months (Article 105.17.4 of the Russian Tax Code):</p> <p>The Federal Tax Service is entitled to use the following methods to determine the conformity of the transaction prices to the market prices (Article 105.7.1 of the Russian Tax Code):</p> <ul style="list-style-type: none"> - comparable market price method, - resale price method, - cost method, - comparable profit generation method, - profit distribution method. <p>The rules for performing transfer pricing audits will be established in accordance with the following timetable:</p> <ul style="list-style-type: none"> - An audit of transfer pricing in the transactions performed in 2012 can be started not later than 31 December 2013 	

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		<ul style="list-style-type: none"> - An audit of transfer pricing in the transactions performed in 2013 can be started not later than 31 December 2015 - The rule for the standard three-year period which can be audited will come into force only on 1 January 2014. <p>The specific features of performing a field tax audit of the consolidated taxpayer group have been established as of 1 January 2012.</p>	
	5. Tax authorities' request for documents	<p>As of 1 January 2012, the time limits are extended by at least 10 days when performing a tax audit of a consolidated taxpayer group.</p> <p>The documents requested during a tax audit are presented within 10 days (20 days when the consolidated taxpayer group undergoes a tax audit) from the day on which the relevant request is received.</p> <p>Clauses 1.1 and 8 were added to Article 93.1 of the Russian Tax Code:</p> <p>1.1. When performing a desk tax audit of the calculation of the financial result of an investment partnership, the tax authority is entitled to demand the following information for the period under review from a party to the investment partnership agreement, i.e., a managing partner who is responsible for the management of tax accounting:</p> <p>1) the composition of parties to the investment partnership agreement, including information on the changes in this composition,</p>	

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		<p>2) the composition of parties to the investment partnership agreement, i.e., the managing partners, including information on the changes in this composition,</p> <p>3) the share of profit (expenses, losses) of each managing partner and partner,</p> <p>4) the share of participation of each managing partner and partner in the investment partnership's profit, as set by the investment partnership agreement,</p> <p>5) the share of each managing partner and partner in the partners' total equity,</p> <p>6) the changes in the procedure for the determination by a party to an investment partnership agreement, i.e., the managing partner responsible for managing tax accounting, of the expenses incurred in the interests of all partners concerning the management of the partners' common affairs when such a procedure is established by the investment partnership agreement.</p> <p>Article 93. Requesting Documents When Performing a Tax Audit</p> <p>1. A tax authority official who is performing a tax audit shall have the right to request from the audited person such documents as are needed for the audit. Where a tax authority official who is performing a tax audit is on the taxpayer's premises, a request for documents shall be transmitted to the director (the legal or authorized representative) of the organization or to the physical person (his</p>	<p>Article 93. Requesting Documents When Performing a Tax Audit</p> <p>1. A tax authority official who is performing a tax audit shall have the right to request from the audited person such documents as are needed for the audit.</p> <p>(as amended by Federal Law No. 248-FZ of 23 July 2013)</p> <p>Where a tax authority official who is performing a tax audit is on the taxpayer's premises, a request for documents shall be transmitted to the director (the</p>

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		<p>legal or authorized representative) in person against signed receipt or in electronic form via telecommunications channels. Where it is impossible for a request for documents to be transmitted in the manner stated above, it shall be sent by registered mail and shall be regarded as received six days after the registered letter is sent.</p> <p>Article 93.1 Requesting Documents (Information) Concerning a Taxpayer, Levy Payer or Tax Agent and Information Concerning Particular Transactions</p> <p>In the event that a reasonable need arises for tax authorities to obtain information concerning a particular transaction outside the context of the performance of tax audits, a tax authority official shall have the right to request and obtain that information from the parties to that transaction or from other persons possessing information concerning that transaction.</p>	<p>legal or authorized representative) of the organization or to the physical person (his legal or authorized representative) in person against signed receipt.</p> <p>(the paragraph was added by Federal Law No. 216-FZ of 23 July 2013)</p> <p>Where it is impossible for a request for documents to be transmitted in the manner stated above, it shall be sent in accordance with the procedure established by clause 4 of Article 31 of this Code.</p> <p>(the paragraph was added by Federal Law No. 216-FZ of 23 July 2013)</p> <p>Requested documents may be presented to a tax authority in person or through a representative, sent by registered mail or transmitted in electronic form via telecommunications channels.</p> <p>Article 93.1 Requesting Documents (Information) Concerning a Taxpayer, Levy Payer or Tax Agent and Information Concerning Particular Transactions</p> <p>In the event that a reasonable need arises for tax authorities to obtain documents (information) concerning a particular transaction outside the context of the performance of tax audits, a tax authority official shall have the right to request and obtain those documents (that information) from the parties to that transaction or from other persons possessing documents (information) concerning that transaction.</p> <p>(Clause 2 as amended by Federal Law No. 134-FZ of 28 June 2013)</p>
	6. Procedure for sending documents to a taxpayer	Under Article 101.2 of the Russian Tax Code, a taxpayer must be duly notified of the time	Documents which are used by tax authorities in exercising their powers in relations governed by tax

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		<p>and place of the examination of tax audit materials.</p> <p>A tax audit report is sent to the location of the organization (autonomous subdivision) or to the place of residence of the physical person (Article 100.5 and Article 105.17.12 of the Russian Tax Code).</p>	<p>and levy legislation may be transmitted by a tax authority to the person to whom they are addressed or to that person's representative directly against signed receipt, sent by registered mail or transmitted in electronic form via telecommunications channels through an electronic document interchange operator, unless the method of their transmission is directly prescribed by the Tax Code. Persons obligated by the Tax Code to submit a tax declaration (calculation) in electronic form receive such documents from a tax authority in electronic form via telecommunications channels through an electronic document interchange operator.</p> <p>If a tax authority sends a document by registered mail, it is regarded as received six days after the registered letter is sent.</p> <p>(Article 31.4 as amended by Federal Law No. 248-FZ of 23 July 2013)</p> <p>Where documents used by tax authorities in exercising their powers in relations governed by tax and levy legislation are sent by post, those documents are to be sent by the tax authority:</p> <ul style="list-style-type: none"> - to a taxpayer that is a Russian organization (or a branch or representation thereof) – at the address (location of its branch or representation) indicated in the Unified State Register of Legal Entities, - to a taxpayer that is a foreign organization – at the address where it carries out activities in the Russian Federation, as indicated in the Unified State Register of Taxpayers, - to a taxpayer who is a private entrepreneur, a privately practicing notary, a lawyer who has

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			<p>founded a legal office or an individual who is not a private entrepreneur – at the address of his place of residence (place of stay) or at the address provided to the tax authority for the sending of the documents referred to in this clause, as indicated in the Unified State Register of Taxpayers.</p> <p>The form of a notice of the provision by a taxpayer who is a private entrepreneur, a privately practicing notary, a lawyer who has founded a legal office or a physical person who is not a private entrepreneur to a tax authority of an address for the mailing of documents which are used by tax authorities in exercising their powers in relations governed by tax and levy legislation are to be approved by the federal executive body in charge of control and supervision in the area of taxes and levies.</p> <p>(Article 31.5 was introduced by Federal Law No. 134-FZ of 28 June 2013)</p>
	<p>7. Time frames for presenting the report and decision of the tax authorities to the taxpayer, effective dates for reports and decisions</p>	<p>Time limit for presenting - 5 days from the date when a decision is issued.</p> <p>Article 101. Issuing a decision on the results of examining tax audit materials</p> <p>As of 1 January 2012, in the event of a tax audit of the consolidated taxpayer group, a notification of the time and place for examining the tax audit materials is to be sent to the accountable member of that group who is deemed the entity to be audited.</p> <p>The representatives of the accountable member as well as other members of that group are entitled to take part in examining</p>	

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		<p>the tax audit materials.</p> <p>The accountable member of the consolidated taxpayer group is obliged to notify the members of that group of the time and place for examining the tax audit materials. (the paragraph was added by Federal Law No. 321-FZ of 16 November 2011)</p> <p>The tax authority is obliged to notify the member of the consolidated taxpayer group of the time and place for examining the tax audit materials.</p> <p>(the paragraph was added by Federal Law No. 321-FZ of 16 November 2011)</p> <p>In the event of an audit of the consolidated taxpayer group, the decision may contain instructions to hold one or several members of the group liable.</p> <p>(as amended by Federal Law No. 321-FZ of 16 November 2011)</p> <p>If the decision envisaged by clause 7 of this article is made with regard to the results of examining the materials of the on-site tax audit of the consolidated taxpayer group, the supportive measures set by this article may be taken in relation to the members of the group. In this respect, the supportive measures are taken first and foremost in relation to the accountable member of the group. When the supportive measures taken in relation to the said accountable member are not enough to execute the decision envisaged by clause 7 of this article, the</p>	

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		<p>supportive measures can successively be taken in relation to other members of the consolidated taxpayer group with regard to the restrictions set by Article 46.11 of the Code. Federal Law No. 29-FZ.</p> <p>(the paragraph was added by Federal Law No. 321-FZ of 16 November 2011)</p> <p>The decision to hold an entity liable for a tax offense and the decision not to hold an entity liable for a tax offense, made with regard to the results of examining the materials of the on-site tax audit of the consolidated taxpayer group, are to come into force 20 days after they are presented to the accountable member of that group. (Article 101.9 as amended by Federal Law No. 321-FZ of 16 November 2011)</p> <p>Article 100.5, Article 105.17, clause 12 of the Russian Tax Code</p> <p>If a person in relation to whom an audit has been performed (or a representative) evades receiving the audit report, this is recorded in the audit report, which is sent by registered mail at the location of the organization or at the place of residence of the individual.</p> <p>If it is impossible to present the decision, it is sent to the taxpayer by registered mail and is considered received six days after sending the registered mail.</p>	<p>The decision to hold an entity liable for a tax offense and the decision not to hold an entity liable for a tax offense (except for decisions made with regard to the results of examining the materials of the on-site tax audit of the consolidated taxpayer group), are to come into force one month after they are presented to a person (a representative) in relation to whom the decision has been issued. The decision to hold an entity liable for a tax offense and the decision not to hold an entity liable for a tax offense, made with regard to the results of examining the materials of the on-site tax audit of the consolidated taxpayer group, are to come into force one month after they are presented to the accountable member of that group.</p> <p>A decision to hold an entity liable for a tax offense and the decision not to hold an entity liable for a tax offense made by the federal executive authority authorized to exercise control and oversight in the field of taxes and levies comes into force on the day it is presented to a person (a representative) in relation to whom the decision has been issued. The decision specified herein should be presented to a person (a representative) in relation to whom the decision has been issued within five days from the date of issue against signature, or delivered in a way manifesting the date when the decision was received</p>

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			<p>by this person (representative). If the decision cannot be presented or delivered in any other way manifesting the date when the decision was received by this person, it is sent by registered mail at the location of an organization (separate subdivision) or at the place of residence of an individual. If the decision is sent by mail, it is considered received on the sixth day after sending the registered mail.</p> <p>(Article 101.9 as amended by Federal Law No. 153-FZ of 2 July 2013)</p> <p>If the decision of tax authorities is appealed, it comes into force as specified in Article 101.2 of the Code.</p> <p>(Article 101.9 as amended by Federal Law No. 153-FZ of 2 July 2013)</p>
	<p>8. Time frame provided for looking through the materials of additional tax control measures</p>	<p>Article 101. Issuing a decision on the results of examining tax audit materials</p> <p>Clause 2, paragraph 2</p> <p>The person in relation to whom a tax audit was performed shall have the right to participate in the process of examining the materials relating to that audit in person and (or) through a representative. The person in relation to whom a tax audit was performed shall have the right, before the decision provided for in clause 7 of this Article is issued, to look through all materials in the file, including materials relating to additional tax control measures. In case of a tax audit of a consolidated group of taxpayers, representatives of the responsible member of that group and other members of the group</p>	<p>Article 101. Issuing a decision on the results of examining tax audit materials</p> <p>Clause 2, paragraph 2</p> <p>The person in relation to whom a tax audit was performed shall have the right to participate in the process of examining the materials relating to that audit in person and (or) through a representative. In the event that the person in relation to whom a tax audit was performed submits a request to look through all materials in the file, the tax authority shall be obliged to familiarize such person (or a representative) with the tax audit documents and with the materials of additional tax control measures no later than two days before examining the tax audit materials. In case of a tax audit of a consolidated group of taxpayers, representatives of the responsible member of that group and other</p>

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		<p>shall have the right to participate in the process of examining the tax audit materials. (the time frame is undefined)</p>	<p>members of the group shall have the right to participate in the process of examining the tax audit materials. (as amended by Federal laws No. 229-FZ of 27 July 2010, No. 321-FZ of 16 November 2011, and No. 248-FZ of 23 July 2013)</p>
	<p>9. The procedure for lodging an appeal against decisions, acts and actions of tax authorities</p>	<p>Article 139. The procedure and time frame for lodging an appeal</p> <p>An appeal to a higher tax authority (higher official) shall be lodged, unless otherwise stipulated by the Tax Code, within three months from the day when the person became aware or should have become aware of the violation of his rights.</p>	<p>Article 139. The procedure and time frame for lodging an appeal</p> <p>The appeal shall be lodged with a higher tax authority through the tax authority, the non-normative acts of which or the actions or inaction of whose officials are being challenged. The tax authority, the non-normative acts of which or the actions or inaction of whose officials are being challenged, shall be obliged to forward such appeal with all respective materials to the higher tax authority within three days from receiving the appeal.</p> <p>2. Unless otherwise stipulated by the Tax Code, an appeal to a higher tax authority may be lodged within one year from the day when the person became aware or should have become aware of the violation of his rights.</p> <p>An appeal against a decision to impose or not impose sanctions for a committed tax offense which entered into force and was not challenged, may be lodged within one year from the date when the contested decision was adopted.</p> <p>An appeal may be lodged with the federal executive body authorized to exercise control and oversight in the field of taxes and levies within three months from the date when the higher tax authority adopted a decision on the appeal (appellate appeal).</p> <p>In the event that the deadline for lodging an appeal is</p>

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		<p>There are no provisions regulating pre-litigation procedures</p>	<p>missed for a valid reason, this deadline can be extended by the higher tax authority upon request of the appellant.</p> <p>(as amended by Federal Law No. 153-FZ of 2 July 2013)</p> <p>A mandatory pre-litigation procedure for contesting any non-normative acts of tax authorities and the actions or inaction of their officials will be introduced from 2014 (Article 138, clause 2 of the Russian Tax Code, Article 3, clause 3 of Federal Law No. 153-FZ of 2 July 2013). There will be two exceptions to this rule. First, non-normative acts adopted following consideration of appeals, including appellate appeals, may be contested both in a higher tax authority and in court (Article 138, clause 2, paragraph 3 of the Russian Tax Code). Second, non-normative acts of the Russian Federal Tax Service and actions (inaction) of its officials may be contested directly in court (Article 138, clause 2, paragraph 4 of the Russian Tax Code). The exceptions stipulated by paragraphs 3 and 4 of Article 138, clause 2 of the Russian Tax Code are applicable since 3 August 2013.</p> <p>Until 1 January 2014, the mandatory pre-litigation procedure applies only to decisions about imposing (not imposing) sanctions adopted under Article 101 of the Tax Code (Article 3, clause 3 of Federal Law No. 153-FZ of 2 July 2013). However, starting from 3 August 2013 it is possible in a certain case to appeal directly to court without waiting for the decision of a higher tax authority. Thus, according to Article 138, clause 2, paragraph 2 of the Tax Code, the taxpayer is considered to have complied with the pre-litigation procedure if no decision was adopted regarding an</p>

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		<p>Article 101. Issuing a decision on the results of examining tax audit materials</p> <p>Clause 8. The decision on imposing or not imposing sanctions for committing a tax offense shall stipulate a time frame within which the person in relation to whom the decision was issued may appeal against that decision, the procedure for appealing against the decision to a higher tax authority (to a higher official), the name and location of the authority and other necessary data.</p> <p>Article 138. Appeal procedure</p> <p>Appeals against acts of the tax authorities and the actions or inaction of their officials may be made to a higher tax authority (higher official) or to a court. There is no definition of appeal and appellate appeal.</p>	<p>appeal (appellate appeal) within the established time frame. Previously, this matter was not determined legislatively however court practice favored taxpayers (e.g., Ruling of the Federal Arbitration Court of the Moscow District No. A40-77655/10-99-382 of 25 April 2011 and No. A41-25652/09 of 27 May 2010).</p> <p>Under the amended Article 101, clause 8, Article 101.4, clause 9 and Article 138 of the Tax Code, non-normative acts of the tax authority, as well as actions or inaction of its officials, may now be contested only in a higher tax authority. Hence, it is no longer possible to appeal to a higher tax official (Article 1, clause 1, subclause "a" and Article 1, clause 3, of Federal Law No. 153-FZ of 2 July 2013).</p> <p>Article 138, clause 1 now defines the following concepts: appeal and appellate appeal.</p> <p>An appeal is defined as a representation made by a person to a tax authority with the object of contesting non-normative decisions of a tax authority which have entered into force and acts or inaction of officials of a tax authority where, in the opinion of that person, the contested decisions or the acts or inaction of officials of the tax authority violate his rights.</p> <p>An appellate appeal is a defined as a representation made by a person to a tax authority with the object of contesting a decision of a tax authority concerning the imposition of tax sanctions or a decision concerning the non-imposition of tax sanctions which</p>

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		<p>The issue of tax authorities dismissing appeals remains disputable. (The Russian Tax Code establishes an exhaustive list of decisions which may be taken following consideration of an appellate appeal; this right is not included)</p>	<p>was issued in accordance with Article 101 of the Tax Code and has not entered into force where, in the opinion of that person, the contested decision violates his rights.</p> <p>Article 139.2 of the Tax Code sets forth the form and content of an appeal, including an appellate appeal. The appeal must be submitted in writing and signed either by the appellant or by his/her representative. The appeal shall contain information about the appellant and the tax authority, the acts of which or the actions (inaction) of whose officials are being challenged; the subject of the appeal; grounds on which the appellant considers his rights to have been violated; and his demands (Article 139.2, clause 2 of the Russian Tax Code).</p> <p>Documents supporting the appellant's arguments may be enclosed with the appeal (Article 139.2, clause 5 of the Russian Tax Code).</p> <p>The appeal (appellate appeal) shall be lodged through the tax authority, the non-normative act of which or the actions or inaction of whose officials are being challenged by the appellant. Within three days, the tax authority must forward the appeal itself and all relating materials to a higher tax body (clause 1 of Article 139 and clause 1 of Article 139.1 of the Russian Tax Code).</p> <p>Grounds for dismissing an appeal (appellate appeal) have been established.</p> <p>Starting from 3 August 2013, the higher tax authority is entitled to dismiss an appeal (appellate appeal) in whole or in part. Article 139.3 of the Russian Tax Code contains an exhaustive list of reasons for</p>

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			<p>dismissing an appeal. The higher tax authority shall dismiss an appeal (appellate appeal) if it establishes the following (clauses 1 and 4 of Article 139.3 of the Tax Code):</p> <ul style="list-style-type: none"> - The appeal is not signed or it is signed by a person whose powers are not duly confirmed. - A request to withdraw the appeal (appellate appeal) in full or in part was received before a decision on it has been adopted. - An appeal (appellate appeal) on the same grounds has already been lodged. <p>Article 139.3, clause 1, sub-clause 2 of the Russian Tax Code provides the following reason for dismissing an appeal against actions (inaction) of officials and acts which have entered into force: the appeal was lodged after expiry of the deadline stipulated by the Tax Code and contains no request to extend the missed deadline (or such a request has been rejected).</p> <p>Failing to sign the appeal and missing the deadline for its submission without requesting an extension of the time frame do not preclude the taxpayer from lodging a repeated appeal (Article 139.3, clause 3 of the Russian Tax Code).</p> <p>The tax authority considering the appeal shall decide on dismissing the appeal in whole or in part within five days from receiving the appeal or a notice of its withdrawal in whole or in part. The appellant shall be informed of the decision within three days from its adoption in writing.</p>

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		<p>The procedure for considering an appeal: Article 140 of the Tax Code</p> <ol style="list-style-type: none"> 1. An appeal shall be considered by a higher tax authority (higher official). 2. After considering an appeal against an act of a tax authority, the higher tax authority (higher official) shall have the right: <ol style="list-style-type: none"> 1) to reject the appeal, 2) to annul the tax authority's act, 3) to annul the decision and terminate proceedings in respect of the tax offense, 4) to amend the decision or adopt a new decision. <p>After considering an appeal against the actions or inaction of officials of tax authorities, the higher tax authority (higher official) shall have the right to adopt a decision on the merits of the case.</p> <p>After considering an appellate appeal against a decision, a higher tax authority shall have the right:</p> <ol style="list-style-type: none"> 1) to leave the tax authority's decision unchanged and reject the appeal, 2) to rescind or amend the tax authority's decision in whole or in part and adopt a new decision on the case, 3) to rescind the tax authority's decision and terminate proceedings on the case. 	<p>The procedure for considering an appeal: Article 140 of the Tax Code (as amended by Federal Law No. 153-FZ of 2 July 2013)</p> <ol style="list-style-type: none"> 1. During examination of the appeal (appellate appeal) and before a decision on it has been adopted the appellant may provide additional documents in support of his arguments. 2. The higher tax authority shall consider the appeal (appellate appeal), documents supporting the arguments of the appellant, any additional documents provided in the course of examining the appeal (appellate appeal), and the materials provided by the lower-level tax body in the absence of the appellant. 3. After considering the appeal (appellate appeal), a higher tax authority shall have the right: <ol style="list-style-type: none"> 1) to reject the appeal (appellate appeal), 2) to annul the tax authority's non-normative act, 3) to annul the tax authority's decision in whole or in part, 4) to annul the tax authority's decision in whole and to adopt a new decision on the case, 5) to declare the actions or inaction of tax officials unlawful and to decide on the merits of the case. 4. The documents enclosed with the appeal against the decision which was issued according to the procedure set forth in Articles 101 or 101.4 of the Russian Tax Code, or with the appellate appeal, as well as any additional documents submitted in the

Topic	Description	Status in October 2012	Status in October 2013
		<p>3. A decision of a tax authority (official) on an appeal shall be adopted within one month from the day of receiving the appeal. This time limit can be extended by the head (deputy head) of the tax authority for a maximum of 15 days for the purpose of obtaining documents (information) necessary to consider the appeal from the lower-level tax authority. The appellant shall be informed of the decision within three days from its adoption in writing.</p>	<p>course of examining the respective appeal but prior to issuing a decision on it, shall be considered by the higher tax authority if the appellant provides the reasons for not presenting such documents timely to the tax authority whose decision is being contested.</p> <p>5. In the event that after considering the appeal (appellate appeal) against a decision issued according to the procedure set forth by Article 101 of the Russian Tax Code, the higher tax authority concludes that significant procedural aspects were violated in the course of examining tax audit materials, it shall be entitled to annul such a decision, examine the above materials, as well as documents supporting the appellant's arguments, any additional documents submitted in the course of considering the appeal (appellate appeal), and the materials provided by the lower-level tax authority. The higher tax authority shall examine the above according to the procedure set forth in Article 101 of the Tax Code and pass a decision provided for by clause 3 of that Article.</p> <p>In the event that after considering the appeal against a decision issued according to the procedure set forth in Article 101.4 of the Russian Tax Code, the higher tax authority concludes that significant procedural aspects were violated in the course of examining the materials of other tax control measures, it shall be entitled to annul such a decision, examine the above materials, as well as documents supporting the appellant's arguments, any additional documents submitted in the course of considering the appeal, and the materials provided by the lower-level tax authority. The higher tax authority shall examine the above according to the</p>

Topic	Description	Status in October 2012	Status in October 2013
			<p>procedure set forth in Article 101.4 of the Russian Tax Code and pass a decision provided for by clause 3 of that Article.</p> <p>6. The higher tax authority shall adopt a decision on the appeal (appellate appeal) against a decision to impose or not impose sanctions for a committed tax offense issued according to the procedure set forth in Article 101 of the Russian Tax Code within one month from the date the appeal (appellate appeal) was received. This time limit can be extended by the head (deputy head) of the tax authority for a maximum of one month for the purpose of obtaining from the lower-level tax authority documents (information) necessary to consider the appeal (appellate appeal), or in the event that the appellant submitted additional documents.</p> <p>The tax authority shall adopt a decision on an appeal not stipulated in paragraph one of this clause within 15 days from the date the appeal was received. This time limit can be extended by the head (deputy head) of the tax authority for a maximum of 15 days for the purpose of obtaining from the lower-level tax authority documents (information) necessary to consider the appeal, or in the event that the appellant submitted additional documents.</p> <p>The decision of the head (deputy head) of the tax authority to extend the time frame for considering the appeal (appellate appeal) shall be handed or forwarded to the appellant within three days from its adoption.</p> <p>The decision of the tax authority on the appeal (appellate appeal) shall be handed or forwarded to the appellant within three days from its adoption.</p>

Topic	Description	Status in October 2012	Status in October 2013
		<p>Article 141. Consequences of submitting an appeal</p> <p>1. The submission of an appeal to a higher tax authority (higher official) shall not suspend the execution of the contested act or action, except in the instances provided for by the Russian Tax Code.</p> <p>2. Where a tax authority (official) considering an appeal has sufficient reasons to believe that the contested act or action is at variance with Russian law, that tax authority shall have the right to suspend the execution of the contested act or action in whole or in part. The decision to suspend the execution of an act (action) shall be adopted by the head of the tax authority which adopted the act or by a higher tax authority. The appellant shall be informed of the decision within three days from its adoption in writing.</p> <p>Pursuant to clause 5 of Article 101.2 of the Russian Tax Code, the deadline for appealing to court against the decision on imposing (or not imposing) sanctions for a tax offense shall be calculated from the day when the taxpayer (tax agent, levy payer) became aware that the decision had entered into force.</p> <p>Article 100. Documenting the results of a tax audit</p> <p>Clause 6. Where a person in relation to whom a tax audit has been performed (or his representative) disagrees with facts stated in the tax audit report or with the conclusions</p>	<p>Article 141. Repealed. - Federal Law No. 153-FZ of 2 July 2013.</p> <p>According to the amended clause 3 of Article 138 of the Russian Tax Code, starting from 3 August 2013 the time frame for a court appeal is calculated from when an appellant became aware of the decision adopted by the higher tax authority on the appeal, or from when the term for consideration of this appeal expired. Until 1 January 2014, this provision applies only to appeals against decisions on imposing (not imposing) sanctions adopted under Article 101 of the Tax Code (Article 3, clause 3 of Federal Law No. 153-FZ of 2 July 2013).</p> <p>Article 100. Documenting the results of a tax audit</p> <p>Clause 6. Where a person in relation to whom a tax audit has been performed (or his representative) disagrees with facts stated in the tax audit report or with the conclusions and recommendations of the</p>

Topic	Description	Status in October 2012	Status in October 2013
		<p>and recommendations of the inspectors, that person may, within 15 days after receiving the tax audit report, present to an appropriate tax authority written objections to the report in whole or to its certain statements. The taxpayer shall be entitled to supplement written objections with supporting documents (or their notarized copies) or to submit such documents to the tax authorities within a specified time frame.</p> <p>Article 101.4. Legal proceedings in respect of tax offenses envisaged by this Code</p> <p>Clause 5. In the event that a person who has committed a tax offense disagrees with facts stated in the report or with the conclusions and recommendations of the official who identified the tax offense, that person may, within 10 days from receiving the report, present to an appropriate tax authority written objections to the report in whole or to its certain statements. The person shall be entitled to supplement written objections with supporting documents (or their notarized copies) or to submit such documents to the tax authorities within a specified time frame.</p>	<p>inspectors, that person may, within one month after receiving the tax audit report, present to an appropriate tax authority written objections to the report in whole or to its certain statements. The taxpayer shall be entitled to supplement written objections with supporting documents (or their notarized copies) or to submit such documents to the tax authorities within a specified time frame.</p> <p>(as amended by Federal Law No. 248-FZ of 23 July 2013)</p> <p>Article 101.4. Legal proceedings in respect of tax offenses envisaged by this Code</p> <p>Clause 5. In the event that a person who has committed a tax offense disagrees with facts stated in the report or with the conclusions and recommendations of the official who identified the tax offense, that person may, within one month after receiving the report, present to an appropriate tax authority written objections to the report in whole or to its certain statements. The person shall be entitled to supplement written objections with supporting documents (or their notarized copies) or to submit such documents to the tax authorities within a specified time frame.</p> <p>Transitional provisions: if the terms envisaged by Article 100, clause 6, and Article 101.4, clause 5 of the Russian Tax Code (one month) do not expire before the date this law comes into effect (Article 6, part 1 of Federal Law No. 248-FZ of 23 July 2013), the terms shall be determined according to the new rules.</p>

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			<p>Clause 11 of Article 101.4 of the Russian Tax Code was repealed. According to that norm, a copy of the decision adopted by the head of the tax authority was either handed to the person who committed a tax offense against signature, or delivered in a way which showed the date when the document was received by the person in question. Where the person evaded receiving a copy of the decision, it was sent to him by registered mail.</p>
	<p>10. Informing about the participation in Russian and foreign organizations</p>	<p>Article 23. Obligations of Taxpayers (Levy Payers)</p> <p>Taxpayers - entities and individual entrepreneurs should inform tax authorities at the location of an entity or at the place of residence of an individual entrepreneur:</p> <ul style="list-style-type: none"> - about all cases of participation in Russian and foreign organizations - not later than one month from the date of participation, - about reorganization or liquidation of an entity - within three days from the date of relevant decision. 	<p>Article 23. Obligations of taxpayers (levy payers)</p> <p>Taxpayers - entities and individual entrepreneurs should inform tax authorities at the location of an entity or at the place of residence of an individual entrepreneur about all cases of participation in Russian organizations (except for participation in business entities and limited liability companies) and foreign organizations - not later than one month from the date of participation.</p> <p>The clause concerning reorganization and liquidation is no longer in force.</p>
	<p>11. Tax obligations of banks</p>	<p>As of 1 January 2012, the banks open accounts for organizations and individual entrepreneurs and give them the right to use the corporate electronic means of payment for electronic cash transfers only when a certificate of registration with the tax authority is presented.</p> <p>A bank is obliged to provide information on the granting of the right to or the termination of the right of an organization or an individual</p>	<p>New clause 4.1 has been added to Article 46 of the Russian Tax Code. Pursuant to the clause, the instruction to debit and transfer cash from taxpayers' (tax agents') accounts is suspended based on the following:</p> <ul style="list-style-type: none"> - Tax authority decision, where a decision is made to suspend payment of the amount due for the period when an application for a deferral of tax payment is reviewed

Topic	Description	Status in October 2012	Status in October 2013
		<p>entrepreneur to use corporate electronic means of payment for electronic cash transfers, and on a change in the details of the corporate electronic means of payment in electronic form, to the tax authority at its location within three days from the date of the relevant event.</p> <p>The rules set forth in this article are also applied to the investment partnership's accounts.</p>	<ul style="list-style-type: none"> - Receipt from an enforcement officer of a resolution to arrest cash with bank, including electronic cash - Decision of higher tax authority in cases set forth in the Russian Tax Code. <p>In these cases, an instruction to transfer electronic cash is also suspended.</p> <p>The instruction is renewed based on tax authority decision to cancel suspension.</p> <p>In addition, the new clause includes an exhaustive list of grounds to withdraw instructions that have not been executed fully or partially. In particular, an instruction is withdrawn in the following cases:</p> <ul style="list-style-type: none"> - due date for paying taxes, levies, penalties or fines has changed, - fulfillment of obligations set forth in the Russian Tax Code to pay interest on taxes, levies, penalties or fine, and in case of overpayment offsetting, - decrease in the amount of taxes, levies, penalties resulted from filing an adjusted tax return.
	<p>12. An obligation to file a tax return</p>	<p>The name of Article 119 of the Russian Tax Code has changed:</p> <p>Article 119. Failure to present a tax declaration (calculation of the investment partnership's financial result).</p> <p>(as amended by Federal Law No. 336-FZ of 28 November 2011)</p>	

Topic	Description	Status in October 2012	Status in October 2013
		<p>Clause 2 was added to Article 119:</p> <p>Failure by the managing partner responsible for maintaining tax accounting to submit the calculation of the investment partnership's financial result to the tax authority at the place of registration within the time limits set by the tax and levy legislation</p> <p>shall entail a fine of RUB1,000 for every full or incomplete month from the day set for its submission.</p> <p>(clause 2 was introduced by Federal Law No. 336-FZ of 28 November 2011)</p> <p>Article 119.2 was added to the Russian Tax Code.</p> <p>Submission of a calculation of the investment partnership's financial result with inaccurate information by the managing partner responsible for maintaining tax accounting to the tax authority</p> <p>(introduced by Federal Law No. 336-FZ of 28 November 2011)</p> <p>1. The submission of a calculation of the investment partnership's financial result with inaccurate information by the managing partner responsible for maintaining tax accounting to the tax authority shall entail a fine of RUB40,000.</p> <p>2. The same actions performed intentionally shall entail a fine of RUB80,000.</p> <p>Article 80. Tax Return</p>	<p>Article 80. Tax Return</p> <p>Information on the average number of employees for</p>

Topic	Description	Status in October 2012	Status in October 2013
		<p>Information on the average number of employees for the preceding calendar year is submitted to the tax authority by a taxpayer before 20 January of the current year, and in case an entity has been established (reorganized) - not later than on the 20th day of the month following the month of establishment (reorganization). This information is submitted to a tax authority at the location of an entity (at the place of residence of an individual entrepreneur) according to the form approved by the federal executive body authorized to exercise control and oversight in the field of taxes and levies.</p>	<p>the preceding calendar year is submitted to the tax authority by an entity (individual entrepreneur who employed people during this period) before 20 January of the current year, and in case an entity has been established (reorganized) - not later than on the 20th day of the month following the month of establishment (reorganization). This information is submitted to a tax authority at the location of an entity (at the place of residence of an individual entrepreneur) according to the form approved by the federal executive body authorized to exercise control and oversight in the field of taxes and levies.</p>
	<p>13. Obligation to provide accounting (financial) statements</p>	<p>Article 23. Obligations of Taxpayers (Levy Payers)</p> <p>1. Taxpayers are obliged to:</p> <p>5) present a book of income and expenses and business transactions to the tax authority at the place of residence of an individual entrepreneur, a privately practicing notary or a lawyer who has founded a legal office; present accounting statements to the tax authority at the location of an entity in accordance with the Federal Law "On Accounting", except for the cases when entities, pursuant to the above law, are not obliged to maintain accounting records or are exempt from it;</p> <p>(as amended by Federal Law No. 229-FZ of 2 July 2010)</p>	<p>Article 23. Obligations of Taxpayers (Levy Payers)</p> <p>1. Taxpayers are obliged to:</p> <p>5) present a book of income and expenses and business transactions to the tax authority at the place of residence of an individual entrepreneur, a privately practicing notary or a lawyer who has founded a legal office; present annual accounting (financial) statements not later than three month after a reporting year except for the cases when, pursuant to Federal Law No. 402-FZ "On Accounting" of 6 December 2011, an entity is not obliged to maintain accounting records;</p> <p>(Clause 5 as amended by Federal Law No. 97-FZ of 2 July 2012)</p>

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	<p>14. Time frames for fulfilling tax payment demands</p>	<p>Article 69. Demand for Payment of a Tax or Levy</p> <p>A tax payment demand should include the information about tax payable, penalties incurred as of the date of the demand, tax payment date, as set forth in tax and levy legislation, deadline for demand fulfillment, and about measures to collect taxes and ensure fulfillment of tax obligations that are taken when a taxpayer fails to fulfill the demand.</p> <p>Article 70. Time frame for Sending a Demand for Payment of a Tax or Levy</p> <p>A tax payment demand developed based on a tax audit should be sent to a taxpayer (a responsible member of a consolidated group of taxpayers) within 10 days from the date when a relevant decision comes into force.</p> <p>A tax payment demand should be sent to a taxpayer (a responsible member of a consolidated group of taxpayers) not later than three months from the date when tax deficiency has been discovered, unless otherwise stated in Clause 2 hereof.</p>	<p>Article 69. Demand for Payment of a Tax or Levy</p> <p>A tax payment demand should include the information about tax payable, penalties incurred as of the date of the demand, deadline for demand fulfillment, and about measures to collect taxes and ensure fulfillment of tax obligations that are taken when a taxpayer fails to fulfill the demand. A tax payment demand should also include the information about tax payment date as set forth in tax and levy legislation.</p> <p>(as amended by Federal Law No.154-FZ of 9 July 1999 and Federal Law No.248-FZ of 23 July 2013)</p> <p>Article 70. Time frame for Sending a Demand for Payment of a Tax or Levy</p> <p>A tax payment demand developed based on a tax audit should be sent to a taxpayer (a responsible member of a consolidated group of taxpayers) within 20 days from the date when a relevant decision comes into force.</p> <p>A tax payment demand should be sent to a taxpayer (a responsible member of a consolidated group of taxpayers) not later than three months from the date when tax arrears has been discovered, unless otherwise stated herein. In case the amount of arrears and relevant fines and penalties does not exceed RUB500, a tax payment demand should be sent to a taxpayer within one year from the date when tax arrears has been discovered, unless otherwise stated in Clause 2 hereof.</p> <p>(as amended by Federal Law No. 248-FZ of 23 July 2013)</p>

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	15. Electronic document flow	The forms and formats of the documents which are stipulated in the Tax Code and are used by the tax authorities when exercising their powers in the relations governed by tax and levy legislation as well as the procedure for completing the forms of those documents and the procedure for submitting such documents electronically by the telecommunications channels are approved by the federal executive body authorized to exercise control and oversight in relation to taxes and levies if some other procedure for approving them is not set forth in the Tax Code.	The forms and formats of the documents which are stipulated in the Tax Code and are used by the tax authorities when exercising their powers in the relations governed by tax and levy legislation, documents required to ensure document flow in the relations governed by tax and levy legislation, as well as the procedure for completing the forms of those documents and the procedure for submitting and receiving such documents in hard copy or electronically by the telecommunications channels are approved by the federal executive body authorized to exercise control and oversight in relation to taxes and levies if some other federal executive body is not authorized to approve them as set forth in the Tax Code. (Clause 4 as amended Federal Law No. 248-FZ of 23 July 2013)
	16. Registration specifics for certain taxpayers	Article 83. Registration of Organizations and Individuals, Clause 5 For the purposes of this article the location of assets shall be: 2) vehicles not specified in Sub-clause 1 hereof - place of State Registration, or, where such place does not exist - the location (place of residence) of assets owner.	Article 83. The clause relating to registration of organizations and individuals has been supplemented as follows: Clause 1.1 has been added: Management companies of closed-end mutual funds that provide trust management of immovable property of these funds should be registered with tax authorities at the location of this immovable property. The registration of a Russian organization with tax authorities at the location of the organization, its branch or representative office, the registration of a foreign non-commercial non-government organization at the location of its operations in the Russian Federation through its subdivision, and the registration of an individual entrepreneur at the place

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			<p>of residence is performed based on the information in the Unified State Register of Legal Entities and in the Unified State Register of Individual Entrepreneurs, respectively.</p> <p>(Clause 3 as amended Federal Law No. 229-FZ of 2 July 2010)</p> <p>The following paragraphs have been added to Clause 4.1:</p> <p>Where an organization is a foreign entity arranging the Sochi 2014 XXII Olympic Winter Games and XI Paralympic Winter Games pursuant to Clause 3 of this Federal Law, and activities associated with the arranging and hosting the Sochi 2014 XXII Olympic Winter Games and XI Paralympic Winter Games within the period that does not exceed 12 months and includes, fully or partially, the period of performance of the Sochi 2014 XXII Olympic Winter Games and XI Paralympic Winter Games as stated in Article 2.2 of this Federal Law, such organization is registered with tax authorities based on a notification sent by such organization to a tax authority.</p> <p>(the paragraph was appended by Federal Law No.216-FZ of 23 July 2013)</p> <p>The form of the notification which is used as a basis for registration with tax authorities of an organization being a foreign marketing partner of the International Olympic Committee, official broadcasting company and/or a foreign entity arranging the Sochi 2014 XXII Olympic Winter Games and XI Paralympic Winter Games, is approved by a federal executive body authorized to exercise control in the field of taxes and levies.</p>

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			<p>Clause 4.2 has been added:</p> <p>When performing activities under FIFA (Federation Internationale de Football Association) by FIFA subsidiaries, FIFA counterparties, as well as by confederations, national football associations specified in the Federal Law "On Arranging and Hosting 2018 FIFA World Cup in the Russian Federation and Amending Certain Legislative Acts of the Russian Federation" that are foreign organizations operating through separate subdivisions in the Russian Federation, such organizations are registered with tax authorities based on notifications sent by the organizations to a tax authority.</p> <p>The form of the notification which is used as a basis for registration with tax authorities of the organizations specified in the first paragraph hereof, is approved by a federal executive body authorized to exercise control in the field of taxes and levies.</p> <p>Clause 4.3. has been added:</p> <p>An organization being a responsible member of a consolidated group of taxpayers is registered by the tax authority that, pursuant to Article 25.3 of the Tax Code, registered an agreement on the establishment of a consolidated group of taxpayers within five days from the date of registration. The notification about registration with tax authorities as a responsible member of a consolidated group of taxpayers is provided (sent) to the organization within the same period.</p> <p>Clause 4.4. has been added:</p> <p>An organization being a party to an investment partnership agreement and a managing partner in</p>

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			<p>charge of tax accounting is registered by the tax authority - where a copy of investment partnership agreement is sent - within five days from the date of receipt of the copy or notification about performing managing partner functions pursuant to Article 24.1 of the Tax Code. The notification about registration with tax authorities as a party to an investment partnership agreement and a managing partner in charge of tax accounting under the investment partnership agreement is provided (sent) to the organization within the same period.</p> <p>An organization being a party to an investment partnership agreement and a managing partner in charge of tax accounting is registered by the tax authority under each investment partnership agreement separately.</p> <p>Clause 5 has been amended:</p> <p>For the purposes of this article the location of assets shall be:</p> <p>2) vehicles not specified in Sub-clause 1 hereof - location (place of residence) of assets owner;</p> <p>Clause 8 is no longer effective.</p>
	17. Transfer pricing	<p>As of 1 January 2012, the Law reduces the list of controlled transactions. Controlled transactions will include mainly related party transactions and certain transactions between parties that are not related.</p> <p>Among foreign trade transactions, controlled transactions shall include the following operations:</p>	<p>For controlled transactions for which income and expenses must be recognized in 2012, the report filing deadline has been extended by six months. Taxpayers must file such a report not later than 20 November 2013 (Article 4, part 8.1 of Federal Law No. 227-FZ of 18 July 2011).</p> <p>The deadline for making a decision on the review of 2012 transactions for conformity with market prices has been also extended by six months. Such a</p>

Topic	Description	Status in October 2012	Status in October 2013
		<ul style="list-style-type: none"> - All transactions between related parties (without restrictions) - Transactions with third parties involving global trade exchange commodities which are included in the following commodity groups: oil and oil products, ferrous and nonferrous metals, mineral fertilizers, precious metals and precious stones, provided that the revenue from the transactions is over RUB60 million; - Transactions with third parties located in states (territories) in the so-called "black list", approved by the Russian Finance Ministry, provided that the revenue from the transactions is over RUB60 million. - As for non-foreign trade transactions, in case the RUB60 million threshold is surpassed, controlled transactions shall include the following operations between related parties: <ul style="list-style-type: none"> - a transaction in a commodity which is subject to mineral extraction tax at the <i>ad valorem</i> tax rate or - at least one party to the transaction is exempt from the taxpayer's obligations concerning corporate profits tax or applies the 0% rate in accordance with clause 5.1 of Article 284 of the Russian Tax Code, i.e., is a participant in the Skolkovo project or 	<p>decision must be made not later than 30 June 2014 (Article 4, part 8, paragraph 2 of Federal Law No. 227-FZ of 18 July 2011).</p> <p>In addition, new part 8.2 of Article 4 of Federal Law No. 227-FZ of 18 July 2011 stipulates that documents on controlled transactions for which income and expenses must be recognized in 2012 may be requested from the taxpayer not earlier than 1 December 2013 (Article 105.15, clause 1 of the Russian Tax Code).</p> <p>Provisions of the Tax Code governing the verification of calculation and payment of tax on related party transactions apply to transactions for which income and expenses are recognized as stipulated by Charter 25 of the Russian Tax Code starting 1 January 2012 irrespective of the relevant agreement date (Article 4, part 5 of Federal Law No. 227-FZ of 18 July 2011). Now there is an exception to this rule.</p> <p>The mentioned provisions of the Russian Tax Code do not apply to agreements on loans (including commodity and commercial loans), sureties and bank guarantees which were entered into before 1 January 2012 and for which income and expenses are to be recognized after this date. But this is valid only when conditions of such agreements have not been amended after 1 January 2012. The new rule established by Article 4, part 5.1 of Federal Law No. 227-FZ of 18 July 2011 applies to relationships arising since 1 January 2012 (Article 5, part 4 of Federal Law No. 39-FZ of 5 April 2013).</p> <p>Thus, the mentioned transactions cannot be tested</p>

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		<ul style="list-style-type: none"> - at least one of the parties is a resident of the special economic zone (such transactions will be controlled only from 2014). <p>As of the beginning of 2014, when the threshold of RUB100 million in transactions within Russia is surpassed, controlled transactions shall include operations between related parties if one of the parties to a transaction is a taxpayer who uses one of the following tax regimes: unified tax on imputed income for certain activities or unified agricultural tax (if a transaction is within the scope of the relevant activity).</p> <p>Other transactions between related parties within Russia shall be controlled if the revenue from all such transactions exceeds RUB3 billion. In this respect, some of these transactions will not be deemed controlled if the parties to a transaction are participants in the unified consolidated taxpayer group (after the relevant law enters into force), and also when all the following occur at the same time:</p> <ul style="list-style-type: none"> - The parties to a transaction are registered in one constituent entity of the Russian Federation, and they <ul style="list-style-type: none"> - have no subdivisions in other constituent entities of the Russian Federation, and - do not pay profit tax to the budgets of other constituent entities of the Russian Federation, and 	<p>for conformity with market prices.</p>

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		<ul style="list-style-type: none"> - have no losses which are taken into account when profit tax is calculated. - There are no other grounds for control than those mentioned above (for which the threshold used is RUB60 million or 100 million). <p>Related parties</p> <p>Related parties will be defined more broadly. The law has several criteria whereby companies and individuals may be considered related. The key criterion, however, is still equity interest, when one organization (jointly with its related entities) directly and (or) indirectly participates in another organization and the portion of such participation is over 25% (it is now 20%). In this respect, the law indicates that Russian state participation in the organizations is not in itself grounds for regarding such organizations as related.</p> <p>The law also indicates that, by taking account of the facts, the court is entitled to recognize organizations and (or) individuals as related parties on other grounds if it is proved that influence is exerted on the terms or results of transactions due to the relations between the entities.</p> <p>Methods</p> <p>The law provides for five methods for determining the market price, which are similar to those used in international practice. The comparable market price method (CMP)</p>	

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		<p>will prevail, while the profit split method will be used only when other methods cannot be applied. In addition, taxpayers will be able to use other methods in addition to the five methods set forth in the law.</p> <p>All the five methods provided for by the law are briefly described below:</p> <ol style="list-style-type: none"> 1. To apply the CMP method, it is enough for at least one transaction to meet the criteria of comparability, provided that the seller in the comparable transaction does not dominate the market. 2. The resale price method will be applied to determine the market price at which the buyer acquires goods from a related party and sells them to an independent party. When that method is used, the gross margin resulting from resale within the limits of a controlled transaction should be compared with the market profit margin established in relation to the information on non-controlled comparable transactions. 3. The cost method will be used largely for transactions related to providing services, except in instances when they involve intangibles which have a considerable impact on profitability. In this respect, the gross profitability of costs of the tested party is compared to the market profit margin range. 4. The comparable profits method (CPM) can be used, for instance, when it is impossible to adequately compare financial accounting data 	

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		<p>and reliably determine the profit margin range as may be done using the resale price method and the cost method. When using this method, a tested party should be represented by a company which, compared to the other party to the transaction, performs less functions, assumes less economic (commercial) risks and has no intangibles which have a significant influence on the profit margin level.</p> <p>To apply that method, the following profitability indicators can be used: sales margin, gross profit margin of commercial and management costs (if the reseller bears insignificant commercial risks), cost margin and the return on assets.</p> <p>When using the CPM method, other profitability indicators can be used, provided that their use is justified based on functional analysis.</p> <p>5. The profit distribution method is used when other methods cannot be used and when the parties to a transaction co-own intellectual property.</p> <p>Two types of that method can be used: the distribution of gross profit and the distribution of net profit. The profit is split between the parties to a controlled transaction based on the evaluation of the parties' contribution to the gross profit from the tested transaction by assessing the following criteria:</p> <ul style="list-style-type: none"> - Costs incurred by a party to a controlled transaction with regard to construction of 	

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		<p>unique intangible assets, the usage of which directly affects the actual sales profit under the controlled transaction</p> <ul style="list-style-type: none"> - Number of employees that directly affects the actual sales profit under the controlled transaction; and - Market value of assets, the usage of which directly affects the actual sales profit under the controlled transaction - Other indicators that reflect the interrelation between functions, assets, risks and the amount of profit received. <p>If the above mentioned methods do not make it possible to identify whether the price of a single transaction complies with the market price, such compliance may be identified based on the market value of the subject of the transaction calculated during an independent appraisal.</p> <p>Market price range (profit margin range)</p> <p>The law abolishes the permitted deviation of 20% from the market price and introduces a market price range instead. A statistical approach similar to that used in the majority of other OECD states will be used to calculate a market price range.</p> <p>To calculate a market price range for the purposes of CMP method application, at least one comparable transaction is required. To calculate a profitability range for the purposes of the subsequent sale price method, cost</p>	

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		<p>method and comparable profit method, at least four comparable entities are required (ideally).</p> <p>If less than four comparable entities are available, the search limit can be extended to analyze functionally comparable companies. In addition, ownership interest may be increased from 25% to 50% in order to facilitate the search for additional comparable companies. If, despite all measures taken, the number of comparable companies is still less than four, the range can be calculated based on the information available.</p> <p>The law also provides for adjustment of profitability indexes in order to account for differences in payables and receivables and in inventories between comparable companies and a taxpayer.</p> <p>The law provides for the taxpayers' right to adjust their tax liabilities at their own discretion, if prices used in a controlled transaction differ from market prices. However, the law does not entitle the taxpayers to adjust prices or change markups, if a taxpayer's profit margin is outside the market profit margin range.</p> <p>Sources of information</p> <p>When checking transaction prices for conformity with market prices, both the tax authorities and the taxpayers are required to use only publicly available sources of information. The following sources of</p>	

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		<p>information may be used for these purposes:</p> <ul style="list-style-type: none"> - information on global exchange trade prices and quotations (applicable for global exchange-traded commodities), - customs data published by the Federal Customs Service, - information on prices and exchange quotations obtained from the following sources: <ul style="list-style-type: none"> - authorized governmental agencies, - official information sources of foreign states, - international organizations. - published and (or) publicly available materials and information systems, - information from agencies that provide information on prices, - information on transactions provided by the taxpayer, - data from the organizations' financial statements and statistical reports. Data provided by foreign organizations may be used only when it is impossible to use data provided by Russian organizations, - information on the market value of the appraisal targets determined by an independent appraiser, and - other information that may be used to determine the market price range and 	

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		<p>profit margin using the permitted TP methods.</p> <p>When transaction prices are reviewed for conformity with the market prices, use may not be made of the information classified as a tax secret as well as any other information access to which is restricted by the laws of the Russian Federation (excluding information on a taxpayer being audited).</p> <p>Reporting controlled transactions</p> <p>Taxpayers will be required to file a report with the tax authorities on controlled transactions which they performed if the total income from the transactions completed by the taxpayer with one party during a calendar year exceeds RUB100 million. Such a report should be filed with the tax authorities not later than the 20th of May of the year following the calendar year in which the controlled transactions were completed.</p> <p>4 That amount will be reduced to RUB80 million in 2013. In 2014, the restriction will be lifted.</p> <p>Reports on controlled transactions are to contain information on the subject of a transaction, its parties, and income received from or expenses incurred in a controlled transaction.</p> <p>TP documentation requirements</p> <p>In accordance with the law, taxpayers will be required to prepare documents in arbitrary</p>	

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		<p>form with a substantiation of the pricing methodology used for controlled transactions if the total income from all the controlled transactions performed by the taxpayer with one party during a calendar year exceeds RUB100 million. The taxpayer should file such documents with the tax authorities within 30 days after receiving the relevant request. However, such a request may not be made before the first of June of the year following the calendar year in which the controlled transactions were performed.</p> <p>The documents will not be required for foreign trade transactions with independent entities, transactions where prices match regulated prices or are in line with the anti-monopoly authorities' requirements (as specified by the law for such transactions), transactions involving securities and financial futures traded on the organized securities market, as well as transactions in respect of which a pricing agreement has been entered into.</p> <p>In the event of all transactions with related parties, taxpayers will be obliged to prepare documents in the form generally used in countries with an advanced system of control over transfer pricing. The documents should have a functional analysis of the parties to a controlled transaction (provided that the analysis was made by the taxpayer), information on the organizational structure of the taxpayer, a description of the transaction terms, a substantiation of the choice of the transfer pricing method and the information</p>	

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		<p>sources used, a calculation of the market price range and adjustments to the tax base made by the taxpayer.</p> <p>Symmetrical adjustments</p> <p>Where the tax authorities establish that the price of a controlled transaction does not match the relevant market price and decide that the tax base of one of the parties to the transaction should be increased, the other party will be entitled to implement a symmetric adjustment, i.e., reduce the tax base with regard to the adjusted price (taxpayers will not be able to make such adjustments at their discretion).</p> <p>Such adjustments will be permitted only for Russian organizations and only in respect of the transactions performed in Russia.</p> <p>Pricing agreement</p> <p>The law introduces a provision on pricing agreements. Starting 1 January 2012, taxpayers may file an application for concluding a pricing agreement which outlines the pricing procedure or pricing methods for a controlled transaction. The law also clarifies that the right to enter into a pricing agreement will be granted to taxpayers classified as major taxpayers. Foreign companies will not be allowed to enter into pricing agreements.</p> <p>The application for concluding a pricing agreement will be handled within nine months. Agreements will be entered into for a</p>	

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		<p>period of up to three years with an option to be extended for two years.</p> <p>The law also provides for the conclusion of a multilateral pricing agreement in respect of a foreign trade transaction, given that a party to the transaction is a tax resident of a foreign state with which there is a double taxation treaty (agreement).</p> <p>Pricing agreements will be effective from 1 January of the year following the year in which they were signed (unless otherwise provided by the agreement). But an agreement may also cover prior periods, namely it may be effective starting from the date on which the taxpayer filed a report on its conclusion or before its effective date.</p> <p>Penalties</p> <p>Penalties for the failure to pay tax resulting from the use of non-market prices will not be applied in respect of the years 2012 and 2013. According to a provision of the law that will take effect in 2014, such non-payment will be penalized by a fine totaling 20% of the amount of additional tax. Starting 2017, the fine will increase to 40% of the amount of additional tax, but at least RUB30,000. Penalties are not applied if the prices have been set under a pricing agreement or if the taxpayer has submitted documents justifying the use of market prices.</p>	

Topic	Description	Status in October 2012	Status in October 2013
	<p>18. Recovery of delinquent taxes through collection of the organization's property</p>	<p>Article 77 Property lien</p> <p>Clause 3. A lien may be applied only for the purpose of recovering tax, penalties and interest through the collection of the corporate taxpayers' property, as stipulated in Article 47 of the Russian Tax Code.</p> <p>Clause 3.1. The decision to put a lien on property co-owned by partners and property of managing partners may be made only after the decision to recover tax through the collection of the mentioned individuals' property has been made.</p> <p>Clause 13. The lien on property is revoked by an authorized tax or customs officer after the liability to pay tax, penalties and interest is</p>	<p>Article 77. Property lien</p> <p>Clause 3. A lien may be applied only for the purpose of recovering tax, penalties and interest through the collection of the corporate taxpayer's property and only after tax authorities have made the decision to recover the tax, penalties and interest in accordance with Article 46 of the Russian Tax Code and when the corporate taxpayer has no or insufficient cash on its accounts or digital funds or no information is available about its accounts or details of its corporate electronic payment facilities used for electronic funds transfer.</p> <p>(clause 3 as amended by Federal Law No. 248-FZ of 23 July 2013)</p> <p>Clause 3.1. The decision to put a lien on property co-owned by partners and property of managing partners may be made only after the decision to recover the tax, penalties and interest in accordance with Article 46 of the Tax Code has been made and when the investment partnership or individuals representing managing partners have no or insufficient cash on their accounts or no information is available about their accounts.</p> <p>Clause 12.1. At the request of a corporate taxpayer that faces a lien on its property, tax authorities may replace the lien with a property pledge agreement as stipulated in Article 73 of the Tax Code.</p> <p>(clause 12.1 introduced by Federal Law No. 248-FZ of 23 July 2013)</p> <p>Clause 13. The lien on property is revoked by an authorized tax or customs officer after the liability to pay tax, penalties and interest is discharged or a</p>

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		discharged.,	property pledge agreement is signed in accordance with Article 73 of the Tax Code. (as amended by Federal Laws No. 137-FZ of 27 July 2006, No. 248-FZ of 23 July 2013)
	19. Declaring debt non-collectible	<p>1. Outstanding arrears, penalties and interest due from taxpayers, levy payers and tax agents are declared non-collectible when their payment and (or) collection has proved impossible in the following cases:</p> <p>1) A legal entity is liquidated in accordance with Russian legislation while its outstanding arrears, penalties and interest have not been settled because this organization does not have sufficient property and (or) its founders (participants) are not able to settle them to the extent and in accordance with the procedure established by Russian legislation.</p> <p>2) An individual entrepreneur is declared bankrupt in accordance with Federal Law No. 127-FZ of 26 October 2002, On Bankruptcy, while its outstanding arrears, penalties and interest have not been settled because the individual does not have sufficient property.</p> <p>3) An individual has died or been declared dead in accordance with the procedure established by Russian civil procedure laws while there are unsettled taxes and levies, including taxes specified in Article 14, clause 3 and Article 15 of the Tax Code, which exceed the value of the individual's inheritable property, even if the Russian Federation become the owner of such</p>	Federal Law No. 153-FZ of 2 July 2013 extended the list of cases when outstanding arrears, penalties and interest are declared non-collectible. According to new sub-clause 4.1 of clause 1 of Article 59 of the Russian Tax Code, outstanding arrears will be declared non-collectible if a court bailiff issues a decision to close the enforcement proceedings due to the impossibility of recovering such arrears. Herewith, two more conditions should be met. Firstly, the arrears must remain outstanding for five years since they arose. Secondly, their amount with outstanding penalties and interest included must not exceed the minimum amount of debt that makes authorities eligible to open a bankruptcy case against the debtor, as stipulated by Russian bankruptcy legislation.

Topic	Description	Status in October 2012	Status in October 2013
		<p>property.</p> <p>4) A court issues a decision that makes it impossible for tax authorities to collect outstanding arrears, penalties and interest due to the expiration of the established statute of limitations for such collection, including a refusal to allow filing a court claim for the collection of outstanding arrears, penalties and interest past the statute of limitations.</p> <p>5) Other cases stipulated by Russian tax legislation.</p>	
	20. Deflator		<p>Clause 2 of Article 11 of the Russian Tax Code that lists terms used for tax legislation purposes was amended to include a new term, deflator. This ratio is established every year for the next calendar year and calculated by multiplying the deflator used in the previous year by a ratio measuring changes in consumer prices of goods (work, services) in the Russian Federation in the previous calendar year. The correcting deflator is used for purposes of personal income tax, unified tax on imputed income, and taxes paid under the STS and license-based taxation system.</p> <p>According to the general rule established by clause 2 of Article 11 of the Russian Tax Code, deflators are established by the Russian Ministry of Economic Development based on data of official statisticians and must be officially published in the newspaper <i>Rossiyskaya Gazeta</i> not later than the 20th of November of the year in which they were established. It should be noted that deflators for STS and</p>

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			licensed-based taxation system purposes were established by part 4 of Article 8 of Federal Law No. 94-FZ of 25 June 2012 at one.
2. VAT	1. Determination of tax base	<p>Article 154 Determination of the tax base in connection with the sale of goods (work, services).</p> <p>Clause 10</p> <p>The tax payer includes an upward revision of the cost (net of tax) of goods shipped (work performed, services rendered), property rights transferred, which has been caused, inter alia, by an increase in the price (rate) and (or) quantity (volume) of the goods (work, services) and the property rights, in the tax base for the tax period in which the goods were shipped (the work was performed, the services were rendered), the property rights were transferred.</p>	<p>Article 154 Determination of the tax base in connection with the sale of goods (work, services).</p> <p>New paragraph, 2.1, was added</p> <p>A bonus (incentive payment) that the seller of goods (work, services) pays (provides) to a buyer for the fulfillment of specific conditions of the contract for the supply of goods (work, services), including the purchase of a specific quantity of goods (work, services), is not deductible by the seller for tax base purposes (and by the buyer as part of applicable tax deductions) from the cost of the goods shipped (work performed, services rendered) unless the deductibility of the bonus (incentive payment) from the cost of goods (work, services) is provided for in this contract.</p> <p>Clause 10 was amended:</p> <p>The taxpayer includes an increase in the cost (net of tax) of goods shipped (work performed, services rendered) and property rights transferred, which has been caused, inter alia, by an increase in the price (rate) and (or) the quantity (volume) of the goods (work, services), the property rights, in the tax base for the tax period in which documents supporting correcting invoices, as specified in clause 10 of Article 172 of the Tax Code, were issued.</p> <p>(clause 10 as amended by Federal Law No. 39-FZ of 5 April 2013)</p>

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	<p>2. Tax benefits</p>	<p>The VAT benefit in respect of pedigree livestock was applied only when it was leased under a hire purchase contract (Article 26.3 of Federal Law No 118-FZ of 5 August 2000).</p> <p>Importation of pedigree cattle, pigs, sheep and goats, semen and embryos of these animals, pedigree horses and pedigree ova into the customs territory of the Russian Federation was exempt from VAT in the period between 1 January 2007 and 1 January 2012 (Article 26.1 of Federal Law No. 118-FZ of 5 August 2000, clause 1 of Article 1 of Federal Law No. 92-FZ of 24 June 2008). In 2012, there was no such VAT benefit in place.</p> <p>Sales of margarine are taxable at a tax rate of 10% (Article 164, clause 2, sub-clause 1, paragraph 7 of the Russian Tax Code).</p> <p>Not subject to VAT:</p> <ul style="list-style-type: none"> - Effective 1 January 2012, real estate property may be transferred to replenish special-purpose capital of non-commercial entities (part 3 of Article 4 of this Law) Therefore, starting the date specified above, both funds transferred for the formation of special-purpose capital of non-commercial entities and real estate property transferred to replenish the capital are not subject to VAT (Article 146, clause 2, sub-clause 8 of the Russian Tax Code). If such transfer of real estate property takes place, the donor shall restore the amounts of VAT 	<p>On 1 January 2013, clause 2 of Article 164 of the Russian Tax Code was amended to include sub-clause 5 reading that sales of pedigree livestock (including pigs, sheep, goats and horses), semen and embryos of these animals as well as ova are subject to VAT at a rate of 10%. This provision is effective until and including 31 December 2017 (clause 3 of Article 3 of Federal Law No. 161-FZ of 2 October 2012).</p> <p>Importation of pedigree livestock (including pigs, sheep, goats and horses), semen and embryos of these animals as well as ova is also subject to VAT at a rate of 10% (Article 164, clause 5, clause 2, sub-clause 5 of the Russian Tax Code).</p> <p>Starting 1 January 2013, sales of not only margarine, but also fat for special use (cooking, confectionery and bakery fat), milk butter substitutes, analogues, cacao butter improvers and substitutes, spreads and melted mixes are subject to VAT at a rate of 10% in accordance with Article 164, clause 2, sub-clause 1, paragraph 7 of the Russian Tax Code.</p>

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		<p>relating to such property, which were previously deducted (Article 170, clause 3, sub-clause 1 of the Russian Tax Code).</p> <ul style="list-style-type: none"> - Effective 1 January 2012, certification services for maintenance inspection operators, maintenance inspection services rendered by maintenance inspection operators in accordance with legislation governing maintenance inspection of vehicles (Federal Law No. 170-FZ of 1 July 2011). - Effective 1 January 2012, special-purpose funds received from a territorial fund of compulsory medical insurance by medical insurance companies participating in the compulsory medical insurance program (Federal Law No. 313-FZ of 29 November 2010). In connection with the compulsory health insurance reform, Article 149, clause 7, sub-clause 3 of the Russian Tax Code was amended to exempt insurance, coinsurance and reinsurance services rendered by insurance companies from VAT. At present, such operations include receipt of funds by medical insurance companies (participating in the compulsory medical insurance program) from a territorial fund of compulsory medical insurance, if such funds: <ul style="list-style-type: none"> - are special-purpose funds and transferred under an agreement on 	

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		<p>compulsory medical insurance funding,</p> <ul style="list-style-type: none"> - are intended for expenses related to compulsory medical insurance services provided in accordance with the above mentioned agreement, - represent compensation for activities provided for in the agreement on compulsory medical insurance funding. <p>Effective 1 January 2012, work and services related to maintenance of marine and inland vessels in ports are not subject to VAT. In particular, this exemption covers vessels repair, port costs, port vessels services, pilotage.</p> <p>Effective 1 January 2012, this exemption also covers maintenance of mixed (sea-river) vessels.</p> <p>On 1 January 2012, Federal Law No. 335-FZ of 28 November 2011, On Investment Partnership, took effect. This law governs regular partnership agreements signed by several parties to engage in joint investment activities. Two new VAT benefits were also introduced.</p> <p>First, services related to the management of partners' common affairs are not subject to VAT (Article 149, clause 3, sub-clause 33 of the Russian Tax Code).</p> <p>Second, VAT exemption applies to the</p>	

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		<p>following (Article 149, clause 3, sub-clause 34 of the Russian Tax Code):</p> <ul style="list-style-type: none"> - transfer of property rights as contribution under an investment partnership agreement, - transfer of property rights to a partner in case of separation of a share of property co-owned by partners or in case of property partition (up to the amount of the contribution paid by such a participant). 	
	3. VAT-exempt operations	<p>Starting 1 January 2012, the performance of work (provision of services) by state institutions as well as budgetary and autonomous institutions under a state (municipal) contract funded by a subsidy out of the relevant treasury of the Russian budget system is also non-taxable (Article 146 of the Russian Tax Code, Federal Law No. 245-FZ of 19 July 2011).</p>	<p>Starting 1 January 2012, the performance of work (provision of services) by state institutions as well as budgetary and autonomous institutions is not subject to VAT, as stipulated by Article 146, clause 2, sub-clause 4.1 of the Russian Tax Code. Herewith, autonomous and budgetary institutions are exempt from VAT only when acting under a state or municipal contract funded by a subsidy out of the relevant treasury. On 8 April 2013, the mentioned provision was extended to cover relationships arising since 1 January 2011 (Article 3 of Federal Law No. 39-FZ of 5 April 2013). Therefore, such institutions may need to revise their 2011 tax liabilities.</p> <p>Sub-clause 29 of clause 3 of Article 149 of the Russian Tax Code has been amended. The amendments extended the list of suppliers of utilities that make management organizations, homeowners associations, building cooperatives and housing cooperatives eligible for the tax benefit on their resale. In particular, the list of utility providers, electricity and gas suppliers was extended to include hot and cold water supply and (or) sewage</p>

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		<p>According to Article 149, clause 3, sub-clause 29 of the Russian Tax Code, sales of utilities purchased by management organizations, homeowners associations, building cooperatives and housing cooperatives as well as other special-purpose consumer cooperatives from utility providers, electricity and gas suppliers were exempt from VAT.</p>	<p>companies.</p> <p>As stipulated by Article 149, clause 3, sub-clause 30 of the Russian Tax Code, regional operators (or local self-government bodies and (or) municipal budgetary institutions where applicable under the Russian Housing Code) are exempt from VAT on work performed (services rendered) by them in the capacity of technical supervisor of major repairs.</p> <p>Regional operators deduct for VAT purposes cash that they receive to form major repairs reserves for common property of apartment buildings. The relevant amendments were made to clause 3 of Article 162 of the Russian Tax Code.</p> <p>In accordance with new sub-clause 12.2 of clause 2 of Article 149 of the Russian Tax Code, the following services rendered in the securities, commodity and currency markets are exempt from VAT:</p> <ul style="list-style-type: none"> - Registrars, depositories (including special depositories and the central depository), dealers, brokers, securities managers, management companies of investment funds, mutual investment funds and non-state pension funds, clearing organizations and trade organizers acting on the basis of licenses to carry out the respective activities. - Services which are directly connected with the above-mentioned services if such services are included in a list established by the Government of the Russian Federation. This benefit may not be applied before such a list is established. - Services related to processing, monitoring and recording deliveries of goods made under

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			<p>commitments eligible for clearing by operators of goods deliveries that are certified in accordance with Federal Law No. 7-FZ of 7 February 2011, On Clearing and Clearing Activities.</p> <ul style="list-style-type: none"> - Services related to assuming commitments subject to inclusion in the clearing pool that are rendered by central counterparties based on licenses to engage in clearing activity or certificates provided in accordance with Federal Law No. 7-FZ of 7 February 2011, on Clearing and Clearing Activities. - Services related to supporting prices, supply, demand and (or) organized trading volumes that are rendered by market makers in accordance with Federal Law No. 325-FZ of 21 November 2011, On Organized Trading. <p>In addition, the clause was amended to specify that the VAT benefit established by Article 149, clause 3, sub-clause 2 of the Russian Tax Code for disability organizations as well as organizations and institutions established by such organizations does not apply to broker and other intermediate services not stipulated in Article 149, clause 2, sub-clause 12.2 of the Russian Tax Code.</p> <p>Starting 1 October 2013, VAT exemption applies to cultural and arts services rendered by the relevant establishments outside their permanent office (Article 149, clause 2, sub-clause 20 of the Russian Tax Code as last amended). As such this rule also applies to services related to exhibiting museum collections, showing performances, organizing concerts and other entertainments.</p>

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	4. VAT invoice	<p>On 26 December 2011, Decree of the Government of the Russian Federation No. 1137 (hereinafter, Decree No. 1137) came into force approving new VAT invoice forms. Decree No. 1137 was published in January 2012.</p> <p>Original and correcting VAT invoice forms do not differ from those used previously. Amendments are primarily concerned with new rules for the correction of VAT invoices: lines were inserted for stating serial numbers and correction dates.</p> <p>A currency line was also added.</p> <p>Consignor (principal) deducts VAT on purchased goods, work or services based on an intermediary's VAT invoice that contains information specified in the seller's VAT invoice.</p> <p>When goods, work, services or property rights are sold through separate subdivisions, the digital index of the relevant subdivision should be added to the VAT invoice serial number (applied within the entire entity) after a separator bar. The index is established by a formal directive on the entity's accounting policy.</p> <p>VAT invoices that do not comply with the established form and its fill-in rules are not registered in the purchase book.</p> <p>Pursuant to this, a taxpayer will not be able to deduct VAT under the VAT invoice that does not comply with requirements of Article 169 of the Tax Code of the Russian Federation and</p>	<p>On 1 July 2013, clause 5.2 of Article 169 of the Russian Tax Code was amended:</p> <p>A taxpayer may prepare a single correcting VAT invoice after a revision of the cost of goods shipped (work performed, services rendered), property rights transferred as per two or more VAT invoices prepared by this taxpayer previously.</p> <p>In accordance with the amendments, the single correcting VAT invoice should indicate the following:</p> <ul style="list-style-type: none"> - serial numbers and dates of all VAT invoices for which this single correcting VAT invoice is prepared (Article 169, clause 5.2, sub-clause 2 of the Russian Tax Code), - the volume of goods, work, services as per all invoices after and before its correction (Article 169, clause 5.2, sub-clause 5 of the Russian Tax Code), - the cost of goods, work, services as per all VAT invoices excluding and including VAT after and before the corrections (Article 169, clause 5.2, sub-clauses 8, 12 of the Russian Tax Code), - the difference between the details of the VAT invoices (Article 169, clause 5.2, sub-clause 12 of the Russian Tax Code). <p>(as amended by Federal Law of No. 39-FZ of 5 April 2013)</p>

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		<p>with the established form.</p> <p>At present, if an error is made when preparing a VAT invoice, the seller should submit a new VAT invoice carrying the same serial number and date and indicate the correction number and date in a special line (1a). When a VAT invoice is prepared for the first time, this line should be marked with the dash. The correcting VAT invoice should be signed by the director or chief accountant of the entity or by other authorized persons.</p> <p>It should be noted that if a VAT invoice must be corrected after correcting VAT invoices have been prepared; the new data should be included in a copy without regard to data indicated in the correcting documents.</p>	
3. Income tax	1. The procedure for recognizing income from sale of immovable property		According to paragraph 2 of the amended Article 271.3 of the Russian Tax Code, the date of receipt of income from sale of immovable property shall be deemed to be the date on which the immovable property is transferred to the person acquiring that property on the basis of a transfer deed or another document confirming the transfer of the immovable property.
	2. The procedure for recognizing expenses related to mobilization preparation work	Under Article 265.1.17 of the Russian Tax Code (in effect prior to 1 January 2010) non-sale expenses shall include expenses for the performance of mobilization preparation work which are not subject to refund from the budget.	Amendments were introduced to Article 265.1.17 and Article 256.1 of the Russian Tax Code. It is now established that the acquired (created) property related to mobilization capacities, shall be amortized in accordance with the general procedure (paragraph 4 of Article 256.1 of the Russian Tax Code). Besides, Article 265.1.17 of the Russian Tax Code prohibits recognizing as a lump sum expenses related to reconstructing, modernizing and technically

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			<p>upgrading assets classified as mobilization facilities. Such capital expenditures increase the cost of fixed assets and are written off through depreciation.</p> <p>It should be noted that the clarification regarding the inclusion of expenses which are not subject to refund from the budget in the expenses for performance of mobilization preparation work was removed from the Article 265.1.17 of Russian Tax Code.</p>
	<p>3. Tax rate</p>	<p>As of 1 January 2012, the tax rate shall be established at 0% for organizations which are residents of a technology development special economic zone (from 1 January 2012 through 1 January 2018) and organizations which are residents of a tourism and recreation special economic zone (from 1 January 2012 through 1 January 2023), which have been combined into a cluster by a decision of the Government of the Russian Federation (Article 284 of the Russian Tax Code)</p> <p>Pursuant to Article 2.1 of Federal Law No. 110-FZ of 6 August 2001, agricultural goods producers that meet the criteria laid down in Article 346.2, clause 2 of the Russian Tax Code, and fishing organizations that meet the criteria laid down in clause 2 and sub-clause 1 of clause 2.1 of Article 346.2 of the Russian Tax Code, and whose activity is not covered by UAT, could apply the 0% income tax rate until the end of 2012.</p> <p>According to clause 1.3 of Article 284 of the Russian Tax Code, in order to get the 0% tax rate, fishing organizations should meet the</p>	<p>The tax rate for agricultural goods producers that meet the criteria laid down in clause 2 of Article 346.2 of the Russian Tax Code and fishing organizations that meet the criteria laid down in clause 2 and sub-clause 1 of clause 2.1 of Article 346.2 of the Russian Tax Code, and whose activity is not covered by UAT and associated with the sale of agricultural products produced and processed by them, shall be established at 0% (clause 1.3 of Article 284 of the Russian Tax Code).</p> <p>Amendments were made to clause 1.3 of Article 284 of the Russian Tax Code. A fishing organization is now entitled to apply 0% income tax rate providing it</p>

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		<p>criteria laid down in clause 2 and sub-clause 1 of clause 2.1 of Article 346.2 of the Russian Tax Code. Pursuant to clause 2 of Article 346.2 of the Russian Tax Code, agricultural goods producers shall be understood, in particular, to be organizations which produce agricultural products, carry out the primary processing and sell those products, provided that income from the sale of agricultural products produced by them accounts for no less than 70% of the total income from the sale of goods (work and services) of such organizations.] When satisfying the criteria established in sub-clause 1 of clause 2.1 of Article 346.2 of the Russian Tax Code, town- or settlement-forming fishing organizations are recognized as agricultural goods producers.</p>	<p>meets the criteria laid down in sub-clause 1 or sub-clause 1.1 of clause 2.1 of Article 346.2 of the Russian Tax Code. In other words, now the fishing organization has the right to apply 0% income tax rate for activities associated with the sale of its catches (fish products and other products from aquatic biological resources) providing the organization is:</p> <ul style="list-style-type: none"> - a town- or settlement-forming organization (and satisfies the criteria established in sub-clause 1 of clause 2.1 of Article 346.2 of the Russian Tax Code) or - an agricultural production co-operative (and satisfies the criteria established in sub-clause 1.1 of clause 2.1 of Article 346.2 of the Russian Tax Code). <p>The amended provisions of clause 1.3 of Article 284 of the Russian Tax Code are extended to cover legal relations that emerged on or after 1 January 2013 (Article 3.3 of Federal Law No. 94-FZ of 7 May 2013).</p>
	<p>4. Depreciation calculation rules</p>	<p>As of January 2012, depreciable items used in research and (or) development constitute a subgroup within a depreciation group, and such depreciation groups and subgroups are recorded separately.</p> <p>(Article 258 as amended by Federal Law No. 132-FZ of 7 June 2011)</p>	<p>On 1 January 2013, clause 1 of Article 257 of the Russian Tax Code was amended to introduce special rules for determining the net book value of a fixed asset in relation to which the taxpayer used a depreciation premium. Instead of the historical cost of such a fixed asset, the taxpayer should now use the value that was recognized upon the inclusion of the asset in the relevant depreciation group (subgroup), i.e. the difference between the historical cost and the depreciation premium recognized within depreciation expenses (Article 258, clause 9, paragraph 3 of the Russian Tax Code). (The paragraph was introduced by Federal Law No. 260-FZ of 29 November 2012).</p>

Topic	Description	Status in October 2012	Status in October 2013
		<p>Article 258, clause 9, paragraph 4</p> <p>When fixed assets to which paragraph 2 of this clause applies are sold earlier than five years after being put into operation, expenses recognized within expenses in the next reporting (tax) period in accordance with paragraph 2 of this clause must be reversed and included in the tax base.</p> <p>Article 258, clause 11 of the Russian Tax Code: where rights to fixed assets are subject to state registration in accordance with Russian legislation, these fixed assets were included in the appropriate depreciation group starting the date of confirmation that</p>	<p>Paragraph 4 of clause 9 of Article 258 was amended.</p> <p>The requirement to reverse the depreciation premium upon the sale of the respective asset within five years since it was put into operation applies only when the asset is sold to a person who is a related party of the taxpayer (Article 258, clause 9, paragraph 4 of the Russian Tax Code).</p> <p>Article 258, clause 9, paragraph 9 of the Russian Tax Code now clearly states that the reversed depreciation premium is recognized within non-sale income in the reporting (tax) period in which the sale took place.</p> <p>On 1 January 2013, sub-clause 1, clause 1 of Article 268 of the Russian Tax Code was amended to include a new paragraph reading that when the taxpayer sells a fixed asset, in relation to which a depreciation premium was used, within five years after this asset was put into operation to a related party, the net book value of this asset increases by the amount of expenses recognized within non-sale income, as stipulated by Article 258, clause 9, paragraph 4 of the Russian Tax Code.</p> <p>According to Article 4, clause 3 of Federal Law No. 206-FZ of 29 November 2012, the provisions of clause 9 of Article 258 and clause 1 of Article 268 of the Russian Tax Code apply to sales of fixed assets starting 1 January 2013.</p> <p>Clause 11 of Article 258 of the Russian Tax Code, which stated that fixed assets subject to state registration in accordance with the legislation of the Russian Federation should be included in the appropriate depreciation group starting the date of</p>

Topic	Description	Status in October 2012	Status in October 2013
		documents for the registration of such rights were submitted.	<p>confirmation that the registration application was submitted, ceased to be in force on 1 January 2013.</p> <p>(Federal Law No. 206-FZ of 29 November 2012)</p> <p>On 23 July 2013, Federal Law No. 215-FZ of 23 July 2013 was published; it added Article 3.1 to Federal Law No. 206-FZ of 29 November 2013. This article states that depreciation on depreciable assets which were put into operation before 1 December 2012 and rights to which are subject to state registration in accordance with Russian legislation should be charged starting the first of the month following the month in which documents were submitted for the registration of those rights.</p>
	5. Interest on debt obligations	According to clause 1.1 of Article 269 of the Russian Tax Code, when there were no debt obligations issued to Russian organizations in the same quarter on comparable conditions, or at the taxpayer's discretion, from 1 January 2011 until and including 31 December 2012 the maximum interest recognized within expenses was to be equal to nil as agreed by the parties but not greater than the refinancing rate of the Central Bank of the Russian Federation multiplied by a factor of 1.8 for Russian-denominated debt obligations or a factor of 0.8 for foreign currency-denominated debt obligations.	The limits were extended throughout the entire year 2013 (by amendments to clause 1.1 of Article 269 of the Russian Tax Code).
	6. Grounds for deduction of bad debt for income tax purpose have been clarified		In accordance with amendments to Article 266, clause 2 of the Russian Tax Code, starting 1 January 2013 bad debts include debts that may not be recovered as stated in a resolution issued by a court bailiff to close the enforcement proceedings in

Topic	Description	Status in October 2012	Status in October 2013
			<p>accordance with the procedure established by Federal Law No. 229-FZ of 2 October 2007, On Enforcement Proceedings. This rule applies when the enforcement document is returned to the recovering party on the following grounds:</p> <ul style="list-style-type: none"> - It is impossible to establish the whereabouts of the debtor or the debtor's assets or obtain information whether the debtor has any cash or other valuables on current and deposit accounts or in custody of banks or other credit organizations. - The debtor has no assets which may be levied and all measures taken by the bailiff to trace such assets have been unsuccessful. <p>(introduced by Federal Law No. 206-FZ of 29 November 2013)</p>
	<p>7. Accounting for losses from the use of assets under fiduciary management</p>	<p>Article 276 Special Considerations Relating to the Determination of the Tax Base of the Parties to an Agreement on the Fiduciary Management of Assets</p> <p>Clause. 4.1</p> <p>Losses incurred during the term of a fiduciary management agreement from the use of assets under fiduciary management shall not constitute losses of the principal (beneficiary) that are taken into account for taxation purposes in accordance with this Chapter.</p>	<p>Article 276 Special Considerations Relating to the Determination of the Tax Base of the Parties to an Agreement on the Fiduciary Management of Assets</p> <p>Clause 4.1 was amended.</p> <p>Losses incurred during the term of a fiduciary management agreement under which the principal is not deemed to be the beneficiary through the use of assets under fiduciary management shall not be taken into account by the principal and the beneficiary when determining the tax base.</p>
	<p>8. Income on Issuance Securities with Mandatory Centralized Custody</p>		<p>A depository which pays income on federal government issuance securities with mandatory centralized custody, irrespective of the date of</p>

Topic	Description	Status in October 2012	Status in October 2013
			<p>registration of the securities issue, and on other issuance securities with mandatory centralized custody (relating only to issuance securities which underwent State registration or were assigned an identification number after 1 January 2012) to foreign organizations acting on behalf of third parties performs the duties of an income tax agent in accordance with the provisions of Article 310.1 of the Russian Tax Code (Article 310.1 of the Russian Tax Code).</p>
	9. Target finance not recognized in income		<p>Budget funds allocated as shared financing to partnerships of housing owners, housing and housing construction co-operatives and other specialized consumer co-operatives and management companies managing apartment buildings for capital repairs of apartment buildings are classified as target finance and shall not be recognized in income (Article 251, clause 3, sub-clause 1 of the Russian Tax Code).</p>
4. Excise duties	1. Excisable goods	<p>From 1 July 2012 the following goods are excisable</p> <ul style="list-style-type: none"> - ethyl alcohol produced from food and non-food raw materials, including denatured ethyl alcohol, crude alcohol, and wine, grape, fruit, cognac, calvados and whiskey distillates (hereinafter referred to as ethyl alcohol). <p>(Federal Law No. 338-FZ of 28 November 2011)</p>	<p>Domestic heating fuel manufactured from straight-run and (or) secondary diesel fractions boiling within a temperature range of from 280 to 360 degrees Celsius was added to the list of excisable goods (Article 181.1.1 of the Russian Tax Code).</p> <p>From 1 July 2013 these goods shall be taxed at the following tax rates: RUB5,860 per ton. The tax rate for 2014 is established as RUB6,446 per ton, and for 2015 – RUB7,735 per ton.</p> <p>(as amended by Federal Law No. 259-FZ of 25 December 2012)</p>

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		<p>From 1 July 2012</p> <ul style="list-style-type: none"> - Potable spirit will be removed from excisable alcohol products, and fruit wine and sparkling wine (champagne) will be added to wines. - The ethyl alcohol level at which beverages are classified as excisable alcohol products will be reduced to 0.5% (Article 181 of the Tax Code, Federal Law No. 218-FZ of 18 July 2011). 	<p>From 1 March 2013 cider, perry and mead are classified as separate alcoholic products and are deemed to be excisable (Article 181.1.3 of Russian Tax Code). Cider, perry and mead shall be taxed separately from other alcoholic products without ethyl alcohol content. The tax rate remains the same:</p> <ul style="list-style-type: none"> - 1 March - 31 December 2013 – RUB7 per litre - 1 January - 31 December 2014 – RUB8 per litre - 1 January - 31 December 2015 – RUB9 per litre. <p>(as amended by Federal Law No. 259-FZ of 25 December 2012)</p>
	2. New increases in excise rates	Federal Law No. 338-FZ of 28 November 2011 increased excise rates (Article 193 of the Russian Tax Code)	<p>The amended Article 193.1 of the Russian Tax Code provides the updated tax rates for petrol, diesel and straight-run petrol to be applied in 2013 and 2014.</p> <p>From 1 January 2013, class 4 petrol is taxed at the rate of RUB8,560 per ton. However, from 1 July 2013 the tax rate will be increased to RUB8,960 per ton.</p> <p>In the second half of 2013 tax rates will also change for class 5 petrol (RUB5,750 per ton instead of RUB5,143 per ton), class 4 and class 5 diesel fuel (RUB5,100 per ton instead of RUB4,934 per ton and RUB4,500 per ton instead of RUB4,334 per ton, respectively). Besides, the tax rates for straight-run petrol were increased as well. From 1 January 2013, the rates will be RUB10,229 per ton (instead of RUB9,617 per ton) and from January 2014 – RUB11,252 per ton (instead of RUB10,579 per ton).</p> <p>(as amended by Federal Law No. 259-FZ of 25 December 2012)</p>

Topic	Description	Status in October 2012	Status in October 2013
5. Personal income tax	1. Social tax deductions	<p>An individual is entitled to a social tax deduction as a result of contributions to charity funds and other socially-oriented non-profit organizations (Article 219.1.1 of the Russian Tax Code).</p>	<p>The possibility to get a social tax deduction for medical treatment, provided by Article 219.1.3 of the Russian Tax Code, was extended.</p> <p>The deduction of amounts paid for treatment can be granted to a taxpayer when treatment is undertaken not only at medical organizations but also through private practitioners. Such private entrepreneurs should carry out medical activities on the basis of a license issued in accordance with the legislation of the Russian Federation (Article 219, clause 1, sub-clause 3, paragraph of the Russian Tax Code).</p> <p>The social tax deduction can be granted for medical treatment of adopted children and children aged under 18.</p> <p>These provisions are extended to cover legal relations that emerged on or after 1 January 2013 (Article 2.3 of Federal Law No. 279-FZ of 29 December 2012).</p> <p>New instances of granting social tax deductions by employers were introduced effective 1 January 2013. Prior to the end of a tax period social tax deductions may be granted to a taxpayer not only with regard to contributions to non-government pension funds and voluntary pension insurance contributions, but also with regard to additional insurance contributions for the funded component of a retirement pension (Article 219.2 of the Russian Tax Code, Article 2.3 of Federal Law No. 279-FZ of 29 December 2012). According to Article 219, clause 2, paragraph 2 of the Russian Tax Code, social tax deductions may be granted subject to presentation of documentary evidence of the taxpayer's expenses and on condition that contributions have been withheld from</p>

Topic	Description	Status in October 2012	Status in October 2013
			<p>payments in favor of the taxpayer and transferred to appropriate funds by the employer.</p> <p>(as amended by Federal Law No.279 FZ of 29 December 2012)</p>
	<p>2. Transactions with securities and term transaction financial instruments</p>	<p>Article 214.3 was supplemented. The procedure for determining the tax base for repo transactions involving securities.</p> <p>It was clarified that the provisions of this article apply to repo transactions that were performed on the taxpayer's behalf by brokers, authorized representatives, agents, trustees (including trade organizers on the securities market and on stock exchanges) based on respective civil law contracts.</p> <p>(Federal Law No. 330-FZ of 21 November 2011)</p> <p>When determining the financial result on transactions with securities received by an individual contributor in the event that special-purpose capital of an NPO is paid back, a donation is canceled or securities contributed to the capital of the NPO are otherwise returned, the individual contributor may expense only those costs on transactions with securities which were incurred prior to the said contribution (Article 214.1, clause 13 of the Russian Tax Code)</p>	<p>Article 214.3 was supplemented. The procedure for determining the tax base for repo transactions involving securities.</p> <p>According to the amendments, it was specified that the financial result from operations involving opening (closing) a short position shall be included in the tax base for operations involving securities both circulating and not circulating on the organized securities market. (the paragraph was introduced by Federal Law No.279-FZ of 29 December 2012)</p> <p>(clause 14 as amended by Federal Law No. 330-FZ of 21 November 2011)</p> <p>A depository which pays income on federal government issuance securities with mandatory centralized custody, irrespective of the date of registration of the securities issue, and on other issuance securities with mandatory centralized custody (relating only to issuance securities which underwent State registration or were assigned an identification number after 1 January 2012) to foreign organizations acting on behalf of third parties performs the duties of a personal income tax agent in accordance with the provisions of Article 214.6 of the Russian Tax Code (clause 18 of Article 214.1 of the Russian Tax Code).</p> <p>(introduced by Federal Law No. 282-FZ of 29 December 2012)</p>

Topic	Description	Status in October 2012	Status in October 2013
	3. Non-taxable (tax exempt) income	Federal Law No. 330-FZ of 21 November 2011, Federal Law No. 338-FZ of 28 November 2011, Federal Law No. 328-FZ of 21 November 2011 and Federal Law No. 359-FZ of 30 November 2011 extend the list of non-taxable income.	<p>Article 217 was supplemented with new provisions according to which the following types of income shall not be taxable:</p> <ul style="list-style-type: none"> - Budgetary funds received by heads of peasant households and farmers in the form of grants for the establishment and development of a peasant farm, one-time assistance for the domestic arrangements of a beginning farmer and grants for the development of a family livestock farm (Article 217, clause 14.1 of the Russian Tax Code) - Subsidies granted to heads of peasant households and farmers from budget funds of the Russian budgetary system (Article 217, clause 14.2 of the Russian Tax Code). <p>These provisions shall apply to grants and subsidies received after 1 January 2012 (Article 3.2 of Federal Law No. 161-FZ of 2 October 2012).</p> <p>Article 217 was supplemented with clause 3.2 which grants a tax-exempt status to the provision of uniforms and accessories to voluntary workers and volunteers under civil-law contracts for the purpose of performing of work and rendering services without consideration. Such contracts are to be concluded in accordance with Federal Law No. 135-FZ of 11 August 1995 "Concerning Charitable Activities and Charitable Organizations" and Federal Law No. 329-FZ of 4 December 2007 "Concerning Physical Education and Sport in the Russian Federation".</p> <p>The provision of clause 3.2 of Article 217 of the Russian Tax Code shall apply to legal relations arising on or after 1 January 2013 (Article 3.2 of</p>

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			<p>Federal Law No. 152-FZ of 2 July 2013).</p> <p>According to Article 217.10 of the Russian Tax Code, amounts received as payment for treatment and medical services by former employees who retired due to disability or old-age shall not be taxable from 1 January 2013.</p> <p>Besides, from 1 January 2013 exemption from personal income tax is applied to amounts which are paid by employers for treatment and medical care for their employees' adopted children and wards (aged 18 and younger). Relevant amendments were made to clause 10 of Article 217 of the Russian Tax Code. Under-aged children are also mentioned in Article 217.28 of the Russian Tax Code under which only amounts up to RUB4,000 received to cover the cost of medical drugs acquired for them under prescription from a doctor are tax exempt.</p> <p>(as amended by Federal Law No. 279-FZ of 29 December 2012)</p>
6. Mineral extraction tax	1. Zero tax rate		The zero mineral tax rate was implemented for amenable stannary ore mined in areas which are fully or partially located in the Far Eastern Federal District (Article 342.1.17 of the Russian Tax Code). The established rules provide that this rate should apply from 1 January 2013 through 31 December 2017.
	2. Increased tax rates	<p>Article 342. Tax Rate</p> <p>The mineral tax rate of RUB446 per ton applies to extraction of dewatered, desalted and stabilized oil during the period from 1 January through 31 December 2012 (Article</p>	<p>Article 342. Tax Rate</p> <p>The mineral tax rate of RUB470 per ton applies to extraction of dewatered, desalted and stabilized oil from 1 January 2013 (Article 324.2.9 of the Russian Tax Code).</p>

Topic	Description	Status in October 2012	Status in October 2013
		<p>324.2.9 of the Russian Tax Code).</p> <p>The mineral tax rate of RUB556 per ton applies to extraction of gas condensate from all types of hydrocarbon deposits during the period from 1 January through 31 December 2012 (Article 324.2.10 of the Russian Tax Code).</p> <p>The mineral tax rate that applies to extraction of combustible natural gas from all types of hydrocarbon deposits during the period from 1 January through 31 December 2012 is RUB509 per 1000 m³ of gas (Article 342.2.11 of the Russian Tax Code). The tax is levied at the tax rate established in this article, multiplied by a coefficient of 0.493.</p>	<p>The mineral tax rate that applies to extraction of gas condensate from all types of hydrocarbon deposits increased to RUB590 per ton. This tax rate applies from 1 January through 31 December 2013.</p> <p>Changed</p> <p>The mineral tax rate that applies to extraction of combustible natural gas from all types of hydrocarbon deposits is RUB582 per 1000 m³ of gas from 1 January 2013 (Article 342.2.11 of the Russian Tax Code). Taxpayers which are neither owners of the Unified Gas Supply System nor have owners of the system facilities as direct and/or indirect participants in their capital (with a total participation interest in excess of 50%) apply a coefficient of 0.455 to the established tax rate in 2013.</p> <p>From 1 June through 31 December 2013, the mineral tax rate on extraction of combustible natural gas from all types of hydrocarbon deposits increases to RUB622 per 1000 m³ of gas, and the coefficient to be applied by these taxpayers also changes to 0.646.</p>
	<p>3. Established procedure for determining the tax base and calculating mineral extraction tax for extraction of gas condensate</p>	<p>The mineral tax rate for gas condensate was 17.5% until 1 January 2012 and from 1 January through 31 December 2012 extraction of gas condensate was taxed at a rate of RUB556 per ton (Article 324.2.10 of the Russian Tax Code).</p>	<p>According to Article 338.2 of the Russian Tax Code effective from 1 January 2013, the tax base for extraction of gas condensate from all types of hydrocarbon deposits is determined as the physical amount of extracted hydrocarbons. The amount of tax shall be calculated, according to Article 343.1 of the Russian Tax Code, by multiplying the applicable tax rate by the tax base. These provisions are extended to cover relationships that arose on or after 1 January 2012 (Article 2.3 of Federal Law No. 204-FZ of 29 November 2012).</p>

Topic	Description	Status in October 2012	Status in October 2013
	4. Items exempt from taxation		Article 336.2.6 of the Russian Tax Code treats coal bed methane as not subject to mineral extraction tax. (subclause 6 was introduced by Federal Law No. 278-FZ of 29 December 2012)
	5. New concept of 'hydrocarbon accumulation' has been introduced		A concept of 'hydrocarbon accumulation' has been introduced effective 1 September 2013. According to revised Article 336.1.1 of the Russian Tax Code, a 'hydrocarbon accumulation' is understood as describing an item of accounting, in the state register of mineral reserves, for oil, gas condensate, combustible natural gas or coal bed methane reserves that exist in a particular site, which was not found to comprise any other items of accounting for reserves.
	6. New coefficients		Effective 1 September 2013, new coefficients apply to the mineral tax rate for dewatered, desalted and stabilized oil, which reflect the complexity of oil extraction (C_e) and the degree of depletion (C_{ed}) of a particular hydrocarbon accumulation (Article 342.2.9 of the Russian Tax Code). A reduced coefficient C_e applies to oil extracted from certain deposits and accumulations where permeability and net pay meet established criteria (clauses 1 and 6, Article 342.2 of the Russian Tax Code). A reduced coefficient C_{ed} applies, if certain criteria are met, only to oil extracted from accumulations where coefficient C_e does not exceed 1 (clause 3, Article 342.2 of the Russian Tax Code). (introduced by Federal Law No. 213-FZ of 23 July 2013)

Topic	Description	Status in October 2012	Status in October 2013
	7. Adjusted procedure to determine initial recoverable oil reserves	The volume of initial recoverable oil reserves – V and V ₃ – is calculated for a deposit or a particular site as a total of reserves of categories A, B, C1 and C2 according to the state register of mineral reserves at a certain date.	Paragraph 2, clause 1.1, paragraph 5, clause 4, and paragraph 4, clause 5, Article 342 of the Russian Tax Code were amended to adjust the procedure for determining the volume of initial recoverable oil reserves – V and V ₃ – for a deposit or a particular site. Effective 1 September 2013, such volumes are calculated as a total of extractable reserves of categories A, B, C1 and C2 and accumulated amount of extracted oil since the development of this site (deposit) commenced, according to the state register of mineral reserves at a certain date. In addition, initial recoverable oil reserves should be approved, taking into account any increases and write-offs thereof, following the established procedure. (as amended by Federal Law No. 213-FZ of 23 July 2013)
7. Corporate assets tax	1. Tax base. Tax benefits	<p>The period for providing tax benefits on assets recorded in the balance sheet of an entity which is a tax resident of a special economic zone has been extended from five to ten years.</p> <p>Highly energy efficient facilities (or those with a high class of energy efficiency) commissioned after 1 January 2012 are exempt from assets tax for three years from their date of registration (Article 381.21 of the Russian Tax Code).</p> <p>Shipbuilding entities which are residents of industrial special economic zones are exempt from assets tax on assets used for building and repairing vessels (Article 381.22 of the Russian Tax Code).</p>	<p>Effective 1 January 2013, corporate movable property recorded as fixed assets on or after this date is exempt from assets tax (Article 374.4.8 of the Russian Tax Code).</p> <p>According to Article 374.4.8 of the Russian Tax Code, movable property that belonged to an overtaken legal entity and was recorded by its legal successor as fixed assets on or after 1 January 2013 is also exempt from assets tax.</p> <p>In addition, from 2013 corporate assets tax is not considered as applicable to:</p> <ul style="list-style-type: none"> - cultural heritage assets of federal significance (Article 374.4.3 of the Russian Tax Code), - nuclear facilities used for scientific purposes, facilities for storage of nuclear materials and radioactive agents and storage facilities for

Topic	Description	Status in October 2012	Status in October 2013
		<p>Entities classified as management companies of a SEZ are exempt from assets tax if fixed assets recorded in their balance sheet are represented by real estate property constructed for the purpose of implementing agreements on establishing the SEZ. The tax benefit applies for ten years from the month following the month when the real estate property is recorded in the balance sheet (Article 381.23 of the Russian Tax Code).</p>	<p>radioactive waste (Article 374.4.4 of the Russian Tax Code),</p> <ul style="list-style-type: none"> - icebreakers, vessels with nuclear propulsion unit and nuclear technology maintenance vessels (Article 374.4.5 of the Russian Tax Code), - space facilities (Article 374.4.6 of the Russian Tax Code), - vessels registered with the Russian International Shipping Register (Article 374.4.7 of the Russian Tax Code). <p>Effective 1 January 2013, corporate assets tax benefit does not apply to public railway lines, trunk pipelines and power transmission lines, and structures that are an integral part of the above facilities (Article 381.11 of the Russian Tax Code). Article 380.3 of the Russian Tax Code establishes the maximum tax rates applicable to these assets, which are lower than rates applicable to other assets. In 2013, these rates cannot exceed 0.4%. The maximum rates are set to raise gradually to 1.9% in 2018.</p> <p>(as amended by Federal Law No.202-FZ of 29 November 2012)</p>
8. Land tax	1. Tax rate	<p>Article 394. Tax Rate</p> <p>Tax rates are set in legislative acts by elected representative bodies of municipalities (laws of the cities of federal significance such as Moscow and Saint Petersburg) and may not exceed:</p> <p>1) 0.3% for land:</p>	<p>Effective 1 January 2013, the land tax rate set by elected representative bodies of municipalities for restricted land that has been provided for the purposes of defense and security and for customs needs, cannot exceed 0.3% of its cadastral value (Article 394.1.1 of the Russian Tax Code). For other land, the tax rate remained at 1.5%.</p>

Topic	Description	Status in October 2012	Status in October 2013
		<ul style="list-style-type: none"> - classified as agricultural land or land within agricultural use zones in settlements and used for agricultural production - occupied by housing stock and engineering infrastructure of housing and public utilities (excluding land ownership share related to facilities that are not part of housing stock or engineering infrastructure of housing and public utilities), or purchased (provided) for housing construction - purchased (provided) for private subsidiary farming, growing fruit and vegetables, or livestock farming, as well as for dachas (summer cottages). <p>2) 1.5% for other land.</p>	<p>Article 394 of the Russian Tax Code was amended by new clause 3 which states that if land tax rates have not been set in legislative acts by elected representative bodies of municipalities (laws of the cities of federal significance such as Moscow and Saint Petersburg), land tax is levied at rates provided in clause 1 of this article.</p> <p>(as amended by Federal Law No. 202-FZ of 29 November 2012)</p>
<p>9. Insurance contributions to the Pension Fund of the Russian Federation, Social Security Fund of the Russian Federation, Federal Compulsory Medical Insurance Fund of the Russian Federation and regional compulsory medical insurance funds</p>	<p>1. Insurance contribution rates</p>	<p>From 1 January 2012, no contributions are made to the regional compulsory medical insurance funds. Compulsory medical insurance contributions at the rate of 5.1% are to be made to the Federal Compulsory Medical Insurance Fund of the Russian Federation. The total insurance contribution rate for the majority of payers (with the exception of those who are entitled to reduced rates) is 30%. The reduced rate for certain categories of payers has been decreased: it amounts to 20% (clause 8, part 1, and part 3.4, Article 58 of Federal Law No. 212-FZ of 24 July 2009)</p> <p>The rate for insurance contributions on job-</p>	<p>Effective 1 January 2013, employers of individuals to whom, according to subclauses 1-18 of clause 1 of Article 27 of Federal Law No. 173-FZ of 17 December 2001, <i>On Labor Pensions in the Russian Federation</i>, old-age labor pension is awarded before they reach the age of 60 for men and the age of 55 for women, must make additional insurance contributions to the Pension Fund to finance the insurance part of their labor pension (Article 58.3 of Federal Law No. 212-FZ of 24 July 2009).</p> <p>In addition, changes have been made in the procedure for calculating insurance contributions paid for themselves by individual entrepreneurs, lawyers, notaries and other individuals engaged in professional practice. The fixed amount of their contribution to the Pension Fund is determined on</p>

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		<p>related payments and other compensation to crew members of vessels registered in the Russian International Shipping Register is 0% (clause 9, part 1 and part 3.3, Article 58 of Federal Law No. 212-FZ of 24 July 2009).</p>	<p>the basis of the double amount of minimum monthly wage established at the beginning of the fiscal year (part 1.1, Article 14, of Federal Law No. 212-FZ of 24 July 2009).</p> <p>The reduced rates of insurance contributions, similar to the STS, are also established for the majority of payers who apply the license-based taxation system. However, individual entrepreneurs who rent out premises, engage in retail trade or provide food services pay their contributions at generally applicable rates (clause 14, part 1 and part 3.4, Article 58 of Federal Law No. 212-FZ of 24 July 2009).</p>
	<p>2. Assessment base for insurance contributions</p>	<p>Since 1 January 2011, the general rate has been applied to payments not exceeding the maximum assessment base for insurance contributions (part 1, Article 58.1 of Federal Law No. 212-FZ of 24 July 2009). In 2012 the maximum assessment base per each employee amounted to RUB512,000. Payments to employees in excess of the maximum assessment base for insurance contributions are taxed at a rate of 10% (part 4, Article 8 and part 1, Article 58.2 of Federal Law No. 212-FZ of 24 July 2009).</p>	<p>Effective 1 January 2013, the maximum assessment base, which amounted to RUB512,000 in 2012, is indexed by a factor of 1.11 (Decree of the Government of the Russian Federation No. 1276 of 10 December 2012). Amounts of RUB500 or more are rounded to the nearest thousand and amounts less than RUB500 are disregarded. Therefore, the contribution assessment base per each employee should not exceed RUB568,000 in 2013. It is calculated on a cumulative basis from the beginning of the calendar year (part 4, Article 8, and Article 10 of Federal Law No. 212-FZ of 24 July 2009).</p>
	<p>3. Amounts not subject to insurance contributions</p>		<p>Individual entrepreneurs, lawyers and other payers specified in clause 2, part 1, Article 5 of Federal Law No. 212-FZ of 24 July 2009, have the right not to calculate and pay contributions for certain periods in which they did not engage in their professional activity (part 6, Article 14 of Federal Law No. 212-FZ of 24 July 2009).</p>

Topic	Description	Status in October 2012	Status in October 2013
	4. Adjusted procedure for recognition as insured under the compulsory pension insurance scheme of foreign citizens and stateless persons who temporarily reside in the Russian Federation	According to clause 1, Article 7 of Federal Law No. 167-FZ of 15 December 2001 (with amendments effective from 1 January 2012), payments to foreign citizens and stateless persons who temporarily reside in the Russian Federation were subject to pension insurance contributions if these individuals had entered into an employment contract valid for at least six months or for an indefinite period.	Payments to foreign citizens and stateless persons who temporarily reside in the Russian Federation are subject to pension insurance contributions if these individuals have entered into an employment contract (employment contracts) valid for a total period of at least six months during a calendar year (clause 1, Article 7 of Federal Law No. 167-FZ of 15 December 2001).
10. Compulsory social insurance for temporary disability and maternity	1. Procedure for calculating pregnancy and childbirth benefits and monthly childcare benefits	<p>For insured events that occurred from 1 January 2011 through 31 December 2012, the average daily compensation for the purpose of calculating the pregnancy and childbirth benefits and monthly childcare benefit can be determined in one of the following ways:</p> <ul style="list-style-type: none"> - Upon an application from the insured person based on their average compensation over the last 12 months preceding the month in which the insured event occurred. The average compensation is divided by the number of days actually worked (taking into account the maximum assessment base for insurance contributions to the Social Security Fund in 2010 – RUB415,000). This benefit calculation procedure applied until 2011 - Based on the average compensation for two calendar years preceding the year in which the insured event occurred. The average compensation is divided by 730 	For insured events that occurred on or after 1 January 2013, the average daily compensation for the purpose of calculating the pregnancy and childbirth benefit and monthly childcare benefit should be determined using new rules established by part 3.1, Article 14 of Federal Law No. 255-FZ of 29 December 2006.

Topic	Description	Status in October 2012	Status in October 2013
		<p>(also taking into account the maximum assessment base for insurance contributions to the Social Security Fund in the respective year). This benefit calculation procedure applied from 1 January 2011.</p> <p>The above mentioned transition period during which insured persons had a right to chose the procedure of determining their average daily compensation for the purpose of calculating benefits was established by part 2, Article 3 of Federal Law No. 343-FZ of 8 December 2010. This period ended on 1 January 2013.</p>	
	<p>2. Refined procedure for calculating the average daily compensation for the purpose of calculating the pregnancy and childbirth benefit and monthly childcare benefit</p>		<p>The average daily compensation for the purpose of calculating the pregnancy and childbirth benefit and monthly childcare benefit is determined by dividing the compensation accrued for two calendar years preceding the year in which the insured event occurred by the number of calendar days in this period, excluding certain calendar days (part 3.1, Article 14 of Federal Law No. 255-FZ of 29 December 2006).</p>
	<p>3. Refined requirements for information to be indicated in the certificate of compensation paid for two calendar years preceding the year in which employment was terminated</p>		<p>In connection with the new procedure for determining the average daily compensation for the purpose of calculating the pregnancy and childbirth benefit and monthly childcare benefit, adjusted requirements apply to information to be indicated in the certificate of compensation that is issued to a resigning employee (clause 3, part 2, Article 4.1 of Federal Law No. 255-FZ of 29 December 2006). Now this certificate must indicate information on the number of</p>

Topic	Description	Status in October 2012	Status in October 2013
			calendar days in the periods of the employee's: <ul style="list-style-type: none"> - Temporary disability - Maternity leave - Childcare leave - Leave of absence with full or partial compensation if no insurance contributions to the Social Security Fund accrued on the employee's compensation.
	4. Indexation of child benefits		Benefits to individuals who have a child/children were indexed by the factor of 1.055. From 2013, the lump sum benefit payable upon childbirth is RUB13,087.61; benefit payable in connection with early pregnancy registration is RUB490.79; minimum monthly childcare benefit for children up to one and a half years old: first child – RUB2,453.93, second child and subsequent children – RUB4,907.85.
11. Compulsory social insurance for industrial accidents and occupational diseases	1. Established maximum amount of temporary disability benefit payable to an employee in connection with an industrial accident or occupational disease		Effective 8 April 2013, there is a limit on the maximum amount of temporary disability benefit payable to an insured person in connection with an industrial accident or occupational disease. The maximum temporary disability benefit payable to an insured person in connection with an industrial accident or occupational disease cannot exceed the quadruple maximum amount of the monthly insurance benefit (clause 2, part 9 of Federal Law No. 125-FZ of 24 July 1998).
12. Special tax regimes: 12.1. Unified tax on	1. Applicability	Federal Law No. 96-FZ of 29 June 2012 Due to the expansion of Moscow, unified tax on imputed income (UTII) may be introduced in certain municipalities included in the intra-urban territory of Moscow, a city of federal	From 2013, the application of the UTII regime is not mandatory (clause 1, Article 346.28 of the Russian Tax Code). Organizations and individual entrepreneurs may elect to transition to this special regime voluntarily, subject to established restrictions, and also if this regime has been introduced in the

Topic	Description	Status in October 2012	Status in October 2013
<p>imputed income (UTII)</p>		<p>significance, as a result of a change in its boundaries, for a period of up to two years from the date of this change.</p> <p>In 2012 and before, the tax regime in the form of unified tax on imputed income was mandatory in municipalities in which this special tax regime was introduced by their local government.</p>	<p>respective territory by the local government.</p> <p>The UTII regime will be canceled in 2018 (clause 8, Article 5 of Federal Law No. 97-FZ of 29 June 2012).</p> <p>Taxpayers who have elected to transition to the UTII regime should register as a UTII payer with a tax authority by submitting an application in the prescribed form within five business days after they start applying UTII (clauses 2 and 3, Article 346.28, clause 6, Article 6.1 of the Russian Tax Code).</p> <p>UTII payers may transition to another tax regime from the next calendar year (clause 1, Article 346.28 of the Russian Tax Code).</p> <p>In case of breaching requirements established for application of the UTII regime in a quarter, the taxpayer is considered to be transitioned to the general tax regime from the beginning of the quarter in which such breach occurred (clause 2.3, Article 346.26 of the Russian Tax Code).</p> <p>Transitional provisions</p> <p>No transitional provisions are provided by Federal Law No. 94-FZ of 25 June 2012 for taxpayers who paid UTII in 2012 and are willing to continue applying this special regime in 2013:</p> <ul style="list-style-type: none"> - These organizations and entrepreneurs should not apply for registration since they are already UTII payers and engage in an activity that is subject to UTII. - The obligation to apply to tax authorities for registration as a UTII payer arises on the day the taxpayer starts applying UTII (clause 3, Article 346.28 of the Russian Tax Code).

Topic	Description	Status in October 2012	Status in October 2013
	2. Adjusted procedure for canceling registration as a UTII payer	According to Article 346.28 of the Russian Tax Code, an application to cancel registration as a UTII payer should be submitted upon termination of activity that is subject to UTII.	<p>According to paragraph 3, clause 3, Article 346.28 of the Russian Tax Code, an application to cancel registration as a UTII payer from 2013 should be submitted in case of:</p> <ul style="list-style-type: none"> - termination of activity that is subject to UTII, - transition to another tax regime, - breach of requirements established for application of UTII in subclauses 1 and 2, clause 2.2, Article 346.26 of the Russian Tax Code. <p>The application to cancel registration should be submitted to a tax inspectorate within five business days after termination of activity, transition to another tax regime or after the last day of the tax period in which the established requirements were breached (paragraph 3, clause 3, Article 346.28 of the Russian Tax Code). The deregistration date is the date which the tax payer indicates as the date of terminating activity, or the date of transition to another tax regime, or the first day of the tax period from which the taxpayer must transition to the general tax regime as a result of breaching UTII application requirements. If the taxpayer misses the deadline set for submitting an application to cancel UTII registration due to termination of activity, the deregistration date is the last day of the month in which the application is submitted (paragraph 5, clause 3, Article 346.28 of the Russian Tax Code).</p>
	3. Date of registration as a UTII payer	The date of starting an activity which is subject to UTII in the municipality (clause 3, Article 346.28 of the Russian Tax Code).	The date of starting the application of the UTII regime indicated in the taxpayer's application for registration as a UTII payer (clause 3, Article 346.28 of the Russian Tax Code).

Topic	Description	Status in October 2012	Status in October 2013
	<p>4. Headcount restriction on applying UTII is determined from the average employee headcount</p>	<p>One of requirements which, if breached, results in losing the right to apply the UTII regime is that the established headcount threshold of 100 employees should not be exceeded (clause 2.3, Article 346.26 of the Russian Tax Code). For the purpose of transition to UTII, this parameter is determined for the year preceding the year of transition to UTII (subclause 1, clause 2.2, Article 346.26 of the Russian Tax Code).</p> <p>Average headcount was expected to be used in 2012.</p>	<p>Effective 1 January 2013, the headcount threshold that entails the right, or the loss of the right, to apply UTII is determined from the average employee headcount (subclause 1, clause 2.2, Article 346.26, paragraph 37, Article 346.27 of the Russian Tax Code). The average employee headcount includes the average number of external secondary job employees and employees (including external) who worked under civil law contracts (clause 77 of Order of the Russian State Statistics Service No. 435, <i>On Approval of Guidelines for Completing Federal Statistical Observation Forms</i>). Previously, there was no requirement to include these employee categories in the calculation of compliance with this threshold.</p> <p>The headcount threshold remained unchanged at 100 employees.</p>
	<p>5. Consumer cooperatives will not be subject to the headcount threshold for the purpose of applying UTII until 31 December 2017.</p>	<p>In 2012, consumer cooperatives and business entities were allowed not to apply the headcount threshold.</p>	<p>According to subclause 1, clause 2.2, Article 346.26 of the Russian Tax Code, organizations and individual entrepreneurs have no right to apply UTII if their average headcount for the previous calendar year exceeded 100 employees. This threshold does not apply to consumer cooperatives and business entities in which a consumer cooperative is the only founder.</p>
	<p>6. Increased basic profitability level for renting out land plots of 10 m² or less</p>	<p>In 2012, the basic profitability level for renting out land plots of 10 m² or less was RUB5,000 (clause 3, Article 346.29 of the Russian Tax Code).</p>	<p>For services that involve the transfer for temporary possession and/or use of land plots of 10 m² or less for the purpose of setting up fixed-location and movable trading outlets and food service entities, the basic profitability level is set at RUB10,000 per each rented land plot for 2013 and onwards (clause 3, Article 346.29 of the Russian Tax Code).</p>

Topic	Description	Status in October 2012	Status in October 2013
	7. Clarified types of activities for which UTII may apply	<p>In 2012, UTII applied to rendering of repair, maintenance and washing services only in respect of motor vehicles (Article 346.26 of the Russian Tax Code).</p> <p>According to subclause 11, clause 2, Article 346.26 of the Russian Tax Code, UTII may apply to activities connected with placement of advertisements about motor vehicles.</p> <p>UTII does not apply to the types of activity that involve the sale of excisable goods, food products and beverages, including alcoholic beverages, in bars, restaurants, cafés and other food service entities, gas, goods vehicles, special vehicles, trailers, semi-trailers, pole trailers, any types of buses, goods ordered on the basis of samples and catalogs outside a fixed-location trading network and through teleshopping channels, telephone and computer networks, the supply of reduced-price (free) prescription</p>	<p>From 2013, UTII applies to activities that involve rendering of repair, maintenance and washing services for motor vehicles, including motorcycles and similar vehicles, and rendering of services that involve provision for temporary possession (use) of parking lots for these vehicles (subclauses 3 and 4, clause 2, Article 346.26 of the Russian Tax Code).</p> <p>The changes were made in the term "repair, maintenance and washing services for motor vehicles" (Article 346.27 of the Russian Tax Code). Effective 1 January 2013, the term includes paid services involving the technical inspection of motor vehicles for conformity to compulsory safety requirements in order for them to be authorized for use on roads in the territory of the Russian Federation and, in cases provided for by international agreements of the Russian Federation, on roads outside the territory of the Russian Federation.</p> <p>Subclause 11, clause 2, Article 346.2 of the Russian Tax Code specifies that UTII may apply to activities connected with the the placement of advertisements using the exterior and interior surfaces of motor vehicles.</p> <p>Addition: UTII does not apply to activities connected with the sale of unclaimed items at pawnshops (paragraph 12, Article 346.27 of the Russian Tax Code).</p>

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		medicines, and products produced (manufactured) in-house.	
	8. Changed procedure for UTII calculation for an activity period that is less than a month	In 2012, in cases where a taxpayer's registration or deregistration did not take place on the first day of a calendar month, UTII for a quarter was computed on the basis of the number of full months starting from the month following the month of registration.	Effective 1 January 2013, according to clause 10, Article 346.29 of the Russian Tax Code, UTII in such cases is calculated from the day of registration (or deregistration) on the basis of the actual number of days in the period of engaging in the activity.
	9. Adjusted procedure for reducing UTII by insurance contributions and social benefits	Taxpayers can reduce UTII calculated for a tax period by the amount of insurance contributions for compulsory pension insurance, compulsory social insurance for temporary disability and in connection with maternity, compulsory medical insurance and compulsory social insurance for industrial accidents and occupational diseases, which were paid (within the limits of calculated amounts) in the same tax period in accordance with Russian Federation laws upon payment by the taxpayer of compensation to employees engaged in those areas of the taxpayer's activities for which UTII is paid, and by the amount of insurance contributions paid by the individual entrepreneurs in form of fixed payments, as well as amounts of temporary disability benefits paid to employees. However, the amount of UTII may not be reduced by more than 50% (Article 346.32 of the Russian Tax Code).	<p>The procedure was adjusted to clarify for taxpayers how to reduce UTII by the amounts of insurance contributions to the Pension Fund, the Federal Compulsory Medical Insurance Fund and the Social Security Fund as well as temporary disability benefits.</p> <p>Subclause 2, clause 2, Article 346.322 of the Russian Tax Code, provides that:</p> <ul style="list-style-type: none"> - Temporary disability benefits paid to employees in the event of an industrial accident or occupational disease do not reduce UTII. - Only benefits paid by the employer for the days of an employee's temporary disability in accordance with Russian laws are taken into account; It is worth reminding that, according to clause 1, part 2, Article 3 of Federal Law No. 255-FZ of 29 December 2006, only the first three days of temporary disability are compensated from the employer's funds. - UTII may be reduced only by part of the amount of temporary disability benefits for the days compensated from the employer's funds which was not covered by the payments to employees

Topic	Description	Status in October 2012	Status in October 2013
			<p>from insurance companies. Such companies should be licensed to carry out the respective type of activity. Moreover, such payments should be made under agreements with employers for the benefit of employees in case of their temporary disability (excluding industrial accidents and occupational diseases).</p> <p>UTII can be reduced not only by the amount of the contributions to the Pension Fund, the Federal Compulsory Medical Insurance Fund and the Social Security Fund and by expenses for temporary disability benefits, but also by payments under voluntary personal insurance agreements entered into with insurance companies for the benefit of employees (subclause 3, clause 2, Article 346.32 of the Russian Tax Code). These payments are deductible provided that:</p> <ul style="list-style-type: none"> - Insurance companies have licenses issued in accordance with Russian laws to carry out the respective type of activity. - Agreements with employers are entered into for the benefit of employees against their temporary disability (excluding industrial accidents and occupational diseases) for days of temporary disability which are compensated from the employer's funds. - The insurance premium under such agreements doesn't exceed the temporary disability benefit, determined according to Russian laws, for the days compensated by the employer. <p>The amount of tax calculated for a tax period shall be reduced by the amount of insurance contributions to</p>

Topic	Description	Status in October 2012	Status in October 2013
			the Pension Fund, the Federal Compulsory Medical Insurance Fund and the Social Security Fund paid in the current tax period (subclause 1, clause 2, Article 346.32 of the Russian Tax Code) and not in the that period as it was established before.
12.2. Unified agricultural tax (UAT)	1. Loss of the right to apply unified agricultural tax	Applying for a change to UAT.	As of 1 January 2013, the application procedure for switching to UAT is changed to a notification procedure (Federal Law No. 94-FZ of 25 June 2012).
	2. The procedure for switching to UAT has been changed	<p>In 2012, the submission of an application was one of the requirements for switching to UAT. An application was to be submitted to the inspectorate within the time limits of 20 October to 20 December (Article 346.3.1 of the Russian Tax Code).</p> <p>A new organization or a newly registered entrepreneur can submit a notification of switching to UAT within five workdays from the date of registration with the tax authorities (Article 346.3.2 of the Russian Tax Code).</p>	<p>As of 2013, a notification is submitted instead of an application to switch to UAT payment (Article 346.2.5 of the Russian Tax Code).</p> <p>It should be submitted to the inspectorate at the location of an organization or the place of residence of an individual entrepreneur by 31 December (inclusive) of the year preceding the switch to UAT payment.</p> <p>A new organization or a newly registered entrepreneur can submit a notification of switching to UAT within 30 calendar days from the date of registration with the tax authorities (Article 346.3.2 of the Russian Tax Code).</p> <p>The consequences of violating the time limits for the submission of a notification to switch to UAT payment are written in Article 346.3.3 of the Russian Tax Code. Organizations and entrepreneurs are not deemed UAT payers if the established time limits are not adhered to.</p>
	3. When there is no agricultural income, UAT can continue to be applied		A new clause, i.e., clause 4.1, has been added to Article 346.3 of the Russian Tax Code. According to it, a new organization (or a newly registered entrepreneur) is entitled to continue to apply UAT

Topic	Description	Status in October 2012	Status in October 2013
			even if it had no agricultural income during the first tax period. In this respect, the requirements for UAT application should be met in that period.
	4. The amount of UAT paid does not reduce the income received		In sub-clause 23 of Article 346.5.2 of the Russian Tax Code, a clarification has been made: income can be reduced by the amounts of taxes and levies paid in compliance with legislation, except for the amounts of UAT.
	5. Additions were made to the procedure for determining and recognizing income and expenses	<p>The following is no longer in force: sub-clause 30 of Article 346.5.2 of the Russian Tax Code</p> <p>Under that regulation, when the tax base was calculated, account was taken of the expenses in the form of a negative exchange rate due to the reappraisal of assets in the form of currency values and requirements (obligations), whose value is expressed in foreign currency.</p>	<p>In clause 5.1 of Article 346.5 of the Russian Tax Code, it is expressly indicated that such a reappraisal is not made, and income and expenses with regard to it are not determined and taken into account.</p> <p>An important addition relates to the return of advance payments: income is reduced by the amount of prepayment refunded to the purchaser (client) in the period wherein the refund is made (sub-clause 1 of Article 346.5.5 of the Russian Tax Code).</p>
	6. Special time limits were set for tax payment and the submission of a declaration in the event of termination of activity as an agricultural producer.		<p>There is a mandatory notification procedure for terminating the activity in relation to which UAT was applied. The relevant notice with an indication of the date of termination of such activity should be submitted to the inspectorate within 15 days from the date of its termination (Article 346.3.9 of the Russian Tax Code). The recommended form of notification concerning the termination of certain activity was approved by Order No. MMV-7-3/41@ of the Federal Tax Service of Russia of 28 January 2013.</p> <p>In such a situation, special time limits are set for taxpayers to pay tax and submit a UAT declaration. All that must be done by not later than the 25th of the</p>

Topic	Description	Status in October 2012	Status in October 2013
	<p>7. Adjustments were made to the requirements whereby agricultural production cooperatives (including fishing cooperatives) are deemed to be agricultural producers</p>	<p>Fish farms, which are not town-forming or settlement-forming companies, are deemed to be agricultural producers and, accordingly, are entitled to apply UAT when the following requirements are met (Article 346.2, clause 2.1, sub-clause 2 of the Russian Tax Code):</p> <ul style="list-style-type: none"> - The average staff size per tax period is not over 300 employees (Article 346.2, clause 2.1, sub-clause 2, paragraph 2 of the Russian Tax Code). - Share of income from the sale of those organizations' catches of aqueous biological resources and/or the sale of fish products and other products which the organizations made from such catches is for the tax period not less than 70% of the total income from the sale of goods (work, services) (Article 346.2, clause 2.1, sub-clause 2, paragraph 3 of the Russian Tax Code). - For fishing, use is made of the fishing ships which belong to those organizations by right of ownership or which are used by them under chartering agreements (Article 346.2, clause 2.1, sub-clause 2, paragraph 4 of the Russian Tax Code). 	<p>month following the month in which, according to the relevant notice, activity as an agricultural producer was terminated (Article 346.9.5 and sub-clause 2 of Article 346.10.2 of the Russian Tax Code).</p> <p>As of 8 May 2013, fish farms, which are agricultural production cooperatives (including fishing cooperatives [collective farms]), are entitled to apply UAT when meeting the following requirements:</p> <ul style="list-style-type: none"> - Share of income from the sale of those organizations' catches of aqueous biological resources and/or the sale of fish products and other products which the organizations made from such catches is for the tax period not less than 70% of the total income from the sale of goods (work, services) (Article 346.2, clause 2.1, sub-clause 2, paragraph 3 of the Russian Tax Code). - For fishing, use is made of the fishing ships which belong to those organizations by right of ownership or which are used by them under chartering agreements (Article 346.2, clause 2.1, sub-clause 2, paragraph 4 of the Russian Tax Code). <p>No requirements for the average staff size.</p>

Topic	Description	Status in October 2012	Status in October 2013
	8. Products which are to be regarded as agricultural products have been specifically indicated.		The additions to Article 346.2.3 of the Russian Tax Code clarify that the catches of aqueous biological resources as well as fish products and other products made from such resources (sub-clauses 4 and 5 of Article 333.3 of the Russian Tax Code) relate to agricultural products only if such catches were made and the products were produced by the agricultural producers indicated in clause. 2.1 of Article 346.2 of the Russian Tax Code.
12.3. Simplified taxation system (STS)	1. Applicability. Notification procedure.	As of 1 October 2012, the application procedure for switching to STS is changed to a notification procedure (Federal Law No. 94-FZ of 25 June 2012).	In the event of termination of activity in relation to which STS was applied, the taxpayer must submit a notification to the inspectorate within 15 workdays from the date on which such activity was terminated (Article 346.13.8, Article 6.1.6 of the Russian Tax Code).
	2. Income limit for switching to STS	RUB45 million without taking account of annual inflation	RUB45 million. This amount will be adjusted annually by a deflator index, which is 1 for 2013 (Article 346.12.2 of the Russian Tax Code).
	3. Net book value of assets for switching to STS	The net book value of assets for switching to STS should not be over RUB100 million. This indicator should include the value of tangibles and intangibles.	Account is taken of only the net book value of tangibles (effective as of 1 October 2012) (sub-clause 16 of Article 346.12.3 of the Russian Tax Code).
	4. Time limits for the submission of a notification to switch to STS by payers applying the general tax regime	From 1 October to 30 November of the year preceding the year of the switch to STS	From 1 October to 31 December of the year preceding the switch to STS (effective as of 2012) (Article 346.13.1 of the Russian Tax Code).
	5. Time limits for the submission of a notification to switch to	5 workdays from the day of registration with the tax authorities	30 calendar days from the day of registration (Article 346.13.2 of the Russian Tax Code)

Topic	Description	Status in October 2012	Status in October 2013
	STS by new organizations and newly registered entrepreneurs		
	6. Notification of a change of the object of taxation	To be submitted by 20 December of the year preceding the year of a change of the object of taxation	To be submitted by 31 December (effective as of 2012) (Article 346.14.2 of the Russian Tax Code)
	7. Time limits for submitting an STS declaration for the current year if the taxpayer voluntarily switched from STS to a different tax regime	For organizations (individual entrepreneurs), not later than 31 March (30 April) of the year preceding the tax period which expired	Not later than the 25th of the month following the month in which activity involving STS has been terminated (Article 346.23 of the Russian Tax Code)
	8. Time limits for submitting an STS declaration for the current year if a taxpayer's income is over RUB60 million from the beginning of the year	For organizations (individual entrepreneurs), not later than 31 March (30 April) of the year following the tax period which expired	Not later than the 25th of the month following the quarter in which the right to apply STS has been lost (Article 346.23 of the Russian Tax Code)
	9. Recognition of R&D expenses when applying STS		Taxpayers can take certain R&D expenses into account by applying the 1.5 multiplier (Article 262.7 of the Russian Tax Code). This rule applies to R&D in the list approved by Decree No. 988 of the Government of the Russian Federation of 24 December 2008 (hereinafter, the "List"). According to sub-clause 2.3 of Article 346.16.1 of the Russian Tax Code, R&D expenses are recognized under all the provisions of Article 262 of the Russian Tax Code.

Topic	Description	Status in October 2012	Status in October 2013
	10. Taxes withheld on the territory of foreign states can be entered by taxpayers applying STS in the expenses		According to sub-clause 22 of Article 346.16.1 of the Russian Tax Code, when determining the tax base, account can be taken of the amounts of taxes and levies paid in compliance with the tax and levy legislation of Russia as well as other countries.
	11. No reappraisal is made of assets as currency values and requirements (obligations), whose value is expressed in foreign currency	Positive exchange rate differences are included in non-sale income, and negative exchange rate differences, in expenses.	As of 1 January 2013, when the tax base is calculated, account is not taken of the expenses in the form of a negative exchange rate resulting from the reappraisal of assets in the form of currency values and requirements (obligations), whose value is expressed in foreign currency (sub-clause 34 of Article 346.16.1 of the Russian Tax Code is no longer in force). In this respect, new clause 5 of Article 346.17 of the Russian Tax Code expressly indicates that such a reappraisal is not made, and income and expenses in relation to it are not determined and taken into account.
	12. A change has been made in the procedure for reducing unified tax by the amounts of insurance premiums and social benefits (when "income" is the object of taxation)	The amounts of unified tax can be reduced by all the temporary disability benefits.	<p>The procedure for reducing unified tax (advance tax payments) by the amounts of insurance contributions to the Pension Fund of Russia, the Federal Compulsory Medical Insurance Fund and the Social Insurance Fund as well as temporary disability benefits has been clarified for taxpayers applying STS with the "income" object of taxation. It is now regulated by Article 346.21.3.1 of the Russian Tax Code.</p> <p>In sub-clause 2 of Article 346.21.3.1 of the Russian Tax Code, the following has been established:</p> <ul style="list-style-type: none"> - The temporary disability benefits paid to employees in the event of an occupational accident or an occupational illness do not reduce unified tax.

Topic	Description	Status in October 2012	Status in October 2013
			<ul style="list-style-type: none"> - The amounts of benefits are taken into account only in relation to the part paid by the employer for the days of an employee's temporary disability in accordance with Russian legislation. - Unified tax (advance tax payment) can be reduced by the amount of temporary disability benefits for the days paid from the employer's resources only in relation to the part not covered by the payments made by insurance companies to employees. In this respect, those companies should be licensed to engage in the relevant activity. Moreover, such payments should be made under agreements with employers in favor of employees in the event of temporary disability (except for occupational accidents and occupational illnesses). <p>Compulsory pension, medical and social insurance premiums as well as expenses on temporary disability benefits and payments under voluntary personal insurance agreements entered into with insurance organizations in favor of employees can be deducted from the amounts of unified tax (sub-clause 3 of Article 346.21.3.1 of the Russian Tax Code); Those payments are recorded if:</p> <ul style="list-style-type: none"> - Insurance companies have licenses, issued in compliance with Russian legislation, to conduct the relevant activity. - Agreements are entered into in favor of employees in the event of their temporary disability (except for occupational accidents and occupational illnesses) for the days paid for by the employer.

Topic	Description	Status in October 2012	Status in October 2013
		<p>The amount of tax (advance tax payments) calculated for a tax period is reduced by the amount of insurance contributions made in the same tax period to the Pension Fund of Russia, the Federal Compulsory Medical Insurance Fund and the Social Insurance Fund (paragraph 2 of Article 346.21.3 of the Russian Tax Code).</p>	<p>- The insurance premium under such agreements is not larger than the temporary disability benefit, determined according to Russian legislation, for the days paid for by the employer.</p> <p>The amount of tax (advance tax payments) calculated for a tax period is reduced by the amount of insurance contributions made in the same tax (accounting) period to the Pension Fund of Russia, the Federal Compulsory Medical Insurance Fund and the Social Insurance Fund (sub-clause 1 of Article 346.21.3.1 of the Russian Tax Code).</p>
12.4. Patent taxation system	1. Patent taxation provisions of the Russian Tax Code	Patent taxation is regulated by the provisions of Article 346.25.1 of Chapter 26.2 <i>Simplified Taxation System</i> of the Russian Tax Code.	A new chapter, Chapter 26.5 <i>Patent Taxation System</i> , has been introduced to the Russian Tax Code.
	2. Probable number of hires	Not more than 5 persons (average staff size)	Not more than 15 persons (average staff size) (Article 346.43.5 of the Russian Tax Code)
	3. Submission of an application to use a patent	Not earlier than one month before the beginning of activity	In 10 days (Article 346.45.2 of the Russian Tax Code)
	4. Payment for a patent	The procedure for paying the cost of a patent does not depend on the term of its validity. One-third of its cost is paid not later than 25 calendar days after the patent comes into force. The remaining part is paid not later than 25 calendar days from the final day of the term for which a patent was received.	If a patent is for a term of up to six months, it should be fully paid for not later than 25 calendar days after it comes into force. If a patent is for a term ranging from six months to one calendar year, it should be paid for in the amount of one-third of the tax not later than 25 calendar days after the patent comes into force and in the amount of two-thirds of the tax not later than 30 calendar days before the tax period comes to an end (Article 346.51.2 of the Russian Tax Code).

Topic	Description	Status in October 2012	Status in October 2013
	5. Use of cash registers	Must use cash registers.	Not necessarily if a receipt or a pay slip is given (paragraph 1 of Article 2.2.1 of Federal Law No. 54-FZ of 22 May 2003).
	6. Insurance premium rate for entrepreneurs concerning a patent with payment to hires	30%	A reduced insurance premium rate of 20% has been set for patent activity (for activities indicated in Article 346.43.2 of the Russian Tax Code, except for clauses 19, 45-47) (clause 14 of parts 1 and 3.4 of Article 58 of Federal Law No. 212-FZ dated 24 July 2009).
12.5. Transport tax	1. Tax rate		In Article 361 of the Russian Tax Code, there is a new rule (clause. 4) whereby taxation is conducted at the transport tax rate set in clause 1 of that article if the rates are not determined by the laws of the constituent entities of the Russian Federation.
13. REFINANCING RATE		On 26 December 2011, the refinancing rate was set at 8%. On 14 September 2012, the refinancing rate was set at 8.25%.	On 14 September 2012, the refinancing rate was set at 8.25%.
14. STATE DUTY	1. Exemption of a taxpayer from the state duty	Previously, juridical authorities were only entitled to decrease the amount of the state duty or reschedule the payment.	Courts of general jurisdiction, justice courts, Russian Constitutional Court and constitutional (charter) courts of constituent entities of the Russian Federation are entitled to exempt a taxpayer from the state duty under relevant proceedings based on taxpayer's status. Clause 2, Article 333.20, clause 2, Article 333.22 and clause 3, Article 333.23 of the Russian Tax Code were amended as described below. The amendments came into force on 29 December 2012.
	2. Certain types of the state duty were increased		Starting from 29 December 2012, the following state duties were increased: - The duty for state registration of title and

Topic	Description	Status in October 2012	Status in October 2013
			<p>encumbrances for agricultural land plots was increased from RUB100 to RUB200 (subclause 1.25 of Article 333.33 of the Russian Tax Code).</p> <ul style="list-style-type: none"> - The duty for provision of a license was increased from RUB2,600 to RUB6,000 (paragraph 2, subclause 1.92 of Article 333.33 of the Russian Tax Code). - The duty for reissue of the document evidencing a license, for provision of a temporary license to perform educational activities, for issue of a license copy, and for extension of a license was increased from RUB200 to RUB600 (paragraphs 4, 5, 6, 7, subclause 1.92, Article 333.33 of the Russian Tax Code). - Maximum state duty for provision of a license to perform banking transactions increased from RUB80,000 to RUB500,000 (subclause 1.93 of Article 333.33 of the Russian Tax Code). <p>Starting from 29 December 2012, the state duty will be charged for provision of a copy of such license (paragraph 4, subclause 1.110 of Article 333.33 of the Russian Tax Code). This state duty amounts to RUB3,000. At the same time, the provision on the state duty for extension of a gambling license was eliminated.</p>
	3. State duty charge for transfer of property to mutual funds		<p>The state duty is paid when registering the right to common shared ownership regarding the property transferred to the mutual fund or purchased to be transferred to this fund, and when registering limitation on the right or transactions with property (subclause 1.22.1 of Article 333.33 of the Russian Tax Code).</p>

Topic	Description	Status in October 2012	Status in October 2013
			<p>Subclause 1.25 of Article 333.33 of the Russian Tax Code that provides for the state duty for registration of the title to agricultural land plots was amended and according to this amendment this clause does not cover registration of land plots that were provided for private subsidiary farming and for other purposes specified in subclause 1.24, Article 333.33 of the Russian Tax Code, and, importantly, transfer of these land plots to mutual funds (purchase for such transactions).</p> <p>All provisions mentioned above became effective on 29 December 2012.</p>
	<p>4. A procedure was established for charging the state duty for registration of ship mortgage agreement</p>		<p>Starting from 29 December 2012, the state duty for state registration of ship mortgage agreement and agreement on its amendment as regards to a ship is charged at a special rate in accordance with subclause 1.61 of Article 333.33 of the Russian Tax Code. The relevant amendment was made to subclause 1.28 of Article 333.33 of the Russian Tax Code).</p>
	<p>5. The state duty was established for issue of the document on passing technical inspection of self-propelled vehicles and for issue of the temporary license to drive such vehicles</p>		<p>Starting from 29 December 2012, the state duty was introduced for issue of the document on passing technical inspection of tractors, self-propelled construction and other vehicles and trailers. This state duty amounts to RUB300 (subclause 41.2, clause 1, Article 333.33 of the Russian Tax Code).</p> <p>The state duty for issue of a temporary license to drive self-propelled vehicles is paid in the amount established for the issue of the national driving license or tractor operator license, i.e. RUB400 or RUB800 depending on expendable materials (paper or plastic). This amendment was made to subclause 1.43 of Article 333.33 of the Russian Tax Code.</p>

Topic	Description	Status in October 2012	Status in October 2013
	<p>6. No state duty is changed when applying for re-issue of copies of legal acts, copies of other documents of a case and copies of enforcement orders</p>		<p>Starting from 1 January 2013, subclause 1.10 of Article 333.19 and subclause 1.13 of Article 333.21 of the Russian Tax Code are no longer in force. Based on the above, no state duty is charged when applying for re-issue of the following documents:</p> <ul style="list-style-type: none"> - copies of decisions, verdicts, court orders, court rulings, ruling of supervisory court presidium and copies of other documents of a case issued by the court, - copies of decisions, rulings, orders and copies of other documents of a case issued by arbitration court. <p>Also, no state duty is charged when applying for the issue of copies of enforcement documents.</p>
	<p>7. State duty is introduced for the preliminary examination of documents required for the state registration of a securities issue as well as for the state registration of the main part of a securities prospectus</p>		<p>A hundred and eighty days after it enters into force (2 January 2013), Federal Law No. 282-FZ of 29 December 2012 introduces a procedure for the preliminary examination of documents required for the state registration of a securities issue (new clause 2.1 of Article 20 of Federal Law No. 39-FZ of 22 April 1996). Based on such a preliminary examination, the registering body must decide whether or not the documents comply with the requirements of law. State duty of RUB100,000 is charged for the preliminary examination of documents required for the state registration of a securities issue or an additional issue. These additions were made to subclause 1.53 of Article 333.33 of the Russian Tax Code. They enter into force on 28 June 2013 (Article 14.3 of Federal Law No. 282-FZ of 29 December 2012).</p>

Topic	Description	Status in October 2012	Status in October 2013
			<p>From 2 July 2013, main and additional parts of a securities prospectus are distinguished (Article 22.6 of Federal Law No. 39-FZ of 22 April 1996).</p> <p>The main part should contain:</p> <ul style="list-style-type: none"> - an introduction summarizing the information in the securities prospectus, - information on the issuer and its financial and economic activity, - the issuer's financial statements and other financial information. <p>The main part of a prospectus must be registered separately from the additional part. In this case, state duty of RUB200,000 is charged (subclause 1.53 of Article 333.33 of the Russian Tax Code). These amendments enter into force on 28 June 2013 (Article 14.3 of Federal Law No. 282-FZ of 29 December 2012).</p>

2. ISSUES AND RECOMMENDATIONS OF FIAC WORKING GROUPS

Foreign Investment Advisory Council

2.1. Improvement of Customs Law

Issue 1. Option of adjusting declarations after goods are released

An important issue for many good-faith cross-border operators is the threat of tough sanctions if it is found, after goods have been released, that inaccurate information was mistakenly given in the goods declaration. So that goods will be in legal circulation, good-faith operators are prepared to adjust goods declarations and remit the customs payments owed (as well as penalties for the deferral that has effectively been provided), but the sanctions under Article 16.2 prevent them from doing so. Importers sometimes decide to destroy goods in order to avoid being held liable or feel compelled to falsify documents.

Moscow District arbitration courts have established a clear judicial precedent on this issue (see, for example, the Ruling of the Federal Arbitration Court of Moscow District of 24 May 2012 in Case No. A41-23449/11 and the Ruling of the Tenth Arbitration Appeals Court of 12 September 2012 in Case No. A41-2930/12). In cases where importers themselves identify errors or inaccuracies in a customs declaration after goods are released, judges are of the opinion that administrative liability for inaccurate declaration should not apply. Various grounds are given for such decisions.

This issue is important for all industrial enterprises that are located in Russia and receive components, ingredients or spare parts from abroad, and its importance will only grow as Russian manufacturing develops and becomes more complex.

FIAC's executive committee discussed this issue in Svetlogorsk on 24 May 2013. As a result, First Deputy Prime Minister Igor Shuvalov instructed that proposals be developed for amendments to Chapter 16 of the Administrative Offenses Code to provide for the adjustment of declarations after goods are released without administrative liability in cases where violations in a customs declaration are identified by the importer.

Recommendations

Chapter 16 of the Administrative Offenses Code should be amended accordingly. To ensure consistent application of the Administrative Offenses Code in cases where violations in a customs declaration are identified by the importer, it is recommended that the following notes be added to Article 16.2:

"Notes:

1. An entity that voluntarily notifies a customs authority of foreign goods that must be declared, but were not declared as prescribed, as well as a customs broker that performed customs operations on behalf of or at the behest of such entity in respect of goods imported into the customs territory of the Customs Union at the same time as such undeclared foreign goods, are released from administrative liability for the offense stipulated in Part 1 of this article, provided that the following conditions are all met:

- When such person gives notification, less than three months have passed since the customs declaration in which goods imported into the Customs Union at the same time as the undeclared foreign goods indicated in the notification was marked to indicate the release of goods.*
- When such person gives notification, the customs authority has not initiated administrative proceedings for a violation involving the declaration of inaccurate information indicated in the notification.*
- When such person gives notification, the customs authority has not duly notified such person that the latter is to be subjected to customs control (after the release of goods) in the form of a customs inspection of premises and territories, a check of the stock accounting system and reporting and/or a field customs audit.*

- *Along with the notification, such person has provided the customs authority with the documents needed in order to adjust and/or supplement the customs declaration in which goods imported into the Customs Union at the same time as undeclared foreign goods were declared as well as documents verifying payment of additionally charged customs payments and penalties.*

2. *A person that voluntarily notifies the customs authority that inaccurate information was declared on goods' designation, description, classification code in the Customs Union's Unified Commodity Classifier for Foreign Economic Activities, country of origin, customs value or other information – if such information served as the basis for an exemption from customs duties or taxes or for an understatement of such duties or taxes – as well as a customs broker that handled the customs declaration of such goods on behalf of or at the behest of such person are released from administrative liability for the offense stipulated in part 2 of this article, provided that the following conditions are all met:*

- *When such person gives notification, less than three months have passed since the customs declaration in which inaccurate information was declared was marked to indicate the release of goods.*
- *When such person gives notification, the customs authority has not initiated administrative proceedings for a violation involving the declaration of inaccurate information indicated in the notification.*
- *When such person gives notification, the customs authority has not duly notified such person that the latter is to be subjected to customs control (after the release of goods) in the form of a customs inspection of premises and territories, a check of the stock accounting system and reporting and/or a field customs audit.*
- *Along with the notification, such person has provided the customs authority with the documents needed in order to adjust and/or supplement the customs declaration containing inaccurate information as well as documents verifying payment of additionally charged customs payments and penalties."*

Issue 2. Development of electronic declaration

2.1. Use of electronic reports on the utilization of funds; proposals on the form of utilization reports

FIAC member companies in Russia think it is important to consider optimizing the form and procedure for obtaining information on the balance of funds on customs houses' personal accounts and reports on the utilization of funds/verification of payment of customs duties and taxes. Cross-border operators need this information for their operations as well as for financial and tax accounting.

Importers are experiencing serious difficulties in obtaining, processing and understanding information in reports on the utilization of prepayments as well as in obtaining data on the balances of funds on customs houses' personal accounts. Information is requested in writing, and such requests are often lost or go unanswered. Customs authorities provide hard-copy reports often exceeding 100 pages. Transformation of such reports into electronic form and their reconciliation with accounting data requires considerable time.

According to FIAC members engaged in foreign trade, it is difficult to understand and interpret information in the approved form of prepayment utilization reports. The approved report form contains no information on cash balances at the beginning and end of the reporting period, which is a major drawback. The absence of data on balances as per payment documents creates serious inconveniences when working with a report and necessitates manual calculations.

Recommendations

1. In order to simplify and accelerate the process of obtaining reports on the utilization of funds and payment confirmations for customs duties and taxes, consider enabling cross-border operators to request and receive such documents electronically, as is currently the case for some government services.

For example, such reports and confirmations may be sent and received via the electronic declaration portal on the website of the Federal Customs Service. Most cross-border operators can register on this portal, which will enable their authorized representatives to contact the customs authorities when necessary and request reports on the utilization of funds and payment confirmations for customs

duties and taxes. In turn, the customs authorities will be able to respond promptly to such requests by generating understandable and easy-to-use Excel documents and sending them electronically, thus saving time and avoiding the additional expense of mailing hard copies through the Russian post.

We request that you consider our proposals and instruct the General Directorate for Federal Customs Revenues and Tariff Regulation to change the report format and instruct the General IT Department and the Central Information and Technical Customs Department of the Federal Customs Service to promptly upgrade software supporting the integrated automated information system of the customs authorities and the electronic declaration portal on the website of the Federal Customs Service in line with the business community's proposals. These measures will simplify and greatly facilitate the electronic exchange of information and electronic document flow between business entities and customs authorities.

2. To make the information in the approved form of prepayment utilization reports more understandable, we request
 - 1) Columns to be added/modified should indicate the amount in the payment document. The amount spent under this document in previous periods; the balance of funds at the start of the report period; expenses during the reporting period, and the balance of funds at the end of the report period in accordance with the attached draft form of the prepayment utilization report.
 - 2) Please note that the report should include all payment documents with any balance of funds, regardless of the date of transfer (even if prior to the reporting period) and regardless of whether there were any expenditures in the reporting period.
 - 3) For purposes of obtaining information on the balances of funds on customs houses' personal accounts, we ask that the form of the report on balances of funds used as prepayments as of the date indicated in a cross-border operator's request (as shown in the appendix) be approved.

So that the new report forms can be put into use as soon as possible, this process should be completed in two stages:

1. Make amendments to Order No. 2554 of the Federal Customs Service of 23 December 2010 concerning report forms
2. Develop and implement a system for providing new report forms electronically.

REPORT ON THE BALANCE OF PREPAYMENTS as of 25 February 2013

Date on which report was generated: 4/2/2013

At the request of Cross-border operator
 TIN 7705000000 CRR 509900001
 ADDRESS ul. Vavilova 1, Moscow 107000

we advise that the balance of funds in Russian currency entered in the Federal Treasury account
 for Novorossiysk Customs House

as of the reporting date is:

No.	Payment document			Balance as per the payment document as of the reporting date
	Number	Date	Amount in the payment document	
1	170	3/1/2011	1,500,000.00	10,000.00
2	887	11/2/2011	2,100,000.00	7,000.00
3	185	2/15/2012	700,000.00	31,000.00
4	197	4/1/2012	900,000.00	29,500.00
5	550	12/1/2012	500,000.00	500,000.00
6	212	2/15/2013	650,000.00	650,000.00
Total				1,227,500.00

The balance as of 25 February 2013 was **1,227,500.00 rubles**

Acting Head _____
 of the Customs House (customs authority) (full name) (signature)

Date 2 April 2013

PREPAYMENT UTILIZATION REPORT
as of *date on which the report was generated*

Date on which report was generated

4/2/2013

Report for the period of 1 January 2013 through 31 March 2013

At the request of

Cross-border operator

TIN **7705000000**

CRR

509900001

ADDRESS

ul. Vavilova 1, Moscow 107000

we advise that funds in Russian currency entered in the Federal Treasury account for **Novorossiysk Customs House**

were expended in the reporting period on the basis of the following documents:

No.	Payment document						Basis for the expenditure of funds			
	Number	Date	Amount in the payment document	Previously expended	Balance at the beginning of the period	Expenses in the reporting period	Balance at the end of the period	Document number	Payment type	Amount
1	170	3/1/2011	1,500,000.00	1,490,000.00	10,000.00	0.00	10,000.00			
2	887	11/2/2011	2,100,000.00	2,093,000.00	7,000.00	0.00	7,000.00			
3	185	2/15/2012	700,000.00	633,000.00	67,000.00	43,000.00	24,000.00	1000000/010113/0001111	1010	5,000.00
								1000000/010113/0001111	2010	1,000.00
								1000000/010113/0001111	5010	25,000.00
								TP 10000000/010113/TP-6150899	9090	7,000.00
								Refund as per the unnumbered application of 31 January 2013 Decision No..... on the Refund of		5,000.00
4	197	4/1/2012	900,000.00	842,000.00	58,000.00	28,500.00	29,500.00	1000000/010213/0001112	1010	5,500.00
								1000000/010213/0001112	5010	20,000.00
								1000000/010213/0001112	2010	1,000.00
								1000000/010213/0001113	1010	2,000.00
5	550	12/1/2012	500,000.00	0.00	500,000.00	115,000.00	385,000.00	1000000/010213/0001113	5010	30,000.00
								1000000/010213/0001113	2010	2,000.00
								1000000/010213/0001114	2010	2,000.00
								1000000/010213/0001114	5010	35,000.00
								1000000/010213/0001114	1010	5,500.00
								1000000/010313/0001115	1010	35,000.00
								1000000/010313/0001116	1010	5,500.00
6	212	2/15/2013	650,000.00	0.00	0.00	0.00	650,000.00			
Total					642,000.00	186,500.00	1,105,500.00			186,500.00

The balance at the beginning of the reporting period was **642,000.00** rubles

Turnover in the reporting period **186,500.00** rubles

The balance at the end of the reporting period **1,105,500.00** rubles

Acting Head

of the Customs Hc

(customs authority)

(full name)

(signature)

Date: 2 April 2013

Note:

The report includes all payment documents with any balance of funds, regardless of the date of transfer (even if prior to the reporting period) and regardless of whether there were any expenditures in the reporting period.

2.2. Option of adjusting electronic declarations

Adjustments to goods declarations after the release of goods are governed by Resolution No. 255 of the Customs Union Commission, "On the Procedure for Amending and/or Supplementing Goods Declarations after the Release of Goods" of 20 May 2010.

Section II of this document sets the procedure for amending and/or supplementing goods declarations.

Pursuant to clause 16 of Section II, "After the release of goods, data declared in a goods declaration may be amended and/or supplemented by an authorized officer in accordance with the declaration adjustment form by adjusting the electronic copy of the goods declaration as prescribed by the laws of Customs Union member states."

The established procedure means that, where it is necessary to amend/supplement a released goods declaration, the declarer/customs broker must not only send a written request to the customs authority but also submit two hard copies of the declaration adjustment form, one electronic copy and documents justifying the amendments to the declaration.

The procedure for incomplete declaration and temporary periodic declaration assumes that, after a declaration is released and goods are exported from the Customs Union, the declarer must adjust the information declared in the incomplete/temporary periodic declaration. However, since Resolution No. 255 of the Customs Union Commission does not provide for the electronic submission of all data required to make the adjustments, the declarer is forced to submit all documents in hard copy, which entails repeated visits to the customs house. Growing distances between customs authorities and declarers' offices make this procedure quite time consuming and mean that declarations cannot be considered 100% electronic.

As a result, the current procedure for amending/supplementing goods declarations after the release of goods prevents declarers from using electronic declaration centers when submitting incomplete or temporary declarations. The same problems affect the adjustment of declarations released by customs posts located far from the declarer/customs broker when technical errors are detected which could result in a vehicle being delayed at the border customs post (in the case of exports), a violation of currency regulations, etc. Adjustments often take several days, as the CUC Resolution does not set any deadlines for data adjustments.

Recommendations

To optimize and further develop electronic documentation involved in declaring goods, we recommend that Decision No. 255 of the Customs Union Commission of 20 May 2010 be amended to enable the electronic exchange of information when information declared in a goods declaration is adjusted after the declaration is released.

For this purpose:

1. Software should enable a declarer/customs broker to send an electronic request to revise/supplement a goods declaration.
2. Information on the customs authority's decision on the declarer's/customs broker's request should be obtainable electronically.
3. Software should enable a declarer/customs broker to respond to requests from the customs authority by providing declaration adjustment forms electronically along with documents justifying the adjustments.
4. It should be possible to obtain information from customs authorities as to the results of data adjustments.
5. A declarer/customs broker should be provided with a document confirming that the information in a goods declaration has been adjusted accordingly.

2.3. Lack of electronic exchange of documents required in order to have vehicles released from a temporary storage warehouse/customs control area and transported to the consignee's warehouse

The current procedure for interaction between a customs post and a temporary storage warehouse when goods are released from the warehouse after customs clearance applies only to goods actually in temporary storage at a temporary storage warehouse and not to goods in a vehicle in a customs control area.

A cross-border operator's representatives must thus be present at the customs authority in order to receive documents from the inspector after goods are released and provide them to the owner of the temporary customs warehouse/permanent customs control area so that the vehicle's departure can be processed and a consignment note can be approved by the customs authority and provided to the driver.

This practice of document exchange is ineffective. Because vehicles and goods are held up longer in a customs control area, vehicles are delayed in reaching the delivery point, and the cross-border operator's resources are not used rationally.

Recommendations

Electronic documents should be used in having vehicles released from a temporary storage warehouse/permanent customs control area and transported to the consignee's warehouse.

2.4. The use of electronic documents for electronic declaration

Under Section II, clause 9, of Order No. 2688 of 29 December 2012, "an authorized person must, within three hours (twelve hours for goods transported by rail or water) after a customs transit procedure is completed (after goods are presented to the customs authority in the place of arrival), submit transport (shipping), commercial and/or customs documents containing information on the goods, the shipper (consignee) and the country of consignment (destination) to the customs post that oversees the operation of the temporary customs warehouse (another place of temporary storage)."

It is also stated that "such documents may be submitted to the customs authority in electronic form and signed with an electronic signature in accordance with Russian law."

As a result, the customs inspector issues a "verification of document registration," which a person authorized by the cross-border operator presents along with the documents to the temporary storage warehouse. Only then will the temporary storage warehouse accept goods for warehousing and release the vehicle.

When the possibility of automating these processes was considered, it turned out that the initiator – the Federal Customs Service – had not formulated terms of reference, and current programs thus do not offer this option.

In effect, this means that a representative of the cross-border operator must be physically present when the delivery procedure is completed and goods are placed in the temporary customs warehouse. In our opinion, this is thoroughly ineffective and at odds with the ideology of electronic declaration. This problem is most significant for cross-border operators located far from a customs post.

Recommendations

1. Terms of reference should be formulated for the development of a program module allowing a declarer to send electronic documents to the customs post section responsible for working with the temporary storage warehouse before an electronic declaration is submitted.
2. There should be an option of preparing an electronic "verification of document registration" and providing it to a temporary storage warehouse along with electronic documents from the cross-border operator.

Issue 3. Placement of goods in a temporary storage warehouse in the case of advance declaration

Order No. 2688 of the Federal Customs Service of the Russian Federation of 29 December 2012 "On Approval of the Procedure for Submitting Documents and Information to a Customs Authority When Goods Are to Be Placed in a Temporary Storage Warehouse (Other Places of Temporary Storage), for Placing (Releasing) Goods in (from) a Temporary Storage Warehouse and Other Places of Temporary Storage and for Submitting Reports on Goods in Temporary Storage as Well as the Procedure and Conditions for Obtaining Permission from a Customs Authority for the Temporary Storage of Goods in Other Places" entered into force on 3 August 2013. Clause 3 of this order specifies cases in which goods do not have to be placed in temporary storage. One such case is when a customs authority receives and registers a customs declaration – in particular, an advance declaration. Here the phrase "do not have to be placed" is interpreted as meaning "cannot be placed."

In practice, cross-border operators frequently face situations in which the issuance of an advance declaration is delayed for reasons not listed in Order No. 2688 as a basis for actually placing goods in a temporary storage warehouse (an additional request for information, a lack of time and/or resources on

the part of the customs authority, etc.). In such cases, goods are placed in the temporary storage warehouse along with the vehicle, which can be much more expensive than placing the goods alone. This is a particular problem when goods and vehicles arrive on the day before a weekend or holiday, since cross-border operators incur higher costs as a result of idle vehicles and paid storage of vehicles and goods at the temporary storage warehouse.

Recommendations

Cross-border operators should have flexibility in deciding whether to place arrived goods in a temporary storage warehouse, and this should not depend on the declaration procedure.

Issue 4. Development and improvement of the institution of authorized economic operator

As noted by the members of the customs law think tank, the institution of authorized economic operator offers such clear advantages as the ability to obtain the release of goods before a declaration is submitted and to do without customs transit guarantees and temporary storage warehouses.

Further expansion of this practice is limited, however, by a number of factors that make it difficult to obtain and keep this status and greatly complicate the operations of authorized economic operators.

1. Use of general security for authorized economic operators

A serious restriction on the work of authorized economic operators is the inability to use general security for customs payments. As a result, the use by cross-border operators of the simplifications available to authorized economic operators is limited to the amount of security provided (EUR 150,000 for manufacturing enterprises and EUR 1 million for other companies). Companies that want to benefit from these simplifications have to monitor payments and guarantees for all declarations in detail and submit the appropriate letters to the customs authorities. It is important to note that such letters are not supported by the Federal Customs Service's electronic systems and must be prepared and delivered in hard copy.

Recommendations

A mechanism of general security should be introduced for authorized economic operators.

2. The Federal Customs Service's electronic support for authorized economic operators

The simplifications available to authorized economic operators are still not supported by many of the Federal Customs Service's electronic systems. As a result, authorized economic operators are unable to take advantage of such important simplifications as remote release and advance declaration.

Recommendations

Systemic support should be provided for remote release and advance declaration so that the simplifications available to authorized economic operators can be used.

3. Specification of customs posts and types of simplification

A serious limitation is the strict specification of customs posts and types of simplification provided, meaning that authorized economic operators cannot flexibly plan their customs operations or use all the advantages available to authorized economic operators.

Recommendations

The practice of specifying the simplifications for authorized economic operators in specific cases should be eliminated, and simplifications should apply throughout the Russian Federation, regardless of specific customs posts/administrations.

4. Requirement that information be provided on a wide range of persons

To obtain the status of authorized economic operator, information must be provided on a company's management and all employees involved in the customs clearance process. In view of the size of companies, the natural rotation of staff and the lengthy procedure involved in obtaining authorized economic operator status (up to seven months), this requirement greatly complicates the procedure as well as further operations, making the company dependent on individual rank-and-file employees. A further complication is the requirement that these employees be shown not to have a criminal record.

Recommendations

People on whom information must be provided in order to obtain the status of authorized economic operator should be limited to CEOs and CFOs.

5. Use of external warehouses (custody agreements) as an authorized economic operator's area for temporary storage, delivery closure and customs operations

Currently, an authorized economic operator may use areas that are leased, owned or under operating management or economic control as sites for customs operations and temporary storage. This greatly limits the number of companies that could benefit from the simplifications available to authorized economic operators, as many of these companies use warehouses under custody agreements (i.e. warehouses owned by third parties). Legally, goods in an external warehouse remain in the ownership of the authorized economic operator, as, for instance, in the event of storage in a leased warehouse, and the authorized economic operator is no less responsible for paying duties and taxes and does not incur greater risks.

Recommendations

Clause 4.4 of Article 88 of Federal Law No. 311 should be amended to allow external warehouses (custody agreements) to be used as sites for authorized economic operators.

6. Simplified procedure of "release prior to submission of a goods declaration" for goods subject to veterinary and phytosanitary control in view of the fact that such control must be performed by the Federal Service for Veterinary and Phytosanitary Oversight

Under current law, when freight subject to oversight arrives at a customs post, it must be given a safety inspection by the Federal Service for Veterinary and Phytosanitary Oversight. Based on the results of sampling or inspection, the doctor stamps "Release Permitted" on the CMR and other freight documents. Such a stamp entitles customs to release the goods. Therefore, the simplified procedure of "release prior to submission of a goods declaration" cannot be applied to goods subject to oversight, as they have not yet been inspected by the Federal Service for Veterinary and Phytosanitary Oversight when they arrive in the authorized economic operator's area.

Recommendations

Amendments should be made concerning the procedure of veterinary and phytosanitary oversight. The Federal Customs Service should clarify the use of the simplified procedure of "release prior to submission of a goods declaration" for goods subject to oversight.

7. Procedure for completing customs transit when simplified procedures are used

Letter No. **04-30/50061** of the Federal Customs Service, citing the Convention on International Goods Transport, states that the procedure for completing freight transit, bypassing the customs post of destination (the simplified procedure of "release prior to submission of a goods declaration"), does not apply to freight transported under TIR carnets. This procedure accounts for as much as 100% of some companies' deliveries, and the simplified procedure is thus disadvantageous for an authorized economic operator if these clarifications are followed.

However, a customs clearance area is currently being created on an authorized economic operator's territory, which is tantamount to a customs clearance area at a customs post. Hence, when completing its transit through an authorized economic operator's territory, freight will still enter a customs control zone, and this is not contrary to the convention.

Recommendations

Letter No. 04-30/50061 of the Federal Customs Service should be annulled or amended to simplify the procedure for authorized economic operators' freight transported under the TIR Convention.

8. Administrative fines

In order to obtain and keep the status of authorized economic operator, an entity must not have committed two or more administrative violations entailing combined fines of over RUB 500,000. However, in the case of major cross-border operators, a single declaration may involve fines of this amount even for minor violations, and companies may thus decide against the status of authorized economic operator or risk losing it.

Recommendations

Instead of having absolute values, fines related to the criteria for an authorized economic operator should be calculated as a percentage of turnover.

9. Recognition of authorized economic operators

The status of authorized economic operator is currently recognized only in the Customs Union member state that granted that status. Thus, an authorized economic operator that is a resident of the Russian Federation cannot fully exercise its rights when it crosses a Customs Union border – in Belarus, for example.

Recommendations

The Eurasian Economic Commission should study the experience of Customs Union countries in developing the institution of authorized economic operator, and these countries should follow a path of integration toward official mutual recognition of the status of authorized economic operator.

10. Time limits for concluding agreements with customs houses

There are currently no set procedures or time limits for concluding agreements with customs houses when an authorized economic operator's certificate is amended. In practice, it may take 3-4 months to conclude an agreement when a certificate is amended, and an authorized economic operator cannot take advantage of special simplifications during this period.

11. An authorized economic operator's reporting

There is no set procedure to be followed by an authorized economic operator in switching from quarterly to annual reporting. An authorized economic operator that has operated for a year without violations is entitled to submit annual reports. However, the Federal Customs Service has not yet provided clarifications on how this change is regulated.

Recommendations for 10 and 11:

The Federal Customs Service should prepare a methodological letter for subordinate customs authorities to clarify the procedure for implementing the customs law provisions regulating the activities of authorized economic operators.

12. Extent of customs control for authorized economic operators

There are no provisions reducing the extent of customs control for authorized economic operators.

Recommendations

The Federal Customs Service should develop a randomizer for authorized economic operators that would reduce excess customs control measures and shift the focus to control at customs posts.

2.2. Technical Regulations and Elimination of Administrative Barriers

Issue 1. Resolving the issue of establishing extended manufacturer responsibility by creating a legal framework for an effective system of recycling packaging materials in the Russian Federation (jointly with the working group for the trade and the consumer sector)

The creation of a sustainable system of consumption waste management is a key issue for FIAC member companies, which for a number of years have been developing a scheme of market incentives for the collection and recycling of waste in Russia (using packaging waste as a model), based on international experience and the most effective approaches. Current EU legislation in this area provides for target indicators – standards for waste collection and recycling over a specified period of time, allowing the waste collection system to be aligned with the development of waste recycling capacity.

In 2011, as part of the requirements for Russia's accession to the OECD, Russia's Ministry of Natural Resources drafted Federal Law No. 584399-5 "On Amendments to the Federal Law 'On Production and Consumption Waste' and Other Legislative Acts of the Russian Federation (as Regards Economic Incentives for Waste Disposal)" and submitted it to the State Duma. The draft law was adopted by the State Duma in the first reading on 7 October 2011.

One of the Draft's declared goals is to create economic stimuli for waste management and to increase manufacturers' responsibility for the entire life cycle of their output. The matter in question is, first and foremost, the legislative establishment of mechanisms to reduce the generation of consumer waste, promote its recycling and put it back into economic circulation.

The Draft, as adopted in the first reading, proposed no such mechanisms.

In 2012 the draft law was revised several times (including conceptually), taking into account comments made by federal executive bodies, business and NGOs. On 10 April the president held a special meeting on the draft law and issued an instruction. The government is preparing the draft for adoption by the end of this year.

During its preparation for the second reading, several rounds of amendments have been made that would require manufacturers to make an "environmental payment" – essentially a para-fiscal levy – for the recycling of product and packaging waste. This payment was originally to be based on product cost, then on the cost of packaging, and now, in the current version, on the cost of recycling a given type of waste. Amendments made in May 2012 proposed the creation of a special reserve fund to be managed by a national association – a nonprofit waste management organization that would manage the funds collected. In the latest versions of the draft law (29 July and 23 August 2013), the fund is to be put on the state budget, but the mechanism for utilizing the funds it receives is still a bone of contention between federal agencies, regional authorities and representatives of the waste recycling industry.

The business community, represented by leading manufacturers of consumer goods, household electronics and foodstuffs, is convinced that a system based on a para-fiscal levy cannot effectively draw producer and consumer waste into the recycling process and improve the environment; on the contrary, it will lead to higher prices for products, including socially important products, make the Russian economy less attractive to investors and less competitive, and encourage corruption in waste recycling.

Recommendations

To launch an effective national system for recycling consumer waste, the following fundamental provisions must be taken into account in the final version of the draft law:

- Fiscal and para-fiscal levies should be rejected as the basis of a system to stimulate consumption waste management, and regulated entities should be free to choose whether they will meet recycling (utilization) requirements independently (including under agreements with waste management operators) and in cooperation with other manufacturers or by making an environmental payment.
- Targets for the utilization (recycling) of product and consumer packaging waste should be set for manufacturers/importers as a percentage of the product or consumer packaging to be utilized.
- An industry-specific approach should be taken, whereby separate subordinate acts set waste disposal rules for specific categories of finished products.
- The rates of "environmental payments," as an alternative to independently meeting recycling obligations, should not be calculated as a percentage of the cost of recycled products, but should be

calculated for each type of product, based on the average market cost of recycling (utilizing) the given type of product (packaging) per item (package) by weight or quantity, as is practiced worldwide.

- The "equivalence principle": the budget fund's resources should be spent for utilization of the appropriate amount and types of waste when a manufacturer (importer) meets its obligation by means of an environmental payment.
- There should be equal regulatory conditions for products manufactured and released into circulation in Russia as well as transported into Russia from outside the Customs Union and from Customs Union member states (the draft should accordingly define "importer" and "release into circulation").
- There should be a transition period of at least two to three years, during which the necessary subordinate regulatory framework can be developed and implemented and all regulated entities can prepare for the new obligations and take them into account in their financial and economic planning, production, etc. (this principle was followed, for instance, in implementing the Customs Union's technical regulations for products in the consumer sector).
- In conditions where the regulatory base and law implementation practice are not fully formed, the licensing of waste disposal and neutralization should not be eliminated in favor of self-regulation; this would lead to an unjustified relaxation of state control over players on the waste disposal market.

Issue 2. Development of the Customs Union's technical regulation system and elimination of administrative barriers to the release and circulation of products on the market

2.1. Conversion of product permission documents into electronic form

Work is currently under way to make state services as well as control and oversight procedures electronic. The declared aims are to improve the government's work, reduce business costs, eliminate administrative barriers and make control and oversight more effective.

But this is being used as a pretext for entrenching the existing administrative barriers and excessive procedures by making them electronic: instead of rejecting a procedure as excessive, it is proposed that the procedure be made electronic.

Recommendations

When control and oversight functions as well as documents and other procedures relating to the release and circulation of goods in the market are converted into electronic form, an assessment should be made of the need to maintain such function, procedure or document for the relevant commodity classification (e.g., the need for an expert sanitation and veterinary examination of processed animal products when the raw materials that went into them have already undergone such an examination).

2.2. Problem of obtaining official clarifications of the Customs Union's technical regulations

Since the adoption of the Customs Union's technical regulations, questions about how to interpret them have come up constantly for members of the business community and state control (oversight) bodies, including customs and certification authorities, test laboratories and other concerned entities.

Plans to implement certain technical regulations of the Customs Union involve formulating recommendations on their implementation. Within the scope of its authority, the Eurasian Economic Commission is currently clarifying certain provisions of the Customs Union's technical regulations by posting answers to questions about their implementation in the appropriately named section of the portal.

The section is still incomplete, however, and contains scattered information which is occasionally at variance with the official answers provided by the Eurasian Economic Commission to individual market players.

The problem is complicated by the fact that authorized bodies of Customs Union member states provide their own clarifications of the Customs Union's technical regulations without consulting each other or the Eurasian Economic Commission.

Recommendations

To optimize this process, state bodies of Customs Union member states that are authorized to perform state control (oversight) of compliance with Customs Union technical regulations, or other state bodies if the matter is directly within their competence, should be authorized to provide clarifications, on their own

initiative and/or at the request of any concerned party, of individual sections and/or clauses and/or issues with respect to the application of the Customs Union's technical regulations. A copy of such a clarification should be sent to the Eurasian Economic Commission and posted in the appropriate section of the Eurasian Economic Commission's website.

If two or more Parties and/or the Eurasian Economic Commission prepare clarifications on issues that are identical or similar in content at the initiative of a concerned entity, the Parties or the European Economic Commission should hold consultations to form a common opinion and/or settle differences. Based on these consultations, drawn up in the form of a protocol, the Eurasian Economic Commission prepares a clarification, sends it to the Parties and the entity concerned and posts it on the website. This clarification should be regarded as final.

Issue 3. Optimizing control/permission functions in connection with industrial investment/construction projects to facilitate their design, construction and commissioning and ensure the safety of industrial facilities

Inefficient and nontransparent state control procedures, both at the early stages of pre-project planning and obtaining title to land for purposes unrelated to residential construction as well as at the stages of obtaining construction permits, building and commissioning industrial facilities. Excessive state regulation in this area is a major administrative barrier to the creation of new production facilities in Russia. The current construction law and industrial safety law must be thoroughly improved to allow Russian production and technology to develop at a rapid rate. Since the administrative barriers to the construction and commissioning of industrial facilities have a strongly negative impact on the Russian investment climate and are the main obstacles preventing Russia from improving its position in the World Bank's international "Doing Business" rating, FIAC makes the following recommendations:

3.1. Sanitation and epidemiological expert examinations and sanitary protection zones

Reduction in the number of procedures to assess compliance with sanitation and epidemiological law during the construction/reconstruction of industrial facilities. The procedure for collecting initial industrial construction permits should be optimized, and the time limit for the collection and consideration of initial permits by the Federal Consumer Rights Protection Service (Rospotrebnadzor) should be reduced to 30 days. It is also proposed to reduce the number of documents required by Rospotrebnadzor and the Federal Center for Hygiene and Epidemiology to one document, i.e., the comprehensive sanitation and epidemiological examination report.

Note There are numerous redundant sanitation and epidemiological oversight procedures involved in the examination of project documentation, approval of a sanitary protection zone and the operation of an industrial facility. In each such case, a separate permit, i.e., a sanitation and epidemiological examination report, is required. Under the Urban Development Code of the Russian Federation, initial permits include a large number of preliminary permits issued by Rospotrebnadzor and the Federal Center for Hygiene and Epidemiology. Virtually every certificate or document must be prepared within 30 days.

Recommendations

Optimization of the procedure for approving the sanitary protection zones of separate facilities as well as facilities located in industrial parks. The time limit for approving the borders of sanitary protection zones should be reduced to three months by drafting and implementing Rospotrebnadzor administrative regulations for approving the borders of industrial facilities' sanitary protection zones.

3.2. Updating rules and regulations in departmental regulatory acts, including sanitary rules and regulations (SanPin) for industrial facilities under construction or reconstruction

Excessive regulation of industrial facilities at the level of departmental acts remains a substantial problem for business. One example of such unjustified regulation is the requirement that safety passports be developed and approved for hazardous facilities. This requirement, set by the Emergency Situations Ministry, is not envisaged by federal law and runs counter to recent legislative amendments on industrial safety.

The issue of updating sanitary rules and regulations (SanPin) requires special consideration. SanPin are currently the only type of document whose legal status needs clarification. On the one hand, SanPin have a significant regulatory impact on business entities' activity and may have retroactive force if amended. At the same time, SanPin are a purely departmental document that does not require approval by federal

executive bodies and is often not subject to a regulatory impact assessment or anti-corruption expert examination.

Recommendations

The interdepartmental group of experts should be instructed to involve the business community in conducting an expert examination of all current departmental acts in the area of industrial safety and SanPin in order to update the list of requirements for facilities under construction or reconstruction. Requirements that this think tank will regard as mandatory should be given the status of standards and be included in the Unified Register of Regulatory Documents that may require verification in the course of an expert examination of project documentation.

3.3. Approving and adopting Eurocodes (European Technical Standards) for design work

The use of outdated CSR (Construction Standards and Rules) and SanPin remains a problem even after the introduction of non-state independent expert examinations of documentation. This makes it impossible to base project decisions on best available technologies. This problem could be solved if Russia were to follow the EU's lead and approve unified Eurocodes in the form of national and even supranational codes of rules and regulations.

Two priority tasks came to the fore after the 24 May 2013 meeting of FIAC's Executive Committee, chaired by Igor Shuvalov: harmonization of Russian and European construction standards and the formation of an institution for insuring construction risks. The first of these tasks was included in the list of instructions made as a result of the meeting. The second – more complex, systemic and involving many members of federal executive bodies in various areas – is still under development.

The key achievement in terms of harmonization will be the adaptation and full application of Eurocodes (EN) for design and construction in the Customs Union. Belarus and Kazakhstan have already completed this process; design engineers in these countries are now free use either CSR or EN for design purposes.

In Russia the National Builders' Association has been translating and adapting Eurocodes since 2011 at its own expense and following its own schedule. The National Builders' Association is supported by the National Association of Design Engineers. The Ministry for Regional Development (Federal Construction and Housing Agency) is charged with approving the completed documents. The procedure is similar to the approval of Special Technical Design Specifications, i.e., the rules can temporarily serve as a guide for design work. As of July 2013, the National Builders' Association says that 55 of 58 volumes of Eurocodes have been translated, 30 national parameters have been developed, and in two years and four months 98 standards have been developed, and another 70 are in the works. The Eurocodes and national parameters have been sent to the Ministry for Regional Development for further approval.

It should be noted that the Program of Measures to Harmonize Regulatory Documents of Belarus, Kazakhstan and the Russian Federation with EU Construction Standards for the Period of 2010-2014, approved in late 2010 and lacking a federal target program for financing, is approaching the end of its planned completion date. A final burst of speed is required so that this work can be completed, the whole system of documents approved and full transition made by January 2015. Another problem in adopting Eurocodes is the introduction of European standards for construction materials, methods of testing and measurement and their full implementation in the industry. These standards will require an upgrading of the test base. This is a long and complex process, similar to approval of Eurocodes.

Recommendations

Translation is only the first step. The European system of regulatory documents in the construction area involves Nationally Determined Parameters (NDP) that describe each country's market specifics. As of today, countries that use Eurocodes have developed a total of 1,500 such national parameters. Russia still needs to do a thorough technical elaboration, create national parameters and do comparative calculations. The adoption of Eurocodes will otherwise be impossible. Training must also be provided for instructors at industry-related educational institutions, experts and professionals in the construction market.

The think tank managed to have this issue put on the agenda for discussion by the Collegium of the Ministry for Regional Development when it meets in August of this year in St. Petersburg. The minister designated these joint efforts by the ministry and national associations of builders and design engineers as priority tasks.

The minimum progress that must be made in this direction is the translation and approval of Eurocodes; the maximum would be the approval of all related national parameters. The Ministry for Regional Development should be consulted about the status of this work on an at least a quarterly basis.

Issue 4. Improving the competitiveness of products and services as well as labor productivity in the Russian market as a result of the efficient regulation of labor resources

4.1. Regulating relations between employers, employment agencies and jobseekers under "employee leasing" arrangements (Draft Federal Law No. 451173-5)

On 20 May 2011 the State Duma of the Russian Federal Assembly adopted, in the first reading, Draft Federal Law No. 451173-5 "On Amendments to Certain Legislative Acts of the Russian Federation (Measures to Prevent Employers from Avoiding Employment Contracts by Unjustifiably Concluding Civil Contracts, Using Employee Leasing Arrangements or Other Means)".

On 26 April 2013, the State Duma adopted Draft Federal Law No. 451173-5 in its second reading. However, when the draft law is given a third reading, it is likely to be sent back to the second-reading stage for further work on some of its formulations. Contentious provisions in the draft federal law and amendments thereto include the following: the need to enter into two employment contracts for a leased employee (with the leasing agency and host employer as well as between affiliates); the limited time frame of employee leasing; the expanded rights of labor inspectors; subsidiary responsibility of the host employer; and the definition of the "secondment" concept.

Foreign investors support legislators' intention to supplement current labor law with provisions regulating relations between private employment agencies, companies and employees that are leased or seconded to these companies.

Currently, however, there is a risk that this instrument for enhancing labor efficiency and production processes, widely used in Russia and around the world, will be over-regulated (during seasonal peaks, the expansion and modernization of production lines, secondment to share skills and experience, the implementation of high technologies and in other cases).

Proposals and comments by FIAC members were sent to the Ministry for Economic Development and the Ministry of Labor.

Recommendations

Additional work should be done on Draft Federal Law No. 451173-5 taking into account FIAC's position on the need to eliminate the risk of excessively regulating the institutions of employee leasing and secondment to allow investors to react promptly and flexibly to changing economic conditions, to ensure the effective use of human resources and the timely employment of highly qualified personnel in full compliance with labor law.

4.2. Enhancing the regulatory framework for compensation and payments to employees working in harmful and hazardous conditions

FIAC members informed the Russian government about the risks of an incorrect interpretation of the provisions of Decree No. 870 of the Russian Government of 20 November 2008 "On Reduced Working Hours, Additional Paid Vacation and Increased Pay for Employees Engaged in Heavy Work or Work in Harmful and/or Hazardous and Other Special Working Conditions" as well as about ambiguous court practice regarding the concurrent provision of all types of compensation to employees, regardless of the class and extent of hazard at a given workplace.

Foreign investors were informed that Decree No. 870 of the Russian Government of 20 November 2008 is to be amended in connection with the development and subsequent adoption of the draft law "On the Special Assessment of Working Conditions".

On 27 August 2013, draft federal laws "On the Special Assessment of Working Conditions" and "On Amendments to Certain Legislative Acts of the Russian Federation in Connection with the Adoption of the Federal Law 'On the Special Assessment of Working Conditions'" were approved by the Russian government.

On 3 September 2013, the Russian government submitted draft federal laws No. 337970-6 "On the Special Assessment of Working Conditions" and No. 337978-6 "On Amendments to Certain Legislative Acts of the Russian Federation in Connection with the Adoption of the Federal Law 'On the Special Assessment of Working Conditions'" to the State Duma.

Unlike the regulatory principles of prior periods, the current versions of these draft laws do not include the principle of differentiated compensation by class and degree of hazard. As currently worded, the draft laws' provisions may substantially drive up costs and require that the business processes of manufacturing companies in the Russian Federation be restructured.

In addition, FIAC members are concerned that until the new federal law enters into force and the relevant regulatory acts are amended, businesses will have to deal with ambiguous judicial interpretations of current law (Decision No. AKPI12-1570 of the Supreme Court of the Russian Federation of 14 January 2013, etc.).

Recommendations

The possibility of amending Decree No. 870 of the Russian Government of 20 November 2008 should be explored in order to establish a procedure for providing employees working in harmful conditions with compensation differentiated by class and degree of hazard (3.1, 3.2, 3.3, 3.4) before the Federal Law "On the Special Assessment of Working Conditions" enters into force.

Amendments should be made to the draft federal laws "On the Special Assessment of Working Conditions" and "On Amendments to Certain Legislative Acts of the Russian Federation in Connection with the Adoption of the Federal Law 'On the Special Assessment of Working Conditions'" to establish the principle of differentiated compensation by class and degree of hazard;

Involve FIAC experts at the stage when the provisions of the Federal Law "On the Special Assessment of Working Conditions" are being agreed on.

4.3 Enhancing the regulatory framework for hiring physically challenged (disabled) employees and providing them with equipped work stations (including by means of budget allocations)

Currently, labor relations between an employer and disabled persons are regulated by Federal Law No. 181-FZ of 24 November 1995 "On the Social Protection of Disabled Persons in the Russian Federation".

Although many amendments and additions have been made to this law (the latest were introduced on 2 July 2013), a number of key issues that directly impact the operations of foreign investors in Russia remain unsettled. For example, although job quotas for disabled persons and funds allocated to employers to equip work stations for disabled persons differ from one federal constituent entity to another, they do not (and cannot) differentiate between disability categories. This makes it impossible to comply with the legislative requirement that "universal" work stations be provided. It also fails to take into account technological and other operational and industry specifics of employers, which may include the remote employment of disabled persons, climatic conditions of federal constituent entities and other important factors.

Generally speaking, the requirement that international companies determine the number of work stations set aside for disabled persons and equip them accordingly before there has been a fair screening of candidates on the labor market, based on the principles of equality and nondiscrimination, seriously affects compliance with the business principles set down in the internal corporate codes of many FIAC member companies and also, in our view, severely limits disabled persons' access to the full range of professions and job roles on the labor market, which is in itself contrary to the idea of the law.

Recommendations

A think tank should be formed jointly with the Ministry of Labor and representatives of FIAC member companies to develop proposals for revising current (introducing alternative) approaches to job quotas for physically challenged (disabled) persons and to allocations for specially equipped work stations, depending on disability group, industry specifics (the mining industry, etc.) and regional climatic conditions (in the Far North, etc.). Target quotas should be tied to the number of work stations potentially suitable for physically challenged (disabled) persons rather than to a company's total headcount;

Proposals should be made for amending draft federal laws No. 337970-6 ("On the Special Assessment of Working Conditions") and No. 337978-6 ("On Amendments to Certain Legislative Acts of the Russian Federation in Connection with the Adoption of the Federal Law 'On the Special Assessment of Working Conditions'") to introduce a procedure for mandatory assessment of work stations' suitability various types of disability.

Issue 5. Resolving the issue of introducing economic incentives to encourage businesses to implement the best technologies (*Draft Law No. 584587-5 "On Amendments to Certain Legislative Acts of the Russian Federation Concerning the Improvement of Environmental Protection Standards and the Introduction of Economic Incentives for Business Entities to Implement the Best Technologies"*)

On 26 July 2011, Draft Law No. 584587-5 "On Amendments to Certain Regulatory Acts of the Russian Federation Concerning the Improvement of Environmental Protection Standards and the Introduction of Economic Incentives for Business Entities to Implement the Best Technologies" was submitted to the State Duma.

The think tank supports the general idea of the Draft Law and a number of its provisions, e.g.:

- The categorization of business entities by hazard level and the corresponding differentiation of requirements made of various categories of business entity as well as methods of state oversight depending on the level of danger to the environment (amendments to the Federal Law "On Production and Consumption Waste")
- Clarification of the objects of state environmental expert examinations; determination of entities entitled to submit documents for state environmental expert examinations; reduction in the time limits for state environmental expert examinations; and reduction in the list of cases in which a favorable expert report loses its legal force (amendments to the Federal Law "On Environmental Expert Examinations", see Article 1.3.2)
- Clarification of several definitions in Article 1 of the Federal Law "On the Protection of the Atmosphere"
- A number of other procedural norms allowing most of the draft law's requirements to be unambiguously applied.

The think tank notes that the Draft Law's basic definitions and certain provisions need considerable revising.

The think tank's principal comments focus on clarifying the concept of "best available technologies" (BAT) and their criteria. For instance, according to the Draft Law, the criteria of "best available technologies" include:

- the least extent and/or level of impact on the environment per volume or mass of goods produced per unit of time or other indicators stipulated in Russia's international treaties,
- the economic effectiveness of implementation,
- the resource- and energy-saving methods available for use,
- the use of low-waste or waste-free processes,
- the technology implementation period,
- industrial implementation at two or more business facilities and other facilities.

According to think tank experts, the proposed criteria cannot be used in their present form due to their extremely vague formulation (they lack references to standard data and recommended limits for determining the "least" extent or level of impact on the environment, the economic effectiveness of implementation [which is always present as a ratio of the effect produced to expenses incurred] and the technology implementation period; there are no criteria for identifying "low waste" processes, allowing for ambiguous interpretations, and some criteria are not linked to business realities and practice in market conditions).

At the same time, the Draft Law authorizes a federal executive body to approve methodological recommendations for determining technological processes, equipment, techniques, methods and means in the form of BAT. This can lead to corruption in the transition to BAT, since substantial fines may be imposed on business and other entities for using "old" technologies, while there is no detailed procedure for forming a list of such technologies.

Moreover, as representatives of the community of foreign investors in Russia, Think Tank experts believe that the list of economic incentives in the Draft Law for the transition of business and other entities to BAT is inadequate and does not fully meet current market requirements. There are also no economic or tax incentives for business entities that already have technologies with all the features of BAT (largely enterprises owned by companies with foreign investments in Russia).

The Think Tank drew up a list of comments on amendments that the Draft Law proposes to make to the following federal laws:

- "On Expert Environmental Examinations"
- "On Production and Consumption Waste"
- "On Air Protection"
- "On Environmental Protection".

Recommendations

- In preparing the draft law for its second reading, the think tank believes that the draft should continue to be widely discussed within the Open Government with the involvement of experts and businesspeople, that the final concept should be approved by the prime minister (as was the case with the draft law on amendments to the Federal Law "On the Industrial Safety of Hazardous Production Facilities") and that the finalized draft law should be submitted to the State Duma for its second reading.
- The general approach and specific comments of the Russian Union of Industrialists and Entrepreneurs should be reviewed:

Consideration should be given to the possibility of using the approach that was successfully applied when the draft Federal Law "On Amendments to the Federal Law 'On the Industrial Safety of Hazardous Production Facilities' and Other Legislative Acts of the Russian Federation" was finalized. This approach is aimed at gradually transitioning to modern methods of regulation by including in the law the option of choosing the method of regulation. If the Federal Law "On Environmental Protection" is amended, such an approach may envisage the following:

- A company may either meet the requirements of current legislation (and the usual regulatory mechanism is then applied to it) or declare its intention to improve ecological efficiency and attain the indicators of best available technologies.
- In the latter case, a company should develop a program for attaining the indicators of best available technologies (BAT level) and improving the ecological efficiency of production, including a schedule for reducing negative impact and a list of steps to be completed in meeting obligations.
- The BAT level is set by an enterprise itself based on its own indicators, Russian experience and, if need be, foreign references.
- The program is submitted for consideration to the state interdepartmental commission, which includes state bodies that control and regulate the company's activity, including its impact on the environment; if approved by the commission, the program replaces all permits and regulations during its term of validity.
- Actual expenses incurred while the program is being implemented are included in the company's payment for negative impact.
- In the event of an unapproved departure from the schedule, the commission examines such a violation and issues a demand for it to be eliminated; if the violation is not eliminated in due time, a multiplier of 100 is applied to payment for negative impact, but the amounts of such payments may be offset if the violations are eliminated or the declared indicators are attained.

Such a mechanism, due to its specificity, will apply to only a limited number of companies, meaning that state bodies' available resources will suffice and also that valuable experience will be gained from such a regulatory approach, since it is conceptually similar to the procedure for coordinating and approving the comprehensive environmental solution in the European Union.

As an option, use can be made of the mechanism of gradual (step-by-step) mandatory transition to such a system of regulating major polluters, beginning with the largest, thereby ensuring the greatest effect in reducing the negative impact on the environment.

Such a mechanism will allow economic stimulation mechanisms of greater complexity to be elaborated, and the categorization of facilities to be simplified by dividing them into facilities producing substantial pollution (which are required to develop programs), those producing inconsiderable pollution (which are not subject to regulation) and others (unless provided otherwise, those in the current system).

Issue 6. Problems involved in implementing the Federal Law "On Water Supply and Drainage"

Federal Law No. 416-FZ "On Water Supply and Drainage" changed the legal status of companies that use centralized drainage systems by categorizing them as natural resource users (hereinafter, water-using companies).

From 1 January 2014, companies that discharge water into centralized drainage systems at a rate of over 200 m³ per day and manufacturers in a government list, regardless of how much they discharge, will be regulated in the same way as economic entities that use bodies of water directly – water services companies, for example.

Such companies are to be placed under the direct supervision of the Federal Service for Natural Resource Management, and they will be required to make *payment for* adverse environmental impact as well as to have the following documents, approved by an authorized government body:

- emission standards for pollutants, other substances and microorganisms,
- a plan for reducing emissions of pollutants, other substances and microorganisms,
- limits on emissions of pollutants, other substances and microorganisms.

However, no transition period is envisaged for obtaining these documents and having them approved by the Federal Service for Natural Resource Management: water-using companies must have all three documents beginning on 1 January 2014, when Chapter 5 of Federal Law No. 416-FZ "On Water Supply and Drainage" (environmental regulation) enters into force, introducing the new form of regulation.

In view of the scale of this new regulatory approach, the thousands of entities affected, and the current practice of obtaining documents from the Federal Service for Natural Resource Management (or having them approved), it should take at least a year to prepare these documents. For at least this period of time, water-using companies will be at risk of huge fines – since all their emissions will be regarded as unauthorized from 1 January – as well as refusal to accept wastewater from companies that will thus be regarded as systematic violators of environmental law.

However, the key problem with the new regulatory scheme is the existing system of limits on admissible pollutants in wastewater discharged into bodies of water. This system is based on water quality standards for fishery purposes, which are much stricter than those for drinking water quality. Any body of water in which wastewater is discharged is assumed to be potentially suitable for fish and fishery purposes, and fishery quality standards are thus applied to water users in all cases. This essentially requires water users to discharge water that is cleaner than the water they receive from centralized water supply systems or take from the same body of water into which they are discharging, which in most cases – especially within city limits – fails to meet both quality standards for fisheries and public health standards for drinking water.

From 1 January 2014 a similar approach will be extended to thousands of companies using centralized water supply systems. Wastewater quality will be monitored at company outlets. The new standards ignore the fact that companies do not discharge wastewater directly into bodies of water, but into centralized drainage systems, which are relatively effective at eliminating pollutants.

The requirement that water released from companies' water disposal systems meet fishery quality standards is clearly unrealistic – both economically and technically.

Article 27.6 (Chapter 5) of Federal Law No. 416-FZ "On Water Supply and Drainage" requires water-using companies to construct their own local treatment facilities in addition to the treatment facilities of water services companies.

It will be an economic hardship for companies to build local treatment facilities even in the seven-year period allowed by law. The construction of local water treatment facilities to meet fishery quality standards is unrealistic both economically and technically:

- Most existing companies, built over 15-20 years ago, lack their own treatment facilities.
- The construction of modern local treatment facilities that eliminate only the main pollutants (taking the food industry as an example) costs several million US dollars; any attempt to reach water quality standards suitable for fishery purposes will at least double the required investment.
- The service and maintenance of such treatment facilities costs additional hundreds of thousands of US dollars annually.
- Wastewater quality that meets fishery standards is technically unattainable: to meet such standards, discharged wastewater would have to undergo reverse osmosis, including subsequent evaporation of the concentrate, i.e., it would actually have to be distilled. Wastewater treatment facilities that can purify water to standards suitable for fishery purposes simply do not exist in Russia.

- At a time when economic growth is slowing and the profitability of industrial enterprises is falling, a return on such investments will take decades.

In such conditions, many water-using companies, especially medium-sized regional and local companies that are only marginally profitable will have to shut down.

Huge costs for the construction of treatment facilities will have an impact on the cost of production, making Russian companies less competitive not only with each other but also with manufacturers in other countries of the Customs Union and further abroad.

The lack of transition periods for the new regulatory scheme, the vagueness of the requirements and the unfeasibility of the new standards from an engineering point of view greatly increase the potential for corruption in the environmental area.

In no country does legislation make such demands on the users of drainage systems, because such demands are senseless from an environmental standpoint and not economical.

The issue of the unacceptability of these provisions of Law No. 416-FZ was first raised in 2012. The government decided to postpone the implementation of Chapter 5 of Law No. 416-FZ for one year – until 1 January 2014 – so that it could be further refined. On 30 December 2012 the State Duma adopted the relevant law (291-FZ).

In June 2013, the working group of the State Duma's Housing Committee completed its work at the general meeting level, but the draft law to amend Federal Law No. 416-FZ, including Chapter 5, has not yet been submitted for consideration by the Duma. According to the available information, the amendments that have been developed do not make the necessary changes, and the regulatory scheme for water-using companies remains almost the same.

The five government decrees that have been adopted to improve articles 27-28 of Chapter 5 of Law No. 416-FZ not only do not solve the problems created by the law, but exacerbate them.

In June 2013 Deputy Prime Minister Dmitry Kozak instructed (clause 3 of Instruction No. DK-P9-128pr of 10 June 2013) the ministries for natural resources, regional development, agriculture and economic development to submit, by 1 September, coordinated proposals and draft regulatory acts amending Russian law to prevent the unjustified application of water quality standards for fishery purposes and to move toward regulatory requirements similar to those in countries of the European Union. There is no information on the current status of this instruction.

Recommendations

- In this situation, we consider it essential to postpone the implementation of the provisions of Chapter 5 of Law No. 416-FZ that are indicated in Law No. 291-FZ until 1 January 2016 in view of the need to adopt and implement regulatory acts amending Russian law to prevent the unjustified application of water quality standards for fishery purposes and to move toward regulatory requirements similar to those in countries of the European Union. These regulatory acts should have a separate section describing the method of calculating VAT for users of centralized drainage systems, taking into account the following key principles:
 - When centralized drainage systems include treatment facilities, the maximum concentration level should take into account the capacity of these facilities to reduce the level of such pollutants as suspended solids, chemical oxygen demand (COD), biochemical oxygen demand (BOD), nitrogen and phosphorus; *(This is also in the interests of centralized drainage systems to support the biological treatment facilities of water services companies, since organic impurities are essential for the biological oxidation of municipal wastewater. For example, a level of COD/BOD equaling 700/500 in wastewater is acceptable for both users and centralized drainage systems).*
 - For other pollutants, the maximum concentration level should not exceed sanitary requirements for drinking water taken from the same centralized water supply system.
 - The method of establishing the maximum concentration level should be dynamic rather than static, meaning that it should provide for a consistent lowering of the concentration of pollutants in line with a discharge reduction plan approved by the authorized government body.
 - The method should be based on technically and economically feasible purification technologies.
- Companies that are natural resource users should be allowed a twelve-month transitional period so that they can obtain standards for admissible discharge levels, discharge reduction plans and discharge limits from the authorized government body.

2.3. Financial institutions and Capital Markets

Development of Moscow as an international financial center

Positioning of Moscow as a center of regional financial integration of CIS countries

Issue 1. Creation of financial market infrastructure and legislation to regulate it

Recommendations: improvement of legislation (adoption of laws/amendments to laws):

- On Stock Exchanges and Organized Trading
- On Bankruptcy of Individuals
- On Economic Insolvency
- Development of legislation to legitimize money transfers
- Preparation of a legislative base for issuing foreign bonds in Russia/Russian depository receipts
- Introduction of the "foreign nominal holder" concept into the regulatory framework.

1.1. Pledge law

The Russian Ministry for Economic Development, in close collaboration with the European Bank for Reconstruction and Development, is working to reform pledge law in accordance with clause 66 of the Anti-Crisis Plan. The reform is intended to address the most serious problems encountered by market participants in using pledges. An increase in market participants' confidence in the reliability and effectiveness of pledges as a form of security should result in greater financing on more favorable terms and so make it possible to satisfy the economy's demand for capital in a more timely and adequate manner.

In the context of an extensive reform of civil legislation, the Presidential Council for Codification and Improvement of Civil Legislation drafted a revised Civil Code, which addresses, among other things, provisions on pledges (Chapter 23, paragraph 3).

It should be noted that the pledge provisions of the draft Civil Code, if adopted in their current form, would not allow Russia to fully meet its goals in reforming pledge legislation. It is thus very important to ensure that the key areas of this reform are reflected in the Civil Code.

Advantages: The draft Civil Code (prepared for its second reading in the State Duma) is more advanced than current legislation with respect to the following:

- Confirms the legitimacy and possibility of levying charges in relation to syndicated loans,
- Recognizes the legitimacy of pledging bank accounts,
- Envisages the registration of pledges and recognizes the validity of a pledge in relation to third parties from the date of its registration. These provisions are supplemented by a recently adopted law under which the Federal Chamber of Notaries is to develop a unified register of notifications of pledges of immovable property and ensure its functioning; this is a revolutionary development in Russia.

Disadvantages: a more flexible and effective approach to pledge transactions is not introduced in the draft, e.g.

- There are still many restrictions affecting extra-judicial claims.
- Pledges of bank accounts will not be as flexible as in many other markets.
- Transaction costs may remain high due to excessive requirements.

Critically important: the draft contains problematic provisions relating to:

- **The description of assets that may be pledged:** the parties must be allowed to describe pledged items as they deem appropriate for their transaction, provided that such a description allows them to identify a pledged item at the time of enforcement. That will expand the range of assets pledged by borrowers and will ensure lenders' confidence in the reliability of pledges offered to them (e.g., lessen the risk that a transaction will be declared "non-existent" on formal grounds that a pledge is described inadequately; currently, such a risk is quite high for lenders) and will also reduce transaction costs involved in secured financing (e.g., when a pledged item is changed, amendments to the pledge agreement need not be made if such a change is covered by the initial general description).
- **The obligation to notarize an extra-judicial claim agreement in relation to pledged immovable property, regardless of who the pledger is.** Such a requirement may be needed to protect individual pledgers, since individuals are usually in a more vulnerable position and would be better protected if they consulted a notary. But there would seem to be no reason for similarly protecting legal entities that pledge their immovable property; besides, such an obligation would substantially increase the transaction costs. There are also provisions in the draft which actually oblige the parties to notarize all pledge agreements so as to have the option of making an extra-judicial claim, but this also increases transaction costs and negatively affects Russia's economic development in the long term.
- **The obligation to notify a debtor about a pledge of the right of claim against him within five days after entering into a pledge agreement.** In the contemporary financial world, it is quite common to pledge rights of claim. The debtor should be notified of such a pledge voluntarily, since there may be various reasons for the parties to consider it inexpedient to notify the debtor immediately. Such notifications also result in additional transaction costs. It is also important to allow the pledge holder to send notification himself without relying on the pledger, because relations with the pledger may worsen by the time such a notification is required by the pledge holder, and the pledger will not then cooperate with the pledge holder.

Recommendations

According to FIAC, the above-mentioned shortcomings should be rectified in the pledge provisions to be considered in the second reading by the State Duma. The European Bank for Reconstruction and Development (EBRD) is ready to provide the text of the corrections which should be made.

In cooperating with FIAC, the EBRD is willing to provide full technical assistance to the Ministry of Justice and the Federal Chamber of Notaries in developing a unified register of notifications of pledges of immovable property so that the system will meet today's market requirements.

1.2. Development of the payment system

There is a need to increase the efficiency and security of the national payment system and promote its further integration into global payment systems.

In June 2011, the Federal Laws "On the National Payment System" and "On Amendments to Certain Legislative Acts of the Russian Federation Following the Adoption of the Federal Law 'On the National Payment System'" were approved by the Federation Council and signed by the Russian President. The think tank's comments on the prohibition of the cross-border exchange of data were incorporated into these laws.

The non-profit partnership National Payment Council (NPC) was established by a resolution of 8 February 2012 and registered in the Unified State Register of Legal Entities on 12 March 2012. Its founders include major Russian and international companies, such as Deutsche Bank Ltd., which coordinates FIAC's Financial Institutions and Capital Markets Think Tank.

Recommendations

Now that the National Payment Council has been established, NPC members should work closely to develop the national payment system and provide input in developing a strategic plan and standards for the national payment system in line with the best international practices.

- Further assistance from the think tank led by Deutsche Bank for the program of information exchange between the CBR and European central banks. Exchange with European organizations in the course of various meetings.

- It is crucial to develop the legislative framework for the effective implementation of the Federal Law "On the National Payment System," particularly in order to ensure the smooth operation of the payment system. The Central Bank will prepare new regulatory acts in connection with the adoption of the law on the national payment system, including rules on the registration of payment systems.
- It is essential that the Strategic Plan for the Development of the National Payment System provide for the formation of the required infrastructure. Ensure:
 - A new payment format aligned with the SWIFT/SEPA standards and formats
 - Online processing of all internal payments, discontinuation of route payments
 - Permission to use the English language
 - Payee identification – standardization of payment purposes, introduction of code words instead of formulations chosen at will
 - Liberalization of currency control
 - Facilitation of tax payments (10 types) – alignment with SWIFT standards and formats.
- More active work by the payment card subcommittee of the Technical Standardization Committee "Financial Operations Standards" (TC 122). There are plans to team up with the Federal Agency for Technical Regulation and Metrology and start drafting the Russian standard "Financial Terms and Definitions."

1.3. Further improvements to legislation regulating the accounting infrastructure of the securities market

There is a need to develop subordinate acts in connection with the Law "On the Central Depository" and amendments to Law 39-FZ "On the Securities Market."

The result should be an effective, transparent and generally accepted accounting infrastructure for the securities market.

1.4. The financial sector's recommendations for amendments to be made to the Russian Civil Code

The amendments to the Civil Code were drafted and introduced to the State Duma, which is considering them and adopting the amendments in parts.

According to the business community, the amendments should be adopted so that the Civil Code would clearly and unambiguously regulate and resolve the following aspects:

- Fee for a loan (this is standard market practice, but currently it is rarely adhered to because of some of the latest court rulings in Russia)
- Syndicated lending
- Agreements between lenders
- Agreements on subordinated loans
- Securitization and sale of loan portfolios
- Easing the regulation of bank guarantees
- Escrow accounts
- Possibility of executing contracts and passing payment documents through electronic means of communication (e.g., SWIFT)
- Greater flexibility in relation to loan agreements and bank accounts: the parties to an agreement should be entitled to include various terms and obligations, which differ from the standard minimum set in the Civil Code, in it.

The current draft amendments do not distinctly regulate the aforesaid directions and several others. Hopefully, the draft amendments will be discussed with the business community and then sent to the State Duma.

Issue 2. Attractiveness of the Russian financial market for foreign investors

2.1. Reform of the pension system

As compared with similar pension reforms in Central Europe, the pension reform in Russia, which began in 2002, has had only limited success. Under the pension reforms in Slovakia, Poland and Hungary, for instance, private companies quickly managed to offer their pension services to most of the working population and create considerable investment assets under management. In Russia, despite recent government efforts, such as the co-financing initiative launched in 2009, cumulative pension insurance is still not very popular and is not actively used by the workforce. As a result, the investment assets built up in the cumulative part of the compulsory pension insurance system are insignificant in relation to Russia's GDP.

A comparison of the non-state pension funds of Central Europe and Russia shows, for instance, that Poland, where pension reform was implemented in 1998, now has only two non-state pension funds, and they are among the top 100 European pension funds. That is largely because this sector of the country's economy is of great interest to investors. Russia has no private pension funds in the Top 100.

As of 31 December 2011, only 15.4 million Russians (20.7 % of the total number of citizens who have pension accruals) agreed to join the private pension system and "privatized" the management of the cumulative part of their pension.

Pension accruals under the compulsory pension insurance system which have been placed in the hands of non-state pension funds as a result of the national pension reform amount to RUB 340.4 billion (USD 11.4 billion). By comparison, AVIVA OFE BPH, the largest pension fund in Poland, manages USD 17.2 billion in assets (as of Q3 2011)

In recent years, there has been an on-going discussion, involving the relevant ministries and departments, on the need for a new pension reform. The cumulative part of the retirement pension and private pension funds are being strongly criticized for alleged mismanagement of pension accruals. The growing deficit of the Pension Fund of Russia and the need to close the gap in its budget are the main reason for concern. The Pension Fund's deficit arose not due to the introduction of the cumulative aspects, but to mechanisms put in place in the Soviet period.

Russian players on the private pension market and potential foreign investors are as yet unclear about the state's goals. Is the idea to privatize the cumulative part of the pension system and bring investments into the private pension system or to retain the existing system, where nearly all pension assets are managed by the Pension Fund of Russia and Vnesheconombank, which is a state management company? The importance of this issue for Russia in general, and Moscow as a financial center in particular, is obvious. The indecisive approach to pension reform keeps foreign long-term investments, so greatly needed by the Russian economy, from entering the Russian market.

If the Russian government is serious about turning Moscow into a global financial center, it needs to clearly outline the prospects of the cumulative component of the compulsory pension insurance system and the future of pension reform as an incentive for Russian and foreign companies to invest in the private pension system. This would result in more active involvement by private organizations in the Russian pension system and would help create a "savings culture" in Russia.

There is also an objective reason for this, i.e., the mechanism of accepting an application for participation has not yet been developed.

Recommendations

- Retain the cumulative part in the Russian pension system. Under the Draft Law "On Amendments to Certain Legislative Acts Concerning Compulsory Pension Insurance," as of 2014, the rates of contributions to the cumulative part of the retirement pension should be cut to 2% for insured persons whose pension accruals are formed in the Pension Fund of Russia and invested by Vnesheconombank, while 4% would be redistributed to the insurance part. The rate of contribution to the cumulative part of the retirement pension will remain at 6%, unless provided otherwise, for insured persons who submit an application to switch to a private pension fund or private management company by 31 December 2013.

Insured persons are to be determined in 2013, and the retention of the cumulative part will be discussed further.

We believe that the development of the pension system is held back by such frequent reforms.

- Develop the cumulative part in the Russian pension system, for instance, by using the pension co-financing program. Until recently, it was unclear whether the state pension co-financing program would be continued. In late November 2012, however, it was decided not to extend the program, since the Government believed that the program had not been successful enough. The program will still be valid for persons who joined it prior to October 2013.

The logic to close the program in October 2013 is largely that Russians are not prepared to voluntarily pay old-age contributions out of their salaries and wages. We believe the campaign is unpopular because the program has not been widely promoted and because the curtailment of the cumulative part has been under discussion for so long.

- Revise the legal status of non-state pension funds, i.e., make them commercial entities. If necessary, consideration should be given to creating two separate classes of pension funds: 1) sector-specific/captive non-state pension funds allowed to operate within the existing framework as non-commercial entities 2) open, independent non-state pension funds that will operate based on other principles as commercial entities.
- Some additional changes are also required. One significant problem is insufficient transparency due to the two-tier system used to determine management fees (charged both by private pension funds and asset management companies). Asset management companies must be established that would collect all fees based on clear guidelines introduced and monitored by the regulator on the disclosure of fee information to clients.
- Review the requirements for investing pension accruals. Offer convenient and transparent long-term investment instruments to the pension accruals market.

Ensure that the security of pension accruals is guaranteed. We believe that it should be clearly established and articulated in the relevant legislation that investment risks lie with the owners of pension accruals, i.e., with insured persons. Investment risks lie with the ultimate beneficiary of the pension account, and returns are a function of the risk taken.

- Revise the current business model for players on the pension market (private pension funds and management companies). The fees that market players can charge for the management of assets in the compulsory pension insurance system should be changed. Fees should be calculated based on the amount of pension assets under management, rather than on return on investments, as is currently the case. The current fees do not allow for proper business planning, given the very volatile local financial market. Besides, the current approach to charging fees may prompt some market players to use riskier investment strategies which may conflict with clients' interests. Fees charged as a percentage of the amount of assets under management or as a percentage of contributions received ensure more stability for private pension funds and asset managers and are more attractive for investors.
- The institution of licensing pension agents should be introduced in order to eliminate fraud involving improper practices by agents. Currently, there is no nationwide system for monitoring/registering/licensing agents, and cases of fraud involving improper practices by agents are common. Private pension funds do their best to perform retrospective reviews of the activities of all agents they engage, but the lack of a nationwide system greatly complicates this task. The need for minimum standards/licensing requirements/guidelines/training for agents must be addressed. This issue may need to be considered in the future, and we hope that a comprehensive system will be created allowing the regulator to perform licensing/control/supervision.
- Expand the list of securities in which funds can invest pension accruals. Such expansion would benefit both pension funds and the securities and derivatives market. Improve the manner in which the regulator decides which securities should be added to the list, as it does not seem entirely consistent. Boost public interest in pension reform. The information available to the public is still insufficient, and thus pension processes are poorly understood, and there is little desire to participate. While appreciating the recent initiatives of the state and the Pension Fund of Russia in promoting the government co-financing program, we recommend investing more in educating the general public.

2.2. Legislation on the insurance business in Russia

The insurance market is one of the backbones of both the capital market and the economy as a whole.

Some of the elements essential for its development are as follows:

- Draft Federal Law No. 625509-5 "On Amendments to the Law of the Russian Federation 'On the Organization of the Insurance Business in the Russian Federation' (to Bring the Law's Provisions into Line with Russian Law and International Practice in Regulating the Insurance Sphere)" is currently being considered by the State Duma in the second reading. This draft law includes amendments prepared by the Russian Ministry of Finance to ensure that Russian insurance law takes in account specific commitments made by the Russian Federation when it acceded to the World Trade Organization. The proposed amendments do not, however, fully reflect the List of the Russian Federation's Specific Commitments with Respect to Services (the "List of Obligations"). The Preamble of Section 7 "Financial Services" of the List of Obligations states that, following Russia's accession to the WTO, the conditions of business for foreign companies in the Russian financial market must not be more restrictive than the conditions in effect on the date of Russia's accession. For the insurance sector there is an additional qualification: "Insurance providers that are subsidiaries of foreign investors (the parent company) and/or whose charter capital is more than 49% foreign-owned (voting shares) as of the date of accession to the WTO and that were licensed to provide life insurance, compulsory insurance and public procurement insurance services before the indicated date may carry out such activities in accordance with the licenses obtained." The latter provision applies primarily to insurance companies that are subsidiaries of foreign investors (main companies) of member states of European communities that are parties to the Partnership and Co-operation Agreement of 24 June 1994, which established partnership relations between the Russian Federation, on the one part, and European communities and their member states, on the other part, since they are excepted from the general restriction under current law. Nevertheless, the wording of clause 4 of Article of the Federal Law On the Organization of Insurance in the Russian Federation, proposed by the draft law, establishes the requirements for the foreign investor, which can only be an insurance company. Current law contains no such restrictions, and management companies not directly involved in the insurance business are thus among the direct shareholders of many companies with foreign capital operating in the Russian market. Such a management structure has to do, in part, with the fact that insurance companies in a number of countries are prohibited by law from having branches or subsidiaries in other countries. Foreign investors in insurance companies currently operating in the Russian market will thus be forced to rethink their strategy and consider whether they should leave the Russian market. The draft law also extends the restrictions in paragraphs 1 and 2 of Article 6.2 to all insurance companies that are more than 49% foreign-owned as well as the requirement that a new license be obtained within one year after the law enters into force, which is contrary to the List of Specific Obligations. It should be noted that Russian law does not require special licensing to insure citizens' life, health or property *using funds allocated for these purposes from the respective budget by ministries and other federal executive bodies (the insurer), to insure the procurement of goods, work and services for state and municipal needs or to insure the property interests of state and municipal organizations*. Thus, insurance companies operating in the Russian market that are more than 49% foreign-owned will have to stop providing life-insurance, compulsory-insurance and state-procurement-insurance services for a period of five years. This will adversely affect insurers that have insurance agreements with foreign companies and may lead *foreign investors to reconsider their medium-term strategy for operations in the Russian market and ultimately force foreign insurers out of the Russian market. This will in turn damage the reputation of the insurance market as a whole*. The assistance of the Ministry for Economic Development is needed in ensuring that all conditions of Russia's accession to the WTO are reflected in Russian law when this draft law is considered in the State Duma.
- Procurement of insurance services for public and municipal needs as well as the needs of certain legal entities (Federal Law No. 223-FZ).
- In reforming the system of procurement for state and municipal needs, for the needs of natural monopolies, state corporations, state and municipal unitary enterprises and other business entities whose charter capital is more than 50% state-owned as well as for the creation of a new two-level procurement system (the federal contract system and Federal Law 223-FZ), the procurement of insurance services must be made more transparent: electronic auctions should be prohibited for compulsory forms of insurance with fixed rates, since prices can't be lowered when all providers charge the same rates; minimum requirements should be established for insurance services provided to these customers, and restrictions should be eliminated on foreign companies providing goods and services to these customers, i.e., when a license is required to work with state secrets, the customer should be required to clearly stipulate in the tender documentation that information constituting a state secret will be communicated to the provider of goods/services under a state contract and indicate the stage of contract performance at which such information will/may be communicated; the tender documentation should also stipulate that the provider of goods/services may use alternative means of

protecting state secrets along with licenses of the Federal Security Service and the Foreign Intelligence Service for work with state secrets, if information classified as a state secret is to be communicated to the provider of goods/services in the process of fulfilling a state/municipal order.

- Improvement of insurance legislation in line with international practice in raising the professional level of all market participants and regulating their activities.
- Development of tools to ensure that the rights of consumers of insurance services are better protected, including the institution of insurance ombudsman.

2.3. Use awareness building and marketing activities as additional tools in developing the International Financial Center (IFC) in the Russian Federation

In recent years, the task of establishing an International Financial Center in Russia has been high on the Russian Government's agenda. The first and most important stage in this process is to improve the local financial infrastructure by passing essential legislative acts and regulation. Despite the work done, there is still a considerable outflow of capital (in excess of USD 80 billion in 2010), and foreign issuers float securities in Russia (three cases in recent years) much less often than Russian securities are floated abroad. This is a clear signal that the Russian financial market is far behind its international competitors, and as a result, local financial companies receive less profit.

It is noteworthy that meetings with international portfolio investors and companies planning to make direct investments are held fairly regularly.

That being said, it seems that IFC organizers have overlooked a whole class of financial market players: foreign issuers. This group is responsible for generating considerable revenue in the financial sector. Such transactions are capable not only of enriching the experience of local market players and creating a basis for the professional development of IFC members, but also of laying the groundwork for reducing the dependence of the Russian financial system on external country risk factors.

One of the reasons for this is a lack of awareness on the part of potential issuers of the opportunities provided by the flotation of securities on the Russian market.

MICEX approved a development strategy according to which it plans to attract foreign issuers. The stock exchange focuses on providing Russian issuers with access to trading floors.

2.4. Initiative for the development of the securities market in Russia

Under the current laws for the debt financial markets of Russia, the Federal Financial Markets Service and the CBR are responsible for regulating and overseeing the debt financial markets. A significant number of legislative acts, including those regulating certain organizations and areas, were adopted to ensure the system's efficiency. At the outset of the global financial crisis, the CBR relaxed the requirements for the debt instruments accepted by it as collateral when providing banks with financial resources. In addition, agreements on the replacement of debt instruments with shares were permitted, and the repo transaction concept was introduced. Legislative reform has thus made progress in this area, though there are still issues to be resolved.

The implemented plans and initiatives include the improved transparent infrastructure of the financial markets, the existence of a central body for trade on the stock exchange, approved instructions for applying insider legislation, and the existing international practice for debt instruments.

In cooperation with the Moscow International Financial Center Think Tank, clarify the existing instructions for the creation of a transparent financial-market infrastructure. In addition, offering documents could be examined more efficiently. The rules for foreign placements could also be clarified.

Introduce international practices for debt instruments. To attract investments, Russian rules and instructions could be aligned with international market practices. It is recommended, for instance, that credit ratings, legal opinions and bondholder meetings be introduced.

Improve the financial markets infrastructure (establish a central body for stock exchange operations, among other steps), develop and approve the instructions concerning the application of insider legislation.

Deadline: 2013.

Issue 3. Banking reform and development strategy for the banking sector

3.1 Banking reform and development strategy for the banking sector

Progress in the banking sector is hampered by a number of unresolved issues:

- Russian legislation imposes a number of restrictions on information (data on transactions of clients and correspondents) which must be transmitted to the parent credit institutions of banking groups and parent companies (management companies) of bank holdings by credit institutions which are members of those groups and holdings for purposes of preparing consolidated statements. The availability of such information is of particular importance for the preparation of consolidated financial statements when the parent company and its subsidiaries are located in different countries. This hinders the development of consolidated supervision and expansion of cooperation between the Bank of Russia and authorized supervisory bodies in Russia and abroad.
- The quality of management, including corporate and risk management, is in some cases unsatisfactory, in particular due to credit institutions' focus on servicing the business of their owners.
- At present, banks have limited opportunities for applying market principles to resolve outstanding issues. This depends mainly on the good faith, corporate behavior and financial capabilities of key owners. The Bank of Russia does not have sufficient authority to assist in restructuring troubled banks under turnaround plans involving the removal of former owners.

To resolve the issues in question, the Russian Ministry of Finance jointly with the Bank of Russia introduced a draft Federal Law on Introducing Amendments to the Federal Law on Banks and Banking Activities and the Federal Law on the Central Bank of the Russian Federation (Bank of Russia) (the "draft law"). The draft law clarifies the key banking supervision provisions and disclosure requirements for credit institutions, banking groups and banking holdings which are to provide information about their activities to the parties concerned. It also authorizes the Bank of Russia to set risk and capital management guidelines for credit institutions.

The draft law was passed by the State Duma of the Federal Assembly of the Russian Federation in its first reading in May 2011.

In the latter half of 2011 and in 2012, work continued in preparing the draft law for its second reading in the State Duma.

The Bank of Russia sent proposals to the Russian Ministry of Finance to introduce amendments relating, among other things, to the exchange of information between the parent credit institutions of banking groups, the parent companies of bank holdings and the members of these associations of legal entities as well as between the Bank of Russia and foreign oversight bodies. Presumably, Russian credit institutions would be able to provide the necessary information (except for information which is a state secret) to the parent credit institutions of banking groups and parent companies (management companies) of bank holdings located in foreign states if the latter ensure the protection (confidentiality) of the information provided at least at the level of protection (confidentiality) envisaged by Russian law. The Bank of Russia will also have the right to provide information on specific transactions and operations of credit institutions, as well as on the transactions and operations of their clients and correspondents which is obtained from the reports of credit institutions, banking groups and bank holdings (except for information which is a state secret), to the central banks and/or other oversight bodies of a foreign state whose functions include banking oversight if they ensure the protection (confidentiality) of the information provided at least at the level of protection (confidentiality) envisaged by Russian law, and if they do not provide this information to third parties, including law-enforcement bodies, without the prior written consent of the Bank of Russia, unless it is provided to the courts in connection with criminal cases.

After being finalized, taking into account the comments and proposals of the draft's co-authors and concerned Russian ministries and departments as well as the results of a coordination meeting held by the Russian Ministry of Finance in September 2012, the draft law was approved and sent to the Russian Government on 4 October of this year to be submitted to the State Duma of the Federal Assembly of the Russian Federation.

The Bank of Russia submitted a set of proposals to the Russian Ministry of Finance concerning the implementation of Clauses 17 and 20 of the Action Plan for Implementing the Strategy for the Development of the Banking Sector of the Russian Federation to 2015 (the "Plan"). It is proposed:

- to entitle the Bank of Russia, if necessary, to set individual threshold values of statutory bank ratios for credit institutions as well as additional requirements for credit institutions applying internal methods (models) of risk assessment within the Basel II framework,
- to entitle the Bank of Russia to set mandatory requirements for the risk and capital management systems used by credit institutions and assess the quality of those systems, using the methods stipulated in regulatory acts of the Bank of Russia,
- to entitle the Bank of Russia to review labor remuneration practices used by credit institutions and require that they be harmonized with the nature and scale of transactions, the results of activity, and the level and combination of assumed risks,
- to entitle the Bank of Russia to establish the procedure for taking measures against credit institutions that are found to have flaws in their activities and to specify the measures to be taken in accordance with international approaches,
- to identify the specific features of the authority and structure of the board of directors (supervisory board) of a credit institution, including by taking account of the recommendations of the Basel Committee on Banking Supervision for improving corporate management.

Recommendations

- The solution for these issues is prescribed in the Strategy for the Development of the Banking Sector of the Russian Federation to 2015, adopted by the Russian Government and the Bank of Russia on 5 April 2011.
- The Russian Government and the Bank of Russia should assist in ensuring the soonest possible adoption of the Federal Law "On Amendments to the Federal Laws 'On Banks and Banking Activity' and 'On the Central Bank of the Russian Federation (the Bank of Russia).'" This new law creates a legal framework for consolidated banking supervision and for aligning the approaches to such consolidated supervision with advanced international practices, including the exchange of information between the participants of the banking groups (bank holdings) and between the Bank of Russia and other, including foreign, oversight bodies (clause 18 of the Plan).
- The Russian Government and the Bank of Russia should take measures:
 - To create a legal framework for implementing the recommendations of the Basel Committee on Banking Supervision, entitle the Bank of Russia to set risk and capital management rules and internal risk assessment rules for credit institutions, and identify the responsibility that members of executive bodies and the board of directors (supervisory board) have for the activity of credit institutions, including their responsibility for risk management (clause 20 of the Plan).
 - To improve Russian legislation by extending the authority of the Bank of Russia to take measures against credit institutions with deficient corporate management systems and against executives and owners of credit institutions, including measures recommended by the Basel Committee on Banking Supervision (clause 17 of the Plan).
 - To extend the authority of the Bank of Russia in its relations with troubled banks and create a regulatory base that would introduce international approaches, primarily those prescribed by the Basel Committee on Banking Supervision, in Russian oversight practice (clause 26 of the Plan).

At a meeting held in November this year with First Deputy Prime Minister Igor Shuvalov, the Russian Ministry of Finance and the Russian Ministry for Economic Development were instructed to work with the Bank of Russia in preparing the draft for its second reading by including provisions of the Draft Federal Law "On Amendments to Certain Acts of the Russian Federation to Improve Bank Regulation," prepared in fulfillment of clauses 17 and 20 of the Action Plan for Implementing the Strategy for the Development of the Russian Banking Sector until 2015, including authorizing the Bank of Russia to set individual limits on binding regulations and a number of additional requirements for banks that use internal risk assessment models for oversight purposes and to assess credit institutions' systems of risk and capital management and internal control. The Bank of Russia sent draft amendments to the Russian Ministry of Finance in fulfillment of this task.

3.2. Improve capital adequacy regulation in the banking sector in the spirit of the Basel Accords

Instructive Regulation No. 2808-U of the Bank of Russia of 28 April 2012 "On Amendments to Instruction No. 110-I of the Bank of Russia of 16 January 2004 'On Binding Norms of Banks,'" which came into force

on 1 July 2012, clarifies the grounds for applying accelerated risk factors in calculating banks' capital adequacy ratios.

According to the banking community, however, Instruction No. 110-I, as currently worded, contains specific requirements which do not conform to the Basel III initiatives, e.g., the requirement that an accelerated risk factor be applied to investments in legal entities' shares in an amount less than 20% of the authorized capital.

Moreover, no action has been taken on the proposal for wider use of the option of not employing an accelerated factor to weigh loans secured with sureties (guarantees) from legal entities that during the 12 calendar months preceding the date on which such sureties (guarantees) were provided, paid taxes and levies or made other compulsory payments established by Russian law that exceeded 10% of the surety issued (provided that such payment is confirmed by copies of the payment orders marked as executed and/or tax declarations marked as received by the Federal Tax Service), based on the annual financial statements of the surety provider (guarantor).

Currently, the calculation of capital adequacy in the banking sector is governed by the rules set forth in Instruction No. 110-I (clarified by Regulation 2613-U). These rules introduced higher capital adequacy ratios for certain types of assets. This version partly conforms to the most recent Basel III initiatives. However, some of the Central Bank's requirements are too hard on credit institutions (for example, in certain cases the use of modern liquidity management practices is regarded as "non-transparency of company operations").

This results in potential regulatory arbitration, which adversely affects the prospects of banking practices in Russia.

3.3. Issues relating to the amendments to the Federal Law on Banks and Banking Activity which were adopted in July 2013

In July 2013, amendments were made to the Federal Law on Banks and Banking Activity. New regulations (including on disclosures and reporting) were introduced for banking groups and banking holdings. As the amendments refer to "banking holdings located in the territory of foreign countries", there exists uncertainty about issues relating to the necessity to inform the CBR on the creation of a banking group if a banking holding is located outside the area of the Russian Federation, and are foreign banking holdings subject to the new requirements on disclosures and reporting.

Issue 4. Taxation

4.1. Russian tax rules for cost and profit distribution in a multinational group of companies

Currently, Russian law does not provide any guidance on distributing the costs incurred and/or profit made from separate activities of a group of companies. However, multinational groups of companies actively distribute profits/costs in proportion to the costs incurred and profits generated by each legal entity or its branch ("branch"). Cost/profit distribution arises where physical settlements, accounting and legal documentation of revenues and expenses are handled centrally by a single group entity and then distributed to all participants in the business.

The fact that there are no legal mechanisms or tax rules in Russian law governing such distribution leads to a situation where distribution is replaced by service contracts, etc. But this type of replacement (a) is not a universal solution, as it leads to incomplete recognition of costs and profits by Russian branches of multinational groups and, as a result, an inadequate relation between tax burden and economic effect; and (b) foreign group companies are at risk of creating a taxable permanent establishment when clarity is lacking as to the amounts due for Russian tax purposes.

Today many Russian branches of multinational banks find the tax authorities extremely reluctant to allow the deduction of expenses that branches incur to cover costs distributed by the head office. The reasonableness and adequacy of such costs can only be proved in court. However, upon careful examination of the business structure and the documents and facts of the case, courts decide in favor of taxpayers.

Since 2012, distribution of profit has been one of the methods of tax control over prices in transactions between related parties. However, this method may be used only if it is proved that the other four control methods are not applicable, and lack of experience in providing such proof makes this a risky method to use. On the other hand, the availability of a method for controlling prices does not resolve the main issue of whether the distribution of profits and losses is appropriately documented and economically justified. The lack of statutory rules for the calculation and taxation of the share of profit distributed to a Russian

branch is a permanent source of tax risks in Russia for the head office, even if such profit is actually distributed in amounts determined in accordance with the transfer pricing rules applicable throughout Europe, because Russian tax authorities may regard such amounts as insufficient.

Recommendations

The Ministry of Finance should engage in dialogue with the drafters of the amendments to the Russian Tax Code submitted in July 2011 on the taxation of distributed costs/profits in order to find acceptable approaches, finalize the draft and ensure its subsequent approval.

4.2. FATCA in Russia and models for its application

The Foreign Account Tax Compliance Act (FATCA) (<http://www.cticompliance.com/assets/pdf/FinalFATCAText.pdf>) was enacted by the United States Congress in 2010. The Act is designed to make significant changes in the current tax treatment of payments made by US residents through foreign financial institutions.

The mechanism for applying FATCA requires that Russian financial institutions enter into a special agreement with the U.S. Internal Revenue Service (IRS); keep track of any accounts opened by U.S. taxpayers with Russian financial institutions and report these to the IRS; withhold and remit to the IRS 30% of revenues from sources in the United States, including revenues earned by entities that fail to disclose information required under FATCA or by non-participating foreign financial institutions.

The Association of Russian Banks (ARB) and National Payment Council Non-Profit Partnership (NPC) have repeatedly asked the Russian Government, the Ministry of Finance, the Federal Tax Service, the Ministry of Foreign Affairs, the Federal Financial Markets Service, the Federal Financial Monitoring Service and the Bank of Russia to consider the conclusion of a special intergovernmental agreement between the Russian Federation and the United States on the procedure for implementing FATCA.

In addition, to expedite the decision-making process on a model for implementing FATCA in Russia, NPC assessed Russian banks' costs in the first year after the adoption of FATCA in Russia. The findings were presented to Presidential Aide Elvira S. Nabiullina, the Bank of Russia and the Russian Ministry of Finance.

Unfortunately, no official information detailing the status of the negotiation process between the concerned state agencies of the Russian Federation and the United States and the selected mechanism for implementing FATCA in Russia has been released so far.

Since no information is available on the Russian Federation's official position and the effective date of FATCA is approaching, a number of financial institutions controlled by a foreign parent have to consider entering into agreements directly with the IRS, since under FATCA an international banking group may be considered compliant only if all its members comply with FATCA.

It should also be noted that Russian credit institutions that have correspondent banking relationships with European and U.S. partners are already getting questions from their foreign partners on how the new regime works in Russia, since a foreign correspondent bank may withhold 30% of all payments made to a correspondent account of a non-participating Russian credit institution held with such bank or may suspend or close such correspondent account.

The position of the Russian Ministry of Finance is that any agreements between Russian banks and the U.S. IRS and any related disclosure of information constituting a bank secret will be regarded as a violation of Russian law (see the enclosed Letters No. 03-08-07 of 24 April 2012 and No. 03-08-05 and 20 August 2012).

At the same time, Russian financial institutions are seriously concerned about the possibility of partial withholding of payments made to them through the United States, should the Russian Federation decline to participate in FATCA.

Many countries are already actively negotiating with the United States to conclude bilateral agreements whereby any transfer of information under FATCA is made centrally through local government bodies, with the possible exchange of similar information in some cases by the United States (among countries planning to do this are Germany, France, the UK, Italy, Spain and the Netherlands). Switzerland and Japan intend to take a different approach to information exchange with the United States under FATCA: local banks will provide information directly to the IRS along with an ad hoc exchange of information between the state agencies of these countries.

In view of what has been said and in order to avoid negative implications for Russian credit institutions, the Association of Russian Banks (ARB), the non-profit partnership National Payment Council (NPC) and the Association of European Businesses (AEB) strongly recommend that the Russian Ministry of Finance and the Bank of Russia inform credit institutions of the official position on the means of implementing FATCA.

Issue 5. Improvement of legislation and the practice of customs authorities in promoting competition in connection with customs services

Use of ordinary bank cards for customs payments

FIAC members have a strong interest in maintaining the presence of alternative methods of customs payment in the market. Competition in the market of customs payment operators helps to improve the quality of services rendered to foreign trade participants, to create increasingly favorable service conditions and, ultimately, to improve their efficiency.

Weaknesses of the current arrangement:

- The procedure for the remote clearance of goods cannot be used to its full potential, i.e., to submit declarations to a customs office on the border if the importer does not have a customs broker with a customs card at a remote checkpoint (in accordance with the Procedure for the Use of Customs Cards in the Customs Clearance of Cargo Customs Declarations, Order No. 757 of 3 August 2001 “On Improving the System of Customs Payments”) or if no advance payment was made using payment orders.
- As concerns the marking of excisable goods, customs payments are made in two portions: one portion is paid by purchasing excise stamps, and the remaining portion is paid by providing a pledge or bank guarantee or by making a deposit of the amounts due and is paid in accordance with the general procedure applicable to the customs clearance of goods. As a result, a foreign trade participant incurs additional expenses associated with the services of the customs broker in the first case (the customs broker has to travel to the border checkpoint where freight is being cleared) and with the freezing of cash on Federal Customs Service accounts in the second.
- It is impossible to debit customs cards to secure payment of customs duties.

Recommendations

Make various options available for using ordinary bank cards to make customs payments, including online payments (via a member's personal password-protected page).

Issue 6. Leasing in Russia

In accordance with court practice, fraudulent lessees (under finance lease agreements):

- derive profit from the use a leased asset,
- make use of the tax advantages of leasing,
- delay and cease payments under lease agreements, and
- after a leased asset is returned with increased wear, request that the lessor reimburse a buy-out price that was allegedly included in the lease payments.

This court practice is based on Ruling No. 17389/10 of the Presidium of the Supreme Arbitration Court of the Russian Federation (SAC of Russia) of 12 July 2011 (the so-called Meta-Leasing case). Pursuant to the Ruling, lease payments comprise:

- a lease payment for the use of a leased asset,
- a buy-out price for transfer of ownership to be reimbursed upon termination of the lease agreement.

From an economic standpoint, it is unfair for the lessee to ask the lessor to reimburse a buy-out price because the lessee has already received it through the cost of services rendered to third parties. Foreign investors are very concerned about this situation. Eventually, this may result in significant losses for lessors and, consequently, in bankruptcy and the departure of companies with foreign investments from the market.

We believe that the Supreme Arbitration Court of Russia should instruct courts on the following issues:

- The determination of a buy-out price (e.g., in the form of an information letter summarizing court practice)
- The need to take account of the specific features of agreements and the facts of a case when settling disputes on the determination of a buy-out price.

Issue 7. Arbitration clause

Arbitration agreements are quite common in international practice. Under such an agreement, the parties agree to have potential disputes between them arbitrated, and one of the parties is entitled to appeal to a court of the appropriate jurisdiction to protect its rights. When entering into such an agreement, the parties take account of their mutual interests and assume all risks and expenses related to the conclusion of such an agreement. An arbitration agreement with such terms is an important means of protecting the legal rights and interests of both parties, especially the party that is financially more vulnerable.

Until recently, such an arbitration agreement was deemed valid and binding for parties in Russia. However, by Decision No. 1831/12 of 19 June 2012, the Presidium of the Supreme Arbitration Court of the Russian Federation changed the existing practice and ruled that "with regard to the general principles of protecting civil rights, a dispute settlement agreement cannot entitle only one party to a contract (the vendor) to file suit with a state court of the appropriate jurisdiction, while the other party (the purchaser) enjoys no such right. If such an agreement is concluded, it is to be deemed invalid, as it upsets the balance of rights of the parties. Hence, a party whose right is infringed by such a dispute settlement agreement is also entitled to file suit with a state court of the appropriate jurisdiction, thereby exercising its guaranteed right to judicial protection on a par with its counterparty." Unfortunately, this decision confirmed the opinion that the Russian judiciary is unpredictable by depriving civil litigants of this means of protecting their rights. This may adversely affect foreign investors' cooperation with Russian companies.

In this connection, we suggest considering the possibility of adding a provision to current Russian law to the effect that parties, guided by the principle of freedom of contract, are entitled to enter into arbitration agreements of this kind which are valid and binding.

2.4. Improvement of Tax Law

Issue 1. Reduction of the rate of insurance fees for compulsory pension insurance from 10% to 5%

On 22 August 2012, Russia officially became the 156th member of the World Trade Organization (WTO). Hence, a developed financial market and the Russian market's greater attractiveness for national and foreign investors, issuers and manufacturers are among the key requirements for the country's economic development.

A reduction of the tariff rate will create a favorable investment climate and promote the strategy of creating an International Financial Center (hereinafter, the "IFC") in Russia, since the introduction of a tariff rate for income which is higher than the maximum limit of the base affects, first and foremost, highly paid employees. A reduction of the additional tariff rate may be regarded as a step towards liberalization and the creation of a favorable investment climate; this applies also to state policy for the strategy of Russia's accession to the WTO.

The high rate of insurance contributions to the Russian Pension Fund is a substantial burden also for the business community as a whole, especially for companies engaged in services whose key resources are their personnel and whose main item of costs is the expenses on payment for the work done by that personnel (banks, financial and investment companies, advisory and law firms, etc.).

Hence, the high rate of insurance contributions to the Russian Pension Fund in the form of 10% of the amount which is higher than the established maximum limit for charging insurance fees negatively affects Russia's general investment climate, the volumes of production in the country and its social development because, when there is a greater burden on the payroll, employers are obliged to cut salary growth and reduce other incentive payments to their employees, thereby negatively affecting the personnel's drive and public purchasing power.

Recommendations

Reduce the maximum rate of insurance contributions for compulsory pension insurance from 10% to 5%.

Issue 2. Application of thin capitalization rules

Literally, Article 269.2 of the Tax Code says that thin capitalization rules should apply to Russian borrower subsidiaries of a Russian parent with more than 20% foreign ownership if such a parent raises loans from local banks against the pledge of its own assets and then transfers the loans to its Russian subsidiaries, even though no loans or guarantees are provided by foreign shareholders. However, if a Russian parent has no foreign shareholders, Article 269 would not be applicable to its borrower subsidiaries under the same circumstances. Hence, Article 269 of the Tax Code literally suggests that a borrower taxpayer is actually discriminated against due to foreign participation in the lender's capital.

The latest litigation on this issue (as was the case with UK BMZ, Integra-Geofizika and Omsk Polypropylene Plant) proved to be exceptionally negative. For instance, the appellate court dismissed the taxpayer's appeal in the Naryanmarneftegaz Case by ruling that Articles 269.2-269.4 of the Tax Code must apply to the interest paid to a foreign affiliate not directly or indirectly participating in the taxpayer's capital. In this respect, the court actually reclassified the loan from a foreign "sister" company into a loan from a foreign shareholder in order to apply thin capitalization rules.

Recommendations

Exclude the operations of Russian taxpayers taking loans on market terms at Russian authorized banks, which are guaranteed by foreign and Russian related parties, from thin capitalization rules. We request that the Ministry of Finance take the initiative to introduce the proposed amendments to the current wording of Article 269 of the Tax Code.

2.5. Trade and Consumer Sector

Issue 1. Increasing manufacturers' responsibility by creating a legal framework for an effective system of recycling production and consumer packaging waste in Russia (*jointly with Technical Regulation and the Elimination of Administrative Barriers working group*)

The creation of a sustainable system of consumption waste management is a key issue for FIAC member companies, which for a number of years have been developing a scheme of market incentives for the collection and recycling of waste in Russia, using packaging waste as a model, based on international experience and the most efficient approaches. Effective EU legislation in this area provides for the introduction of target indicators – standards for waste collection and recycling over a specified period of time whereby the waste collection system would be aligned with the development of the waste recycling capacities.

In 2011, as part of the requirements for Russia's accession to the OECD, Russia's Ministry of Natural Resources drafted Federal Law No. 584399-5 "On Amendments to the Federal Law 'On Production and Consumption Waste' and Other Legislative Acts of the Russian Federation (as Regards Economic Incentives for Waste Disposal)" and submitted it to the State Duma. The draft law was adopted by the State Duma in the first reading on 7 October 2011.

One of the Draft's declared goals is to create economic stimuli for waste management and to increase manufacturers' responsibility for the entire life cycle of their output. The matter in question is, first and foremost, the legislative establishment of mechanisms to reduce the generation of consumer waste, promote its recycling and put it back into economic circulation.

The Draft, as adopted in the first reading, proposed no such mechanisms.

In 2012 the draft law was revised several times (including conceptually), taking into account comments made by federal executive bodies, business and NGOs. On 10 April the president held a special meeting on the draft law and issued an instruction. The government is preparing the draft for adoption by the end of this year.

During its preparation for the second reading, several rounds of amendments have been made that would require manufacturers to make an "environmental payment" – essentially a para-fiscal levy – for the recycling of product and packaging waste. This payment was originally to be based on product cost, then with the cost of packaging, and now, in the current version, on the cost of recycling a given type of waste. Amendments made in May 2012 proposed the creation of a special reserve fund to be managed by a national association – a nonprofit waste management organization that would manage the funds collected. In the latest versions (29 July and 23 August 2013), the fund is to be put on the state budget, but the mechanism for utilizing the funds it receives is still a bone of contention between agencies, regional authorities and representatives of the waste recycling business.

The business community, represented by leading manufacturers of consumer goods, household electronics and foodstuffs, is convinced that a system based on a para-fiscal levy cannot effectively draw producer and consumer waste into the recycling process and improve the environment; on the contrary, it will lead to higher prices for products, including socially important products, make the Russian economy less attractive to investors, and encourage corruption in waste recycling.

Recommendations

To launch an effective national system for recycling consumer waste, the following fundamental provisions must be taken into account in the final version of the draft law:

- Relinquish the collection of fiscal and para-fiscal fees as the basis of the system for stimulating the recycling of consumer waste, giving the regulators free choice of the methods of fulfilling the obligations to ensure the recycling (utilization) of products: independently (e.g., by signing agreements with the waste recycling operators) by using own resources, by cooperating with other producers or by paying an environmental fee
- Establish target norms for product/consumer packaging waste recycling for manufacturers/importers (in percentage of the products or consumer packaging put into circulation and subject to recycling)
- Apply an industry-related approach whereby separate subordinate acts setting waste management rules would be developed for various categories of finished products

- Stipulate that the rates of "environmental payment," as an alternative to independently meeting recycling obligations, should not be calculated as a percentage of the cost of recycled products, but should be calculated for each type of product, based on the average market cost of recycling (utilizing) the given type of product (packaging) per item (package) by weight or quantity, as is practiced worldwide
- "Principle of equivalence": the budget fund's resources should be spent for utilization of the appropriate amount and types of waste when a manufacturer (importer) meets its obligation by means of environmental payment
- There should be equal regulatory conditions for products manufactured and released into circulation in Russia as well as transported into Russia from outside the Customs Union and from Customs Union member states (the draft should accordingly define "importer" and "release into circulation")
- Establish a transition period of at least two or three years when the necessary subordinate regulatory framework can be developed and implemented and all entities to be regulated can prepare for new obligations and take them into account in their financial and economic planning, in production, etc. This principle was followed, for instance, when implementing the Customs Union's technical regulations for products of the consumer sector
- When the regulatory base and law implementation practice are not fully formed, the licensing of waste disposal and neutralization should not be eliminated in favor of self-regulation. This would lead to an unjustified relaxation of state control over players in the waste disposal market.

Issue 2. Draft Federal Law on Veterinary Medicine

This law, which has been under development for over a year, contains ambiguous concepts (veterinary safety, controlled goods, consignment of controlled goods, veterinary certification, and veterinary expert examination), etc., thereby creating conditions for incorrect interpretation and application.

In the document, the term "veterinary certification" applies to the procedure for verifying that controlled goods, objects and processes comply with the federal law and related rules. A veterinary certificate is a document which confirms such compliance. At the same time, authorized officials may carry out veterinary certification (which should ultimately result in the issuance of a veterinary certificate) in the event of state veterinary control (oversight). The role of veterinary certification in the state control (oversight) system must thus be defined very precisely. The conflict in the Draft with the requirements of Federal Law No. 184-FZ of 27 December 2002 "On Technical Regulation" must also be eliminated.

The term "controlled goods and animals" is of particular concern. Obviously, there is a risk that all foodstuffs and fodder in Russia will be classified as goods controlled by the veterinary service, resulting in excessive regulation.

The document does not define "biological waste," making it difficult to determine the scope and parameters of regulation in this area, especially in view of the frequency with which this concept is used in the Draft.

The document indicates that Russian state bodies have authority over the state accreditation of laboratories (testing centers) and veterinary experts. However, under the Draft Federal Law "On Accreditation in the Russian Federation," a single national body would exercise such powers. The draft should be harmonized with the approach to accreditation established by the Draft Federal Law "On Accreditation in the Russian Federation."

The article on veterinary certification says nothing about the need for controlled goods subject to veterinary certification to be supported by veterinary certificates. If the Draft will contain Article 27 (state information system), which is to include information on the veterinary certification of controlled goods, Article 30 should set rules for using veterinary certificates to support controlled goods (throughout Russia as well), including the option of using these certificates instead of information in hard copy from the state information system, as stipulated in Article 27 of the Draft.

There is also a problem with veterinary services provided in connection with foreign trade. Currently, the veterinary services of constituent entities of the Russian Federation prepare and issue supporting export veterinary documents for controlled goods, and the Federal Service for Veterinary and Phyto-Sanitary Oversight exchanges information with the veterinary services in other countries in accordance with international practice. Regional veterinary services thus frequently lack the required information and authority for effective veterinary control when Russian goods are exported. As a result, logistics operations

are disrupted and companies incur financial losses, which has a negative impact on enterprises' export potential and the investment appeal of the Russian market as a whole.

Status: work In progress. Recommendations on the Draft Federal Law "On Veterinary Medicine" were included in the general issue of reforming veterinary law in the Russian Federation, which was raised at a meeting of FIAC's Executive Committee on 24 May 2013 in Svetlogorsk (Kaliningrad Region) on behalf of the trade and consumer sector think tank.

Recommendations

Electronic certification for supporting veterinary documents should be set down in law.

As currently worded, the Federal Law includes only one proposal made by the trade and consumer sector think tank, whereby veterinary certification is unnecessary when fodder is transported in consumer tare.

Issue 3. Problems involved in issuing supporting veterinary documents in Russia (draft order instead of Order No. 422 of the Russian Ministry of Agriculture of 16 November 2006)

Order No. 422 of the Russian Ministry of Agriculture of 16 November 2006 "On Approval of the Rules for Issuing Supporting Veterinary Documents" (hereinafter, "Order No. 422") does not clearly indicate the system to be used for services in drawing up supporting veterinary documents or their cost. Certain provisions of this document directly contradict current Russian law and technical regulations of the Customs Union. This results in non-transparent procedures, excessive costs for foreign investors and major difficulties with operations.

According to the 2010 report of the Ministry for Economic Development "On the Condition of the System of State Control (Oversight) and Municipal Control in the Russian Federation," veterinary control/oversight in Russia is duplicated at federal and regional levels, the system of payment for veterinary documents is not transparent, too many products have to be assessed for compliance with the requirements of the relevant veterinary-safety agency, and there are a great many supporting documents.

The document perpetuates the aforementioned problems of veterinary control/oversight, involving redundant (non-transparent) requirements for supporting veterinary documents as regards the number of documents and the range of controlled products, thereby unreasonably complicating trade relations and creating substantial financial costs for businesses.

Order No. 422 has veterinary forms that apply only to a certain area (a district, region or the Russian Federation as a whole), thereby unreasonably restricting the free movement of controlled goods.

In addition, the document contains ambiguous requirements with respect to supporting veterinary documents for the movement of products in the Russian Federation.

Status: work In progress. Recommendations on the document were included in the general issue of reforming veterinary law in the Russian Federation, which was raised at a meeting of FIAC's Executive Committee on 24 May 2013 in Svetlogorsk (Kaliningrad Region) on behalf of the trade and consumer sector think tank.

Recommendations

1. Align the procedure for issuing supporting veterinary documents with Russian legal requirements (Decree No. 1009 of the Russian Government of 14 December 2009 "On the Joint Performance by the Russian Ministry of Health and Social Development and the Russian Ministry of Agriculture of Regulatory Functions Involving Control over the Quality and Safety of Food Products and the Organization of Such Control") and Customs Union requirements in the area of technical regulation.
2. In the new order, include a procedure for issuing electronic supporting veterinary certificates for cargo subject to veterinary control in the Russian Federation, using the current Mercury information system.
3. Approve the full list of controlled products in the document.

Issue 4. Regulating the trade markup for baby food

Under Article 4 of Federal Law No. 381-FZ of 28 December 2009 "On the Fundamental Principles of State Regulation of Trade in the Russian Federation" (hereinafter, the "Trade Law"), the state regulates trade by setting requirements for trade and its organization as well as by means of antimonopoly regulation, information

support and state control. Other methods of state regulation of trade are not permitted, unless otherwise stipulated by federal laws.

At the same time, **Russian Government Decree No. 239 On Measures to Improve the State Regulation of Prices (Tariffs), dated 7 March 1995** (hereinafter, Decree No. 239), adopted in fulfillment of Russian Presidential Edict No. 221 On Measures to Improve the State Regulation of Prices (Tariffs), dated 28 February 1995, sets the lists of production and consumer goods and the services rendered by transport, procurement and distribution companies and trade organizations, in relation to which the Russian local executive bodies have the right to introduce the state regulation of tariffs and markups.

But no provision is made in federal law for the state regulation of tariffs and markups for a number of goods and services listed in Decree No. 239.

Decree No. 239 creates prerequisites for intervention by the executive bodies of the constituent entities of the Russian Federation in pricing; in some regions, therefore, FIAC members face administrative penalties and litigation in relation to regional legislation enacted on the basis of Decree No. 239 as regards the sale prices of children's products. Children's products include "baby food (including food concentrates)," "products (goods) sold at public catering enterprises in schools, professional/technical colleges and secondary special and higher educational institutions" and "products and goods sold in the Far North and equivalent areas with limited delivery periods."

The survey conducted by the Higher School of Economics in August 2013 showed that the prices of baby food in the regions did not depend on the regulation of trade markups. The price of baby food is determined by other subjective factors, first and foremost by the general price level and public income.

Status: In compliance with clause 6 of the List of Instructions No. ISh-P13-4381 of I.I. Shuvalov of 25 June 2013, the Ministry of Industry and Trade worked out, jointly with the Ministry for Economic Development, the Ministry of Health Care and the Federal Antimonopoly Service, the need to exclude baby food from Decree No. 239. In the letter sent to the Russian Government (EV-11166/08 dated 30 August 2013), the Ministry of Industry and Trade draws the conclusion that it is inexpedient to abolish regulation, referring to the "great social significance of state regulation of the markups to baby food prices," although the letter presents contradictory arguments and conclusions: "the regulation of trade markups by the entities of the Russian Federation does not have a statistically significant impact on the baby food price... which is determined by other subjective factors, first and foremost by the general price level and public income"; "there is no presumed advantage of this regulation, i.e., price reduction"; "it obviously entails the costs of administration by the authorities and business", the recognition of the existence of contradictions with federal legislation, etc. The abolition of baby food markups has been supported by the Ministry of Health Care and the Ministry for Economic Development, while the Federal Antimonopoly Service recognized the negative impact of regulation on competition as well as its ineffectiveness, but did not support the abolition of regulation, referring to the "great social significance" without essential arguments supporting that claim.

Recommendations

Taking account of the existing situation, we ask you to hold a conference on that issue at the level of the Government Executive Office with the participation of the responsible federal executive bodies and FIAC experts.

Introduce amendments to Decree No. 239 to exclude baby food from its coverage to ensure compliance with Federal Law No. 381-FZ *On the Fundamental Principles of State Regulation of Trade in the Russian Federation*. The Ministry of Industry and Trade has introduced a draft of the relevant Government Decree in February of this year. It was supported by all the executive bodies from the legal standpoint. To adopt the Decree, a political decision must be made. A restraining factor in this respect is the fear of a possible negative impact on the socially unprotected groups of the population. The Ministry of Health Care and the regions provide no evidence to substantiate such fears. The estimates made by business on the basis of its economic knowledge show that the abolition of regulation of trade markups will have no negative effect.

2.6. Efficient use of Natural Resources in Russia

Issue 1. Developing a new taxation system for oil and gas projects on the Russian continental shelf

Oil and gas projects on the Russian continental shelf lack appeal in the eyes of both domestic and foreign investors due to the existing taxation regime. Key changes should include: developing a special taxation regime for continental shelf projects which would be uniformly applicable to all entities.

Recommendations

1. Establish that the following is not applicable to continental shelf project participants (taxpayers):
 - Import duties on imports of technological equipment
 - Eliminating the need to "restore" duty or pay additional amounts in respect of the duty (inter alia, in case of disposal) upon expiry of a certain fixed period (reasonable period).
 - VAT on imports of equipment and materials
 - Setting forth (in the event of the full exemption of VAT when equipment is imported) rules for the disposal or subsequent sale of fixed assets that would eliminate the need to "restore" VAT or otherwise pay additional VAT together with interest when writing off or otherwise disposing of such fixed assets.
2. The following is applicable to project participants:
 - Mineral extraction tax. Set forth an increase in the time limits within which a special mineral extraction tax rate is applied, since the time limits in the draft law will most probably coincide with those of the beginning of commercial mining; hence, the "preferential" rate will be in the period when mining has not started yet.
 - Excess profits tax at the rate of 18-26%, determined in this chapter, or a similarly increased profits tax rate
 - Provide for the following:
 - tax base for excess profits tax should be the same as the tax base for income tax,
 - losses can be carried forward without limiting the period (for excess profits tax purposes).
3. Envisage the following specific features when determining the profits tax base:
 - Allow the deduction of expenses related to infrastructural development (e.g., roads, power stations, settlements, hospitals, schools, kindergartens, etc.).
 - Consider the possibility of introducing an uplift (the possibility of writing off over 100% of the fixed costs).
 - Consider the possibility of 100% depreciation of costs when incurred for profits tax purposes (as in the UK for North Sea projects).
 - Consider the possibility of carrying back losses (to earlier periods), for example, to the three previous years.
 - Due to the complexity of offshore projects, provide for the possibility to deduct R&D expenses (both successful and unsuccessful efforts, with a 2.0 multiplier and without any limitations).
 - Allow offshore project participants to deduct exploration expenses for profits tax purposes, even if they have no licenses.
 - Consider the possibility of consolidating offshore projects, i.e., one company operates several projects and must consolidate all income and expenses in one basket for profits tax and excess profits tax purposes.
4. Amend transfer pricing control regulations.
 - Acknowledge the fact that the remuneration received by a project participant holding no production license from the license holder consists of several components rather than being just payment for services. These components are: compensation for the costs incurred, remuneration involving

mineral mining and risk bonuses. Hence, the service control rules should not be applied in such cases.

- The transaction in selling hydrocarbons should not be deemed controllable in the law (this rule is enshrined in the current draft law for transactions between the license holder and the operator, which are performed in relation to hydrocarbon production in the same field).

Issue 2. Liberalizing the export of geological data

The need to receive a license even for "exporting" unclassified geological data is a serious issue.

On 16 August 2012, The Board of the Eurasian Economic Commission adopted Resolution No. 134 which approved the Unified List of goods subject to bans or restrictions applicable to imports or exports by Customs Union member states within the Eurasian Economic Community in trade with third parties (hereinafter, the "Unified List"), and the Guidelines on the Application of Restrictions. The name of the Unified List indicates that it is a list of **goods**. However, it has Section 2.23, Subsurface data on the areas and deposits of fuel, energy and mineral resources, whose export from the customs territory of the Customs Union is restricted. There seems to be no internal logic in this approach. An analysis of the concept of data in Article 2 of Federal Law No. 149-FZ of 27 July 2006 *On Data, Information Technologies and Data Protection* allows one without a shadow of doubt to conclude that data cannot be classified as goods. This conclusion is confirmed by studying the text of Federal Law No. 164-FZ of 8 December 2003 *On the Fundamental Principles of the State Regulation of Foreign Trade Activities*. According to Article 2.26 of the above Federal Law, goods are defined as "movable *property*, and aircraft, sea and river vessels, mixed navigation (river – sea) vessels and spacecraft, as immovable *property*, which includes electric *energy* and other types of *energy*, and are items of foreign trade activity." Evidently, data is not covered by that definition, since there is no code in the Unified Foreign Trade Commodity Classification that could be applied to data.

Licensing the export of geological data that does not constitute a state secret seriously hampers the implementation of joint projects for the geological exploration and development of subsurface resources of the Russian Federation, and makes it impossible to work on a modern technical level. The use of current transaction "techniques", such as electronic access to a partner's documents (Electronic Due Diligence Room), is a violation of the law. A company must have a license to analyze geological data using the opportunities provided by foreign data analysis centers. As a result, work often has to be suspended for a long period of time.

Recommendations

Foreign investors welcome the exclusion of the balance mineral reserves from the list of information which is a state secret. It follows from the reports provided to us by government authorities that the main goal of licensing the export of data is to check whether it contains information which constitutes a state secret. Therefore, to make the reduction of administrative barriers really effective, it is necessary to exclude from the Unified List data which by definition cannot constitute a state secret in accordance with Clause 67 of the List of Data that Constitute a State Secret (approved by Edict No. 1203 of the President of the Russian Federation of 30 November 1995 as amended by Edict No. 90 of the President of the Russian Federation of 11 February 2006), i.e., data received during joint work performed with the participation of legal entities and individuals of foreign states at certain mineral production sites or in their areas.

Issue 3. Issues and recommendations on the introduction of amendments and additions to the legislation in force in order to improve the investment climate

(Federal Law No. 2395-I of 21 February 1992 On Subsurface Resources, Federal Law No. 57-FZ of 29 April 2008 Concerning the Procedure for Foreign Investment in Commercial Organizations of Strategic Importance for the Defense of the Country and National Security of the State)

Proposals concerning the Law on Subsurface Resources

Exploration and production

Foreign investors may participate in developing subsurface areas of federal significance located on the continental shelf only as junior partners of companies controlled by the Russian Federation. To develop other subsurface areas of federal significance, foreign companies need a special permit issued on a case-to-case basis. Apparently, such permits will also be issued only to joint ventures incorporated under the laws of the Russian Federation, where both Russian and foreign companies participate. Actually, such practice is widespread in many oil producing countries and is acceptable for major international oil and

gas companies. In general, foreign investors are prepared to cooperate with Russian companies on a mutually beneficial and efficient basis in developing Russian subsurface resources; however, such cooperation is hindered by certain specific provisions of the legislation in force.

According to the business scheme of international oil and gas companies, they are to develop deposits of natural resources in the capacity of both investors and project operators. Most of the current major oil and gas field development projects are implemented through special purpose vehicles, being companies established by project participants with the express purpose of implementing such projects. Such companies are generally newly incorporated legal entities.

In this respect, the provisions of the Law on Subsurface Resources requiring that the developer of an area of subsurface resources of federal significance that is on the continental shelf should have at least five years' experience in developing the mineral resources of the continental shelf of the Russian Federation make it impossible to implement such projects through special purpose vehicles, as a newly incorporated joint venture established by Russian companies under government control with the participation of foreign investors will be a new legal entity established with the express purpose of implementing the project and cannot have the required experience as such. A way of resolving that issue is to take account of the experience gained by the founders of such joint ventures and/or their subsidiaries in developing subsurface areas on the continental shelf. Experience in developing the Russian continental shelf as well as the experience gained elsewhere in the world may be taken into account. The legal status of an operator as a subsurface resource user can be enshrined in legislation. Accordingly, a company established by project participants through special purpose vehicles may receive the status of an operator.

Recommendations

1. Amend the Federal Law on Subsurface Resources to the following effect: the mandatory five-year experience in developing the continental shelf of the Russian Federation that a legal entity/user of subsurface resources of the Russian continental shelf must have may include the experience in developing the Russian and foreign continental shelf gained by the founders of this legal entity or by their subsidiaries;
2. Introduce amendments to the Federal Law on Subsurface Resources, clarifying what is meant by "under the development of subsurface areas of the continental shelf", and what use of subsurface resources or activities on Russia's continental shelf will be taken into account when determining the required experience.
3. Introduce amendments to the Law on Subsurface Resources that determine the concept and legal status of an operator as a subsurface resource user.

Geological survey of subsurface resources

Russian authorities may decide to terminate the right of legal entities with foreign participation or of foreign investors to use the subsurface areas where deposits of federal significance have been discovered. This makes foreign investors far less interested in investing their financial resources in geological survey in Russia.

The mechanism of reimbursing the expenses related to the exploration and evaluation of the deposits discovered does not seem to work, as the level of compensation will not cover the expenses related to other projects in the event that the efforts made in locating new deposits fail (dry wells, for example). Oil and gas as well as mining companies make investments in the exploration of several subsurface areas which may be located in different regions and even different countries, and commercial mineral resources may be discovered only in some areas. Major companies have extensive investment programs covering a significant number of areas. These investments are risky from a purely geological point of view, and their exposure to additional risks related to the possible termination of the rights to develop the subsurface areas where mineral deposits had been discovered makes the risks simply too high. Moreover, international oil and gas as well as mining companies make investments in exploration because of the prospect of participating in the development of newly discovered deposits.

While Federal Law No. 57-FZ of 29 April 2008 *Concerning the Procedure for Foreign Investment in Commercial Organizations of Strategic Importance for the Defense of the Country and National Security of the State*, passed at the same time as the above amendments to the law on subsurface resources, defines the term "foreign investor", the new version of the Law on Subsurface Resources does not clarify the term "subsurface user which is a legal entity with the participation of foreign investors".

While the former law implies "control", the Law on Subsurface Resources uses the term "participation". While the law defines the notion of control and formulates "control" criteria, it has no definition of "participation" and no criteria in this respect. Therefore, participation may be interpreted as holding only

one share, as neither the law itself nor the bylaws determine any threshold of such "participation" (once again, unlike Federal Law No. 57-FZ of 29 April 2008).

Recommendations

1. Supplement the Law on Subsurface Resources by a provision excluding the possibility of refusal to grant rights to develop a discovered deposit of federal significance or termination of such rights on the grounds of a potential threat to the national security and defense of Russia in respect of subsurface users, including those with foreign participation, which are controlled either directly by the Russian Government or through companies under its control. Such a provision would be like an exception provided for government-controlled companies by Federal Law No. 57-FZ of 29 April 2008 *Concerning the Procedure for Foreign Investment in Commercial Organizations of Strategic Importance for the Defense of the Country and National Security of the State*;

2. Supplement the Law on Subsurface Resources with a provision to the following effect: prior to announcing a tender or auction for the right to the geological exploration of subsurface resources, including under a combined license for exploration and production, the Government of the Russian Federation or a body authorized by it should investigate and issue a statement on the absence or existence of a threat to the defense of the country and national security of the state if the subsurface user is a company with foreign capital and if, as a result of geological exploration, such a company discovers a deposit of mineral resources that would meet the criteria stipulated in part three of Article 2.1 of the Law on Subsurface Resources. A respective statement by the Government of the Russian Federation or a body authorized by it should be published as part of an official announcement on holding a tender or auction for the right to use subsurface resources. If, at the time of the tender or auction, the Government of the Russian Federation or a body authorized by it concludes that there is no threat to the defense of the country or national security of the state in the above case, and the respective information is published as part of the tender or auction announcement, the Government of the Russian Federation may no longer refuse to grant a subsurface resource user in which foreign capital participates, the right to use the subsurface area for exploration and mineral production, nor may it terminate the right to subsurface use under combined licenses.

Other options for guaranteeing the participation of foreign investors in a joint venture established to develop newly discovered mineral deposits may also be considered.

Proposals regarding Federal Law No. 57-FZ of 29 April 2008 *Concerning the Procedure for Foreign Investment in Commercial Organizations of Strategic Importance for the Defense of the Country and National Security of the State*

Article 2, part 7, of Federal Law No. 57-FZ establishes two criteria, each of which makes the provisions of the law not applicable to legal relations associated with foreign investment in legal entities controlled by the Russian Federation. According to experts of the working group, the first criterion is a particular case of the second one and as such is therefore superfluous and can be excluded from the text. Excluding the first criterion will simplify the wording and contribute to a clear interpretation of the provision.

Article 4.4 of the above Law states that transactions with shares (interest) of a commercial organization of strategic importance are not subject to prior approval if a foreign investor or a group of persons already exercised control over 50% of such a commercial organization before entering into the above transactions. We believe this provision to be fair and reasonable. However, the clause "with the exception of commercial organizations of strategic importance which use subsurface areas of federal significance" unreasonably complicates transactions with the shares of such entities. This provision can be interpreted in such a way as to require prior approval for the purchase and sale of shares (interest) within one group of entities controlling over 50% of a Russian company of strategic importance which uses subsurface areas of federal significance. It is unjustified to approve the transfer of shares from one group member to another.

The geological exploration of subsurface resources is classified as strategic activity. This complicates the comprehensive geological survey of Russian subsurface areas, including the Russian continental shelf. We believe this to be unreasonable, especially with regard to the recent proposals on renewing the geological survey of subsurface areas as a separate type of use of subsurface resources on the continental shelf, and on providing opportunities to obtain licenses for this type of use of subsurface areas to all stakeholders, including foreign entities. The exclusion of a geological survey of subsurface resources from the list of strategic activities would stimulate geological (including multi-client) surveys, particularly on the continental shelf, conducted jointly by Russian and foreign companies, and would stimulate the transfer of the state-of-the-art geological techniques to Russian companies, accordingly.

Pursuant to Article 6.2 of Federal Law No. 57-FZ, "work in actively influencing geophysical processes and occurrences" is classified as activity of strategic importance for the defense of the country and national

security of the state. According to experts of the working group, the geological survey of subsurface resources does not meet this definition, which nevertheless should be clarified to preclude all doubt. If there is not enough room in the Law to clarify the above definition, experts of the working group recommend including a reference to a respective bylaw in that clause.

Recommendations

1. Amend Article 2.7 of the Law as follows: *"7. The provisions of the Federal Law which govern relations associated with foreign investment in commercial organizations of strategic importance to the defense of the country and national security of the state, which are engaged in using subsurface areas of federal significance, with the exception of provisions of part 3 hereof, shall not be applicable to relations associated with foreign investment in commercial organizations of strategic importance for the defense of the country and national security of the state which are engaged in using subsurface areas of federal significance if the Russian Federation holds directly or indirectly over 50 percent of the total votes attributable to the voting shares (interest) composing the share capital of such commercial organizations."*
2. Exclude the words *"(with the exception of commercial organizations of strategic importance using subsurface areas of federal significance)"* from Article 4.4.
3. Reword Article 6.2 as follows: *"2) performance of work in actively affecting geophysical processes and occurrences that is included in the list determined by the Government of the Russian Federation."*
4. It is recommended to reword Article 6.39 as follows: *"exploration and production of mineral resources in subsurface areas of federal importance."*

The proposed amendments will help foreign investors assess their risks correctly. In turn, this will significantly improve the investment appeal of the natural resources sector, particularly the Russian fuel and energy industry.

Classification of deposits of federal significance

At present, the solid mineral resource base is characterized by the following trends in the development of the raw material base:

- The reserve of easily discoverable deposits is practically exhausted.
- Depleted deposits of rich free-milling ores are replaced by deposits of lean complex ores.
- Geological survey is shifted to remote areas with difficult mining and geological conditions, a severe climate and an underdeveloped infrastructure.

In this respect, it is necessary to provide incentives for subsurface resource users to look for new major deposits which would be developed because they are economically attractive. This will not only inject real investment into the Russian economy and contribute to creating jobs in remote regions of the country, but will also involve the introduction of new sophisticated technologies in the industry.

At the same time, the legislation in force has certain provisions which hamper the growth of investments in geological exploration and prevent it from becoming more efficient. In particular, as a result of adopting the *Federal Law Concerning the Procedure for Foreign Investment in Commercial Organizations of Strategic Importance for the Defense of the Country and National Security of the State*, the *Federal Law on Subsurface Resources* established the criteria for classifying subsurface areas as those of federal significance. Currently, the subsurface areas of federal significance include those containing 50 tonnes or more of vein gold, 500,000 tonnes or more of copper; there are also certain solid minerals whose mere occurrence gives the subsurface area the status of a federally significant one. In view of the above feature of the mineral resource base and due to the ever lessening content of precious metals in ore, the potential of such subsurface areas is too low for their independent economically efficient development. The existing legal framework does not prompt companies to discover medium-sized and large deposits and to conduct their follow-up exploration, which negatively affects the Russian mineral resource base.

In view of the above, it would be reasonable to propose revising the parameters of subsurface areas of federal significance so that they really reflect how strategically important the asset is to the state, at the same time promoting investment in geological exploration.

Recommendations

1. Article 2.1.2 should be reworded as follows: *"2) located within a constituent entity or constituent entities of the Russian Federation and, according to the state's balance of mineral reserves as of 1 January 2006, has the following:*
 - recoverable oil reserves - 70 million tonnes and more,

- gas reserves - 50 billion cubic meters and more,
- vein gold reserves - 250 tonnes and more,
- copper reserves - 7 million tonnes and more".

Issue 4. Improving the procedure for approving the projects for subsurface resource facilities and clarifying the requirements for project documentation

Amendments should be made in the relevant laws and bylaws in order to eliminate different interpretations of the urban development law as well as the law on subsurface resources, and also to make the urban development law no longer inapplicable to the facilities of subsurface resources. This will ensure a more qualified expert examination of the construction of subsurface resource facilities and will help eliminate redundant and duplicating agreements and expert examinations and reduce the approval period.

Recommendations

Certain amendments should be made to the legislation and bylaws governing the design and construction of subsurface resource facilities:

- Reduce the number of approvals and expert reviews (including those duplicating each other) required for oil and gas development projects
- Develop and approve the regulations governing the content of and the requirements for well construction projects based on the existing industry documents valid in the oil and gas industry. Due to their specifics, well construction projects do not fall within the scope of the currently applicable Urban Development Code and Government Decree No. 87
- Provide that a review of the well construction project's industrial safety shall be sufficient for a construction permit. Currently, such projects are sent to the Head Administration of State Expert Analysis together with other construction projects for the construction of residential buildings, plants and factories.

Issue 5. Proposals on draft laws concerning the prevention and cleanup of oil and petroleum product spills

The Russian Emergency Ministry prepared a draft decree of the Russian Government which provides, in particular, for replacing the mandatory approval of oil spill clean-up plans with a notification procedure, whereby operators will only have to notify the responsible agencies of their respective plans once the same have been approved and adopted by the entity. This may be viewed as a positive step towards radically removing administrative barriers and simplifying business. At the same time, the draft decree keeps the requirement for localizing an oil spill within four hours in the sea and within six hours on land, which may be impossible to do in areas that are difficult to reach, and for re-passing the SEE for Plans in the event of any changes, which may lead to the easy loss by most Plans of the legitimate status and the replacement of the SEE with the obligatory repeated expert examination of plans. Currently, the repeated approval of the Plans is required only if the changes introduced make it necessary to increase the resources for the SEE.

Recommendations

Promote the adoption of the draft decree of the Russian Government prepared by the Emergency Ministry to replace the mandatory approval procedure for oil spill cleanup plans with a notification procedure, taking into account the conflict between Federal Law No. 287-FZ of 30 December 2012 *On Introducing Amendments to the Federal Law on the Continental Shelf of the Russian Federation and to the Federal Law On Inland Sea Waters, Territorial Waters and the Contiguous Zone of the Russian Federation*, which stipulates that oil spill cleanup plans are subject to a positive opinion within the state environmental examination procedure and that executive bodies are to be subsequently notified accordingly, and currently applicable Government Decrees Nos. 240 and 613, which set out the procedure for receiving consent and approval for such plans with regard to the introduction of adjustments of the time interval in the requirements for localization within the four-hour and six-hour intervals, and also a clear determination of the terms for re-passing the SEE.

2.7. Innovation Development

Issue 1. Cooperation with state bodies to identify the basic notions designed to improve the legal field, such as "technology transfer" and "commercialization", and prevent the wrongful and excessive use of the term "innovation"

The idea of using innovations to stimulate economic growth, as formulated by the state, has been favorably received by society and the business community. Unfortunately, the lack of a clear meaning and functional definition of the notion of "innovation" gives rise to all sorts of speculation around this development concept. Certain businesses attempt to falsely represent useless, uncompetitive and impractical products, technologies and business models as innovations. The resulting gaps in the interpretation and implementation of innovative practices make the Russian economy less attractive for investors.

By Decision

Study the methods and practices used by FIAC member companies in designing and structuring their innovation process. FIAC member companies should prepare recommendations and submit them to the relevant federal executive bodies for consideration and possible implementation.

Recommendations

1. Formulate clear criteria for classifying projects and products as innovative, taking into account global practices (as used in the United States, Sweden and Germany), including the criterion of economic efficiency.
2. Prepare a list of priority innovative products and technologies by industry. Set up an advisory panel to use the technical competences of FIAC member companies in collecting information for purposes of decision-making and preparing documents necessary for the determination of priority areas and technologies.

Identify the methods of monetary stimulation for attracting and introducing the best available technology BAT.

Issue 2. Using the technical ability of FIAC member companies to identify the specific and most critical technologies for developing the Russian economy and encouraging the introduction of innovative business models

Development of a mechanism to use the best global innovative and technological competences available through FIAC member companies with a view to encouraging cooperation and providing assistance in shaping Russia's innovation policy

There is no mechanism for using the technological competences available through FIAC member companies in identifying the specific and most critical technologies and introducing innovative business models for the development of the Russian economy. FIAC member companies are now the largest repositories of scientific, technological and engineering knowledge that is vital for modernizing the Russian economy. Their expertise could be applied on a much broader scale to shape Russia's innovation policy and promote the work of state bodies (such as the Council for Modernizing the Economy and Innovative Development of Russia) that have a role to play in economic development.

Solution

Step-by-step accumulation of experience relating to FIAC member companies' activities in the following areas of innovative development: fundamental research, development and modernization of technologies, development and modernization of products, development and implementation of new business models. Consider creating an inter-agency advisory body to include FIAC members as well as involving FIAC technical experts in the work done by existing advisory bodies on innovation-based development. Design pilot projects in specific areas.

Recommendations

Include FIAC technical experts in working groups involved in developing technical regulations, federal laws and subordinate acts for specific ministries. Recommend that a technical expert panel be created by the relevant ministerial orders.

Issue 3. Formulate recommendations for changes in the regulatory framework (Decrees No. 218, 220, etc.) providing state incentives for innovation-based development to interest foreign companies in Russia's innovation-based development programs, providing for joint research and technology efforts and ensuring that the technological experience of world-leading companies is utilized

- 1) There are no mechanisms for exchange of information between the FIAC member-companies and the institutions of development, ministries and agencies (e.g., Russian Energy Agency) for innovation development programs, as a result of which the world leaders' potential is used extremely poorly.
- 2) There is no unified system for evaluating the competitiveness of innovative developments and engineering practices at the international level.
- 3) There is no consensus of opinion on the issue of parallel imports.

Solution

Consider creating an inter-agency advisory body to include FIAC members as well as involving FIAC technical experts in the work done by existing advisory bodies on innovation-based development.

Involve the experts of FIAC members in identifying conditions in conformance with companies' interests, accepted international practices, legislation and the interests of Russia's innovation-based development program.

Recommendations

Analyze the programs of development institutes to identify opportunities for cooperation with FIAC member companies.

Involve designated representatives of the Russian Ministry of Education and Science in the think tank's work in order to synchronize efforts and plan joint activities.

Summarize existing international and Russian law-implementation practice, and assess the potential socioeconomic impact of the proposed legalization of parallel imports.

Issue 4. Promotion of sustainable development principles, including:

- Combination of corporate management methods with adherence to legal rules and ethical standards in business
- Adaptation of sustainable development principles
- Analysis of the potential application by innovation companies of the practices of voluntary initiatives and self-regulation. At this stage, with Russia having acceded to the WTO, there is an acute need to adapt principles of sustainable business development:
 - "Water footprint"¹
 - "Carbon footprint"²
 - Global warming potential
 - Climate change
 - Ozone depletion
 - Soil and water acidification

¹ "Water footprint" refers to the volume of water consumed to produce various goods or provide services.

² In ecology, "carbon footprint" is an assessment of a product's cost in carbon units. For example, the carbon footprint of natural gas is considerably less than that of synthetic fuel obtained from coal, which involves the oxidation of part of coal.

- Air pollution in large cities
- Measures to prevent emissions of electric and electronic equipment.
- Measures to stimulate steady development, elaboration of the state program for supporting and stimulating BAT (best accessible technology), e.g., environmentally safe innovatory electric vehicles.

Solution

In order to improve the current situation, several measures should be taken:

- to replicate and disseminate the principles and norms of sustainable development in Russia,
- to promote and popularize environmentally safe transport in Russia,
- to create, promote and adapt environmental design norms.

Recommendations

1. Consider the need to work out the Federal Target Program which sets forth measures of comprehensive state support of environmentally safe vehicles, to develop clear-cut environmental standards for motor vehicles in Russia and to couple an environmental class of a motor vehicle with tax and other benefits for their owners.
2. Work out and implement the State Target Program for supporting and promoting the environmentally safe innovatory electric vehicles and other products which relate to the following measures on the federal and regional levels:
3. Measures of customs tariff rate stimulation include:
 - 3.1. No import customs duty for electric vehicles;
 - 3.2. Differentiation of a preferential tax rate for long range electric vehicles and hybrid vehicles;
 - 3.3. Preferential differentiation of the recycling fee for green vehicles.
4. Tax incentives for green vehicles – revising transport tax and replacing that with an environmental tax which would take account of a vehicle's environmental class and age.
5. Introduce such non-financial measures of support and stimulation as: free parking, possibility to move along public transport lanes and the further development of charging infrastructure.
6. Other state incentives could include preferential loans and preferential lease programs for acquiring green vehicles.
7. Taking electric vehicles as an example, such state support measures should be applied to other innovatory products, such as energy-efficient solutions for including alternative energy in new infrastructure, the expansion of the market for which will activate the related sectors of Russian industry.
8. Support in developing the service and charging infrastructure for electric cars and plug-in hybrids;
9. Development and adoption of federal regulations on charging infrastructure for parking places.

Issue 5. Innovative development of regions as a means of making them more attractive for investments

According to many expert assessments and forecasts of Russia's economic development, the country's GDP growth rates will slow down in the medium term as the traditional development model is followed. The constituent entities of the Russian Federation will play an increasing role, and their main aim will be to rapidly attract investments. Innovative production, science, education and research will be among the most promising areas for investment. However, special conditions need to be created to bring investments into those sectors. The investment climate and conditions that bring investments into the processing industry may not be attractive for investments in high-tech segments.

Recommendations

1. Develop criteria for assessing the degree of a regional economy's attractiveness for high-tech investments.

2. Identify the regions that are potentially the most attractive for investments in high-tech sectors of the economy.
3. Develop recommendations/a list of measures to bring investments into a region's innovative sectors.
4. Prepare recommendations on amendments to current federal laws to stimulate investments in high-tech and science-intensive sectors in constituent entities of the Russian Federation.
5. Implement a pilot high-tech project (a production facility, research center, etc.) in a region that is attractive for that purpose.

Issue 6. Human capital as a factor contributing to the country's investment attractiveness. Ensuring cooperation between educational institutions and FIAC member companies in training specialists, developing and implementing innovative technologies, conducting up-to-date R&D and making the Russian system of higher education more competitive. Through cooperation between higher educational institutions and international technological companies that are members of FIAC, create conditions to promote the international reputation of leading Russian higher educational institutions, their internationalization, and the entry of 8-10 educational institutions into the elite group of world-class research centers

There is a serious shortage of qualified specialists. Specialists in the area of higher and professional education are unfamiliar with modern and prospective technologies, effective training practices, and applied and fundamental breakthrough research in the interests of industry. This can adversely affect the investment attractiveness of projects involving modern production, engineering and research.

Solution

With a view to improving the current situation, several measures should be taken to:

- 1) Develop recommendations for modifying the content and methodology of education programs in order to raise investment appeal to the level of "qualified staff available."
- 2) Use the international experience of FIAC member companies to develop and submit recommendations to the Russian Government on establishing a unified education center (including distance learning and on-line consulting) to assist both university innovation centers and young innovators in productizing their ideas and launching start-ups.
- 3) Work out a road map for creating an infrastructure to enable the network of university innovation centers to function successfully.
- 4) Work out recommendations for cross-disciplinary training.
- 5) Prepare proposals to develop and implement engineer certification programs based on global practices.
- 6) Develop pilot projects with the Ministry of Education and Science and launch them if there is sufficient financing (see the proposed topics in the next column). Assess the effectiveness of pilot projects and develop recommendations for their wide-scale implementation.

Recommendations

1) Administrative staff of higher educational institutions: jointly with the Russian Ministry of Education and Science, develop programs of further professional training to train the new generation of administrators and researchers at higher educational institutions, with a view to presenting and implementing best global practices in the educational process, as well as applied and fundamental breakthrough research in cooperation with industry and in its interests.

2) Ensure direct cooperation with the Russian Ministry of Education and Science and higher educational institutions and colleges in Russia in order to develop advisory innovation centers at Russian higher educational institutions using technological platforms as well as to make the Russian system of higher education more competitive (development of further education and career development programs). Determine the necessary competences, and look for the educational institutions best suited to develop those competences.

3) Engineering training: formulate recommendations, jointly with the Russian Ministry of Education and Science, on "new engineer education" programs (training in cross-disciplinary skills, creating a "cloud" system of related competences in basic education, establishing a category of engineer entrepreneurs, engineer product managers, etc.).

4) Models of cooperation between higher educational institutions and industry: summarize the experience of FIAC member companies, and develop recommendations on effective forms of cooperation between higher educational institutions and industry (basic departments of such institutions, internships, education and certification centers [including distance learning and on-line consulting], innovation centers involving technological platforms, centers for rapid prototyping and small-scale production, etc.).

To improve cooperation between higher educational institutions and FIAC member countries, the Russian Ministry of Education and Science proposes measures to draw highly qualified specialists and creative young people into the sectors of the economy which determine its innovation development, i.e.:

- Include the representatives of the interested companies in the working groups for developing the federal state educational standards for the innovation sectors of the economy
- Develop stable, long-term academic and cultural relations between higher educational institutions and companies
- Jointly hold events to promote up-to-date technological solutions
- Hold scientific and technological events at higher educational establishments jointly with companies: seminars, conferences, round tables, and forums on priority scientific and technological directions which are of mutual interest
- Establish expert scientific and technological councils and include the representatives of companies in them, draw companies into assessing the quality of learning programs and the efficiency of specialist training
- Jointly develop the content as well as the informational, methodological, material and technological support of the key and additional learning programs for companies that comply with the requirements of modern technologies
- Improve the regulatory legal base (Decree No. 218 of the Government of the Russian Federation of 9 April 2010 On Measures of State Support of the Development of Cooperation between Russian Higher Educational Establishments and Organizations which Implement Comprehensive Projects for Creating High-tech Production, etc.) with a view to creating favorable conditions for participation by foreign companies, which have a high-tech potential and are BAT carriers, in conducting R&D and innovation work
- Work out recommendations for amending legislation to promote the implementation of the R&D results in production on a company's material and technical basis, and then release and subsequently commercialize them
- Draw the representatives of the FIAC innovation working group into the work of the Commission for Modernization and Technological Development of the Russian Economy, Skolkovo and Other Development Institutions
- Create conditions for the fulfillment of contractual work by higher educational establishments on the basis of the order of companies with the engagement of leading specialists of higher educational establishments
- Establish joint creative collective groups which include professors and instructors of a higher educational establishment as well as specialist practitioners in order to modernize and renew the teaching programs of a higher educational establishment
- Teach company employees under additional professional programs of a higher educational establishment (programs for retraining and improving the qualification of specialists)
- Arrange the improvement of the qualification of instructors and workers of higher educational establishments and send them on internships on the basis of the material and technical basis of companies, jointly train specialists with a higher degree of qualification in science with regard to the companies' interests
- Establish departments and other structural subdivisions which provide practical training on the basis of the companies which engage in activity relating to the scope of the relevant training program
- Form stipend programs for students and create grants for young instructors
- Arrange internship, practical training, undergraduate training and other practices for students
- Engage young specialists in an industry wherein a company works, e.g., provision of assistance by companies in professionally training specialists for work in their structural divisions

- Engage in joint professionally oriented work with school pupils (e.g., Enel's educational project "Play Energy") and students in the field of the latest technologies, foreign languages and culture
- Scientific and technological contests to be held by leading higher educational establishments together with the companies concerned in accordance with the direction of these companies' innovation activity, giving grants to the contest winners and prize-holders to allow them to engage in technological development
- Jointly develop and create educational stands and publish handbooks, materials and manuals for educational processes at a higher educational establishment
- Work out recommendations to improve the regulatory legal base so as to create favorable conditions for participation by foreign companies with high technological potential, which are BAT carriers, in joint R&D, innovation development and its subsequent commercialization.

By working on the above proposals further, make the mechanisms of cooperation more effective and improve cooperation between FIAC member-companies and higher educational establishments so as to promote innovation development.

Issue 7. Introduction of a preferential, simplified system of customs, tariff and non-tariff regulation to promote R&D

1. The process of importing and exporting test engineering platforms can take over two months, while the life cycle of these platforms may be only a few weeks after they leave the factory, making it impossible to assume the obligation to test them and perform engineering work in time.
2. Companies setting up new facilities in Russia to manufacture technological products not previously manufactured in Russia or importing samples for testing have to deal with varying interpretations of current procedures by customs authorities. This discourages customs procedures other than import/export, conflicts with current international practice and entails additional expenses for companies. Similar problems arise for exports of samples that have undergone testing and incorporate the findings of such testing/research. It is noteworthy that such equipment is not transported in order to be sold in the Russian Federation.
3. The current procedure for substantiating the customs value of used equipment – like the procedure for substantiating the customs value of demonstration samples and prototypes of high-tech equipment – is complex and not feasible for importers.
4. Section XVI (machines, equipment and mechanisms) and Section XVII of the current Goods Classifier of the Customs Union do not reflect the specifications of new technologies or provide for multiple classification, and therefore the customs duty rates cannot be clearly determined. The mechanism for reducing such rates for high-tech equipment is difficult and lacks transparency, which discourages the import and use of such technologies in Russia.

Solution

Currently, three principal mechanisms are being discussed to simplify the importation of engineering samples:

1. Principal: based on the experience gained in adopting Government Decree No. 911 of 3 November 2011 on imports of foreign goods for the Winter Olympics in Sochi, develop a similar mechanism for imports of engineering samples. This will require amendments to the Eurasian Commission's decision on the list of goods imported into Russia.
2. Backup: optimize the mechanism for temporary imports of engineering samples.
3. Amend the initiative of the Ministry for Economic Development "Schedule of Legal Acts Required to Facilitate.

Imports into the Russian Federation and Exports from the Russian Federation of Materials for Scientific Research" to include engineering samples.

Recommendations

Introduce a special category of goods for internal R&D use (engineering samples), i.e., implement a maximally simplified procedure for importing and exporting test platforms (both tariff and non-tariff regulation) that would be overseen by a single agency (e.g., the Russian Ministry of Communication or the Russian Ministry of Industry and Trade) and would not require additional inter-agency coordination. This

will make Russia more attractive as a site for international companies' R&D centers, promote strong development of IT service companies and make Russian software developers more competitive on the world market. The result will be a growing number of highly paid jobs in the high-tech sector, the spread and adaptation of new technologies and accelerated development of the high-tech industry in Russia.

Expected outcome

1. The customs registration of engineering samples should take no longer than seven days by 2015 and two days by 2020.
2. Russia should be regarded by the international community as a country with favorable customs regulation and be among the Top 20 in terms of innovation and competitiveness. (In 2012, Russia ranked 67th out of 144 in the World Economic Forum's Global Competitiveness Rating, and Russia's innovation potential fell from 57th to 85th place. Source: <http://www.rbcdaily.ru/2012/09/06/world/562949984659366>).

Issue 8. To promote the planned innovation development of the Russian industry and public accessibility to innovation products and goods, it is necessary to ensure the effectiveness, transparency and protection of the intellectual property rights of the developers of original innovation products in the system of state purchases/state contracts

In the pharmaceutical industry, protection against the illicit commercial use of information provided by a manufacturer on pre-clinical and clinical tests for registering medical drugs – one of Russia's commitments in connection with its accession to the WTO, which is expressed, inter alia, in part 6 of Article 18 of Federal Law No. 61-FZ *On the Circulation of Medical Drugs*

1. In order to release new medical drugs into the market, a developer must conduct lengthy (10-12 years) and costly (\$0.8-1.2 billion) pre-clinical and clinical tests. Patent law protects the rights to an innovative drug for 20 years.
2. To protect the rights holders, there is a global system of protection against illicit commercial use of data on preclinical and clinical tests (data exclusivity) which bans the registration of generics for several years after the original drug is registered (5-7 years in the United States and 8-11 years in the EU), based only on bioequivalence data. A generic manufacturer may produce its own drug either by reaching an agreement with the rights holder or conducting clinical tests itself.
3. In accordance with the WTO, Russia also undertook to prevent the registration of reproduced (equivalent) pharmaceuticals for six years after an original drug is first registered, unless the applicants for the registration of a reproduced drug provide their own data meeting the same requirements as for the registration of the original drug or the consent of the holder of the registration certificate for the original drug. It is not specified, however, how this provision is to be legally applied.

Solution

Support the draft Federal Law "On Amendments to the Federal Law 'On the Circulation of Pharmaceuticals' and to Article 333.32.1 of Part Two of the Tax Code of the Russian Federation," prepared by the Russian Ministry of Health, as regards amendments to improve legislation on the protection of rights to clinical drug-test data, and propose additional amendments to improve current law on the protection of exclusive clinical drug-test data.

Recommendations

Actively participate in drafting bylaws which regulate the legal application of the rules to protect intellectual property rights in the pharmaceutical industry.

Expected outcome

Protection against the illicit commercial use of information, provided by a manufacturer on pre-clinical and clinical tests for registering medical drugs, as the fulfillment of Russia's commitments with regard to its accession to the WTO, expressed, inter alia, in part 6 of Article 18 of Federal Law No. 61-FZ *On the Circulation of Medical Drugs*, will help make Russia more attractive for investments.

Russian patients will have greater access to new medical drugs.

2.8. Development of the Far East and Siberia

Report on the Working Group's activities in 2013 and plans for 2014

Promote foreign investments in the Far East and Siberia; provide guidance for foreign investors by demonstrating successful, positive investment experience on the part of FIAC member companies:

1. The year 2013 saw the publication of *Siberia*, the first investment guide in Russian and English covering all 12 regions of the Siberian Federal District, including greetings from all governors of the Siberian regions to FIAC members and brief economic information on all regions and priority investment projects for the Siberian regions as well as contact details (telephone and fax numbers and electronic addresses of the responsible regional ministries).

The investment guide *Siberia* will be presented at the FIAC plenary session, chaired by Russian Prime Minister Medvedev, on 21 October 2013

2. In 2013, top officials from the Jewish Autonomous Region, Novosibirsk Region, Trans-Baikal Territory and the Altai Republic, as well as officials from the Office of the Plenipotentiary Envoy of the Russian President in Siberia and the Ministry for Development of the Far East, addressed FIAC members at the think tank's investment session, giving information on the investment advantages and projects of their regions.

From 2010-2013, the members of the working group were addressed by top officials of the Republic of Sakha (Yakutia), Primorsk Territory, Amur Region, Magadan Region, Irkutsk Region, Krasnoyarsk Territory, Sakhalin Region, Khabarovsk Territory, Tuva, Buryatia, Chukotka, Kamchatka, Jewish Autonomous Region, Novosibirsk Region, Zabaikal Territory and the Altai Republic and by representatives of the Offices of the Russian Presidential Envoys to the Far East and Siberia, the ministry for economic development and the ministry for the development of the Far East.

3. In 2013, major corporations, banks and organizations that are currently not FIAC members have been invited to attend the working group's investment sessions.

Representatives of several companies – JBIC (Japan Bank for International Cooperation), Nomura Research Institute, JETRO and JOGMEG (Japan Oil, Gas and Metals National Corporation) – took part in the investment sessions in 2012 and 2013 and intend to do so in the future.

4. The survey *Impact of Direct Foreign Investments on the Socioeconomic Development of the Far East*, prepared by the Center for Economic and Financial Research and Development (CEFRD), will be presented at the coming FIAC plenary session.

Overview of investment activities of pharmaceutical companies in Russia



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FIAC currently includes four international pharmaceutical companies: *Novartis, AstraZeneca, Sanofi and Abbott Laboratories.*

In April 2013, the Foreign Investment Advisory Council (FIAC) in Russia conducted a survey of international pharmaceutical companies operating in Russia concerning their participation in the development of the Russian pharmaceutical industry including the expansion of research and development activities for the health care system in Russia.

The survey touched upon the investment climate in Russia, which is much discussed recently.

The results of the survey are summarized below. Contribution from the pharmaceutical companies which made the basis for this report will be considered in the subsequent work of FIAC.

Investment activities of international pharmaceutical companies in Russia

The results of the survey demonstrate that the vast majority of the international pharmaceutical companies are involved in investment activity in several areas, including clinical/preclinical research and the construction of production sites.

The companies are also actively involved in projects to support and develop the Russian health care system including:

- ▶ Sponsorship of scientific conferences, forums and staff training programs. In this area pharmaceutical companies are involved in such projects as:
 - All-Russia project Your Health: the Future of Russia
 - National School for Young Psychiatrists

- Rheumatic Club for rheumatologists and surgeons in Moscow and the Moscow region, an innovative online training system for rheumatologists
- The First Global Educational Forum Russian Cardiovascular Days
- Academy of Anaesthesiology - educational programs for anaesthesiologists and other projects.

- ▶ Joint projects with the scientific and research centers, including:
 - The project of staff development within Pharma 2020 – raising the professional level of Russian experts in clinical research
 - Cooperation with The Academician V.A. Almazov Federal Center for Heart, Blood & Endocrinology, Biofund RVC, The Academician I.P. Pavlov St. Petersburg State Medical University, The Prof. N.N.Petrov St. Petersburg Federal Research Institute of Oncology, and other medical research institutions
 - Establishment of the center of clinical research involving Russian medical institutions and other projects.
- ▶ Joint projects with the Russian Presidential Academy of National Economy and Public Administration (RPANEP):
 - Interactive discussion platform Effective Health Care: An innovative Way of Development.

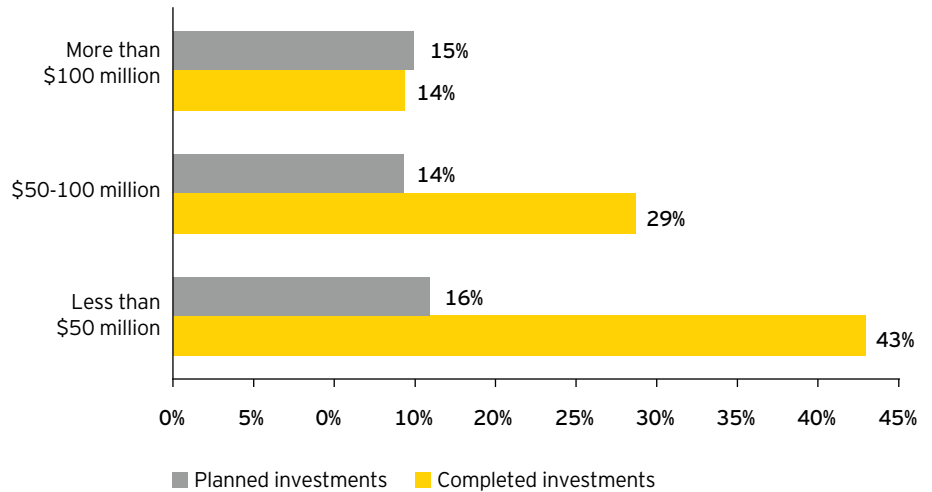


Investment areas

The main area of pharmaceutical companies' investments is the construction of own manufacturing facilities in Russia: about 86% of respondents have already invested in local production, and the remaining 14% are planning to invest in the development of their own production sites. An average investment is about USD 70 million.

It should be noted that approximately 35% of companies, that have already invested in their own production, intend to continue investing in this area.

Figure 1: Investments in own production



Regions to invest

The most attractive regions for investments in the pharmaceutical sector, according to the majority of respondents, are the Kaluga and the Yaroslavl regions. In addition, investors are interested in the Moscow and the Nizhny Novgorod regions as well as the cities of Yekaterinburg and St. Petersburg.

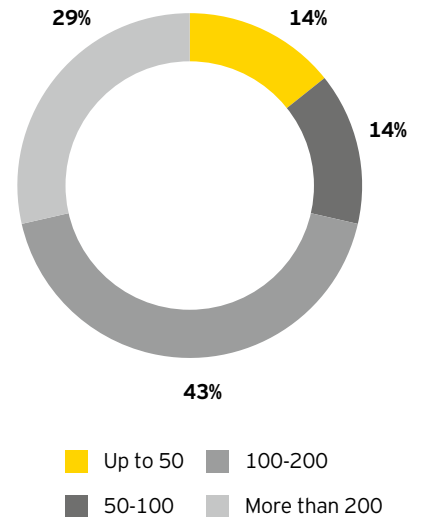
It is not by chance that pharmaceutical companies selected those regions: most of them have set up the so-called clusters - special zones for developing high-tech manufacturing. The companies registered in such clusters have a wide range of regional tax benefits - from lower income tax rates to complete exemption from certain taxes and customs duties for a specified period of time. Major international pharmaceutical manufacturers have already signed investment agreements with the governments of the Kaluga and the Yaroslavl regions.

Creation of workplaces

Investments in own production contribute to the creation of new workplaces in the regions where pharmaceutical manufacturers operate. Generally, the start-up of production sites and business development creates 100-200 new workplaces in Russia, although a number of companies employ over 200 people.

It should be noted that in case of creation of a specified number of workplaces, in some regions, companies can also enjoy tax benefits offered by local legislation.

Figure 2: Creation of workplaces by pharmaceutical companies

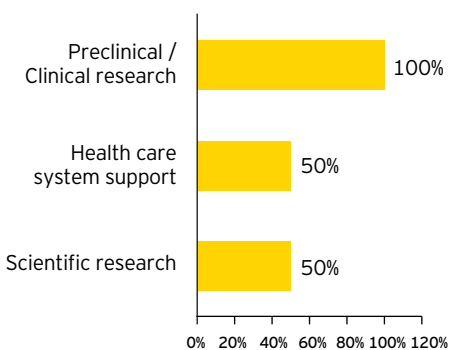




Other areas

All respondents noted that in addition to investing in production assets, they also invest in clinical and preclinical research. 50% of the surveyed companies are also involved in supporting health system and research activities.

Figure 3: Other areas of investment



Average investment in each of the areas listed on the diagram reaches USD 50 million.

The main areas of development of the Russian pharmaceutical market

When studying development opportunities on the Russian market, international pharmaceutical companies consider various forms of business structure. In addition to developing their own production facilities as mentioned above, the most popular form of

cooperation with Russian producers is the contract manufacturing.

A number of companies do not rule possible acquisition of Russian producers (29%).

Figure 4: Production localization in Russia



Manufacturing localization in Russia allows pharmaceutical companies to gain an advantage when bidding for the state (municipal) orders. For example, when bidding for a public procurement contract the price of locally produced drugs will not

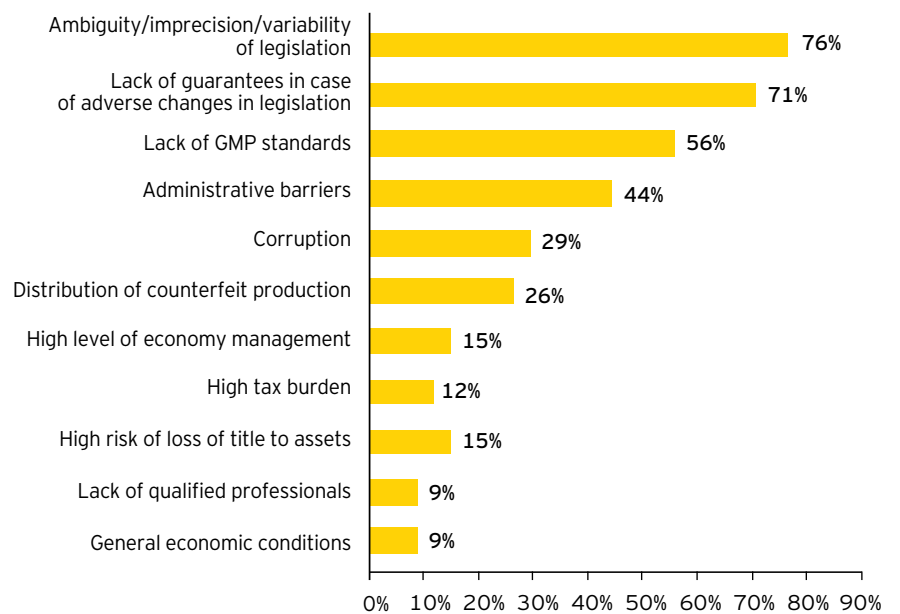
be adjusted upward (by 15% magnification factor) for the purposes of comparing bid prices provided that the drug meets the criteria of sufficient processing, and Russia or Belarus is recognized a country of origin.



Factors preventing investment inflow in Russia

According to the vast majority of survey respondents (76%), ambiguity, inaccuracy and variability of legislation, as well as lack of guarantees in case of adverse changes are the most essential factors that prevent the inflow of investments in Russia. In addition, respondents see the lack of GMP standards and administrative barriers as considerable obstacles for foreign investments.

Figure 5: Main barriers for foreign investments in Russia

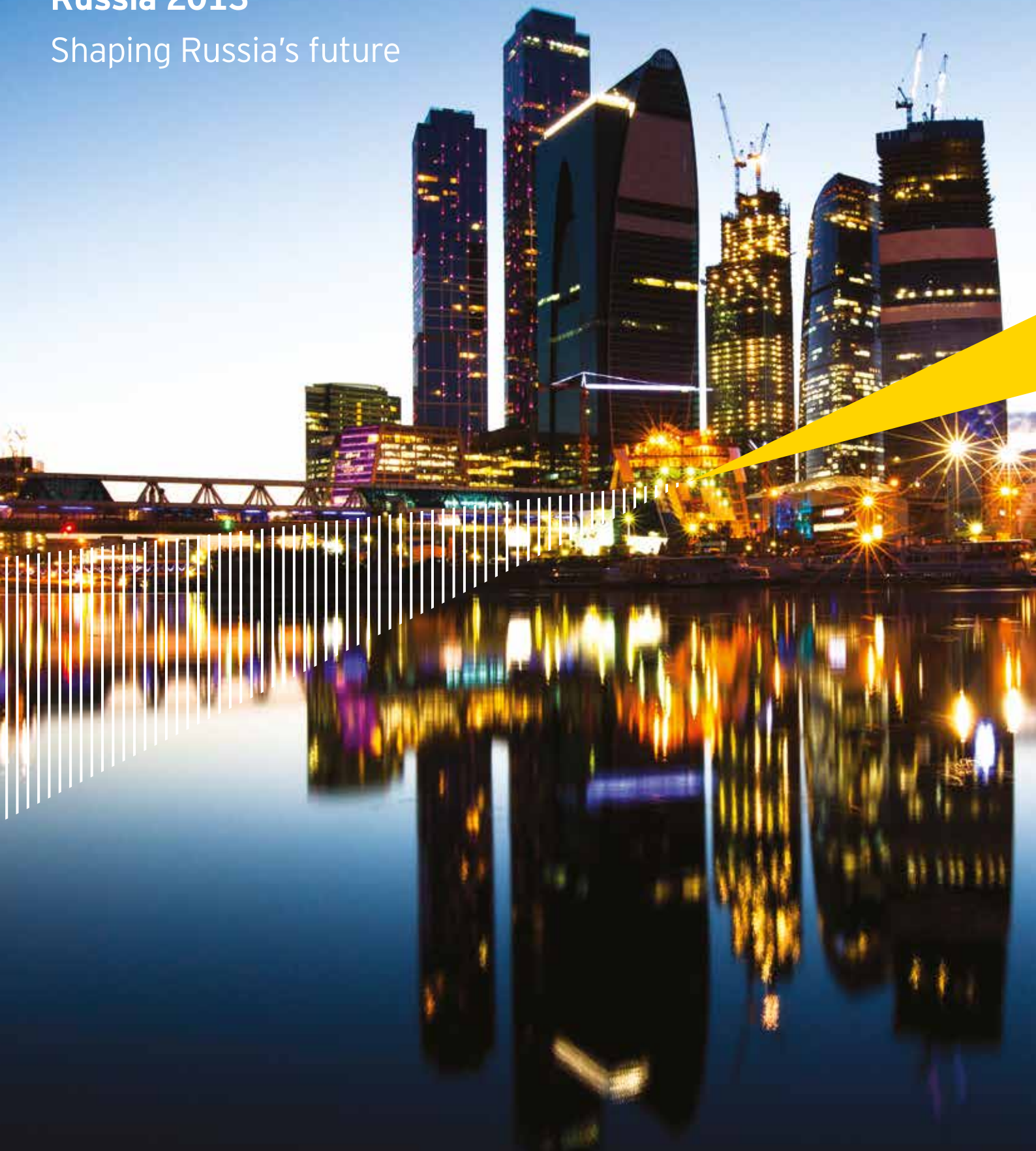


Growing Beyond

Ernst & Young's attractiveness survey

Russia 2013

Shaping Russia's future



Attractiveness

Ernst & Young's attractiveness surveys

Ernst & Young's attractiveness surveys are widely recognized by our clients, the media and major public stakeholders as a key source of insight on foreign direct investment (FDI). Examining the attractiveness of a particular region or country as an investment destination, the surveys are designed to help businesses to make investment decisions and governments to remove barriers to future growth. A two-step methodology analyzes both the reality and perception of FDI in the respective country or region. Findings are based on the views of representative panels of international and local opinion leaders and decision-makers.

Emerging Markets Center



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Foreword

Russia is shaping its future



Jay Nibbe
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For the past 10 years, we've been talking to international business leaders to produce the Ernst & Young attractiveness reports, which analyze international investment markets and explore how countries can make themselves more attractive for foreign direct investment (FDI).

Shaping Russia's future, our third *Russia attractiveness survey*, finds that, although it still faces some challenges, Russia remains an attractive destination for FDI.

Russia's growing consumer market, rising disposable income, expanding middle class, vast resource reserves and highly skilled workforce continue to attract investors from all corners of the world.

In 2012, the country's FDI performance relative to other European countries remained roughly the same. However, the large number of jobs created by foreign investment gave Russia the second-highest level of FDI-generated employment in Europe last year.

Russia also managed to improve the way it's perceived by investors in 2012. Respondents to our survey rank it as the sixth-most attractive country in the world for FDI, and the most attractive in the Commonwealth of Independent States (CIS).

Administrative barriers and corruption are still preventing Russia from realizing its full FDI potential. Diversifying its economy, providing sustainable growth and encouraging the wider use of new technology are also important targets. Russia should think about investing its energy-sector revenues in driving these improvements.

Government efforts to increase transparency and drive modernization have started to yield results. Russia has improved its ranking on several business indices, and accession to the World Trade Organization, as well as other integration efforts, are expected to further improve the investment climate.

There is a substantial gap between the perceptions of current and prospective investors. Those who are already working in Russia are more aware of the country's real investment climate and the efforts being made to improve it. They're also optimistic about the future of FDI in Russia. Bridging this gap between existing and potential investors will be crucial to increasing FDI in the country.

There are also other steps that Russia could take to increase its attractiveness. Being proactive in identifying opportunities, improving the business environment, fostering entrepreneurship and developing its innovation capacity, are a few of the key enablers for future investment and growth.

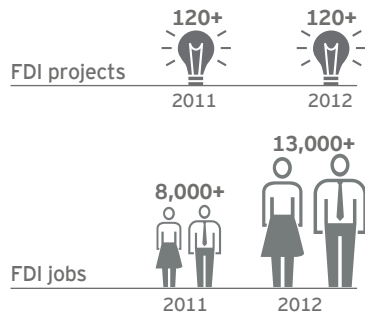
We hope that the *2013 Russia attractiveness survey* will make interesting reading for international investors as well as business and public sector leaders.

We would also like to thank the survey respondents and Ernst & Young professionals who helped us to prepare this report.



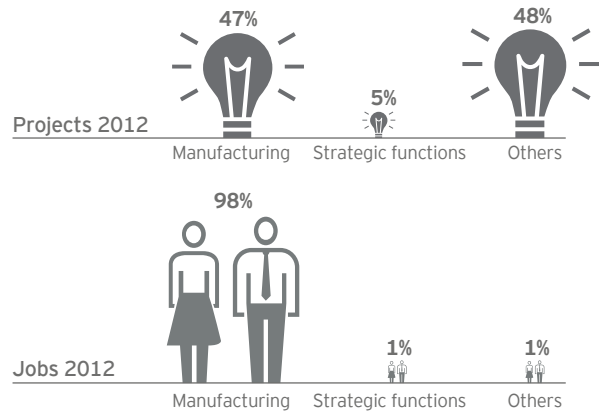
Executive summary

1 Second in Europe in job creation



Source: *European Investment Monitor*, 2013, Ernst & Young.

Jobs created by FDI projects increased by 60%, indicating a large increase in average project size. Russia ranked second in Europe in 2012 in terms of employment generated through FDI, up from its sixth position in 2011, and accounted for 8% of the total jobs created in the region, resulting from a rise in labor-intensive industrial activities.

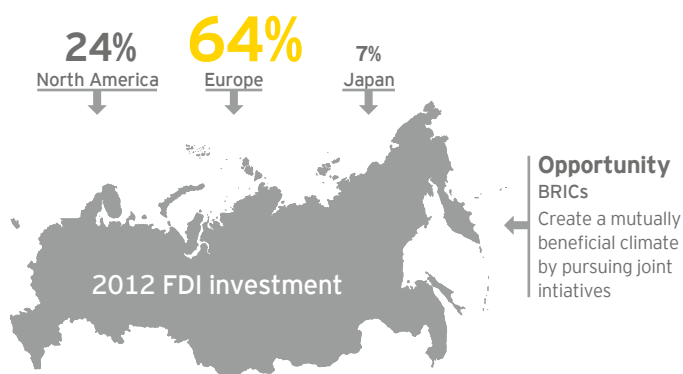


Source: *European Investment Monitor*, 2013, Ernst & Young.

Manufacturing generated by far the most FDI projects and jobs. Projects in strategic functions and other functions also increased. The automotive sector received the most FDI projects, and also accounted for the largest share of jobs created by FDI. The business services sector has also increased its appeal, accounting for the second largest number of projects in 2012.

► For more on FDI projects and jobs in Russia, turn to [p.15](#)

2 From the west ... to Moscow and St. Petersburg



Source: *European Investment Monitor*, 2013, Ernst & Young.

North America and Europe continue to provide the bulk of Russian FDI investment. Companies from the US, Germany and France were the top investors in Russia in 2012. The number of FDI projects from Germany more than doubled, mainly because of increased investment from automotive companies. While Moscow and St. Petersburg attracted the largest number of FDI projects, Kaluga and Nizhny Novgorod are also emerging as major investment sites.

► For more on sources of FDI, turn to [p.22](#)

3 Competitive advantages and areas for improvement



Source: *Russia attractiveness survey* (total respondents: 206), 2013, Ernst & Young.

A large and expanding consumer market, solid telecommunications infrastructure and abundant natural resources are central to Russia's competitiveness. Respondents had a mixed view of the human resource potential and research, innovation and entrepreneurial environment in Russia. High levels of corruption, deficiencies in the legislative environment and inter-regional disparities limit Russia's FDI potential.

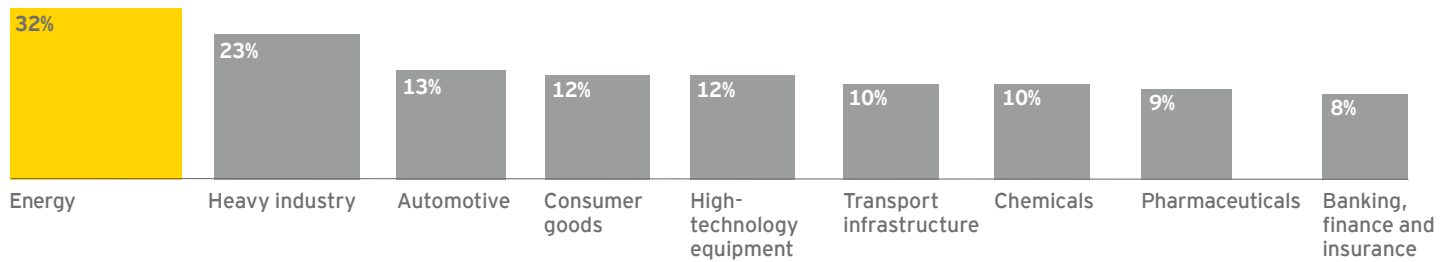
► For more on Russia's strengths and challenges, turn to [p.35](#)

Ernst & Young's 2013 Russia attractiveness survey analyzes:

a) The real attractiveness of Russia among foreign investors, based on FDI data from Ernst & Young's European Investment Monitor (EIM), which tracks greenfield FDI projects but excludes portfolio investments and M&A; and b) the perceived attractiveness of Russia among foreign investors, based on a representative number of telephone interviews conducted with a panel of international business leaders.

► For more on the methodology, turn to p.64

4 Growth opportunities in energy and beyond



Source: Russia attractiveness survey (total respondents: 206), 2013, Ernst & Young.

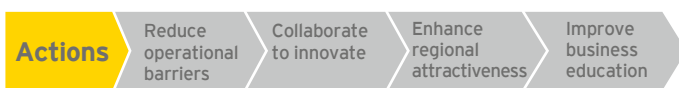
Investors continue to believe that the energy sector will drive Russia's future growth. Beyond energy, they highlight heavy industry, automotive, consumer goods and infrastructure as the future growth drivers. Russia needs to establish a more balanced economy that can offer sustainable long-term growth through

► For more on sectors driving growth, turn to p.47

high-value added manufacturing and new service sectors. It also needs to operate on a modern technological base. To achieve this, Russia should use energy revenues to finance diversification and develop new avenues of growth.

5 Action plan

Russia's sustainable growth model

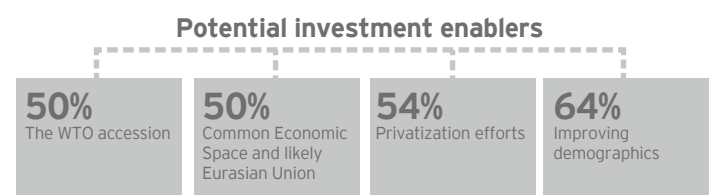


Source: Russia attractiveness survey (total respondents: 206), 2013, Ernst & Young.

To achieve its true potential, Russia needs to intensify its efforts to reduce administrative burdens by minimizing bureaucracy, increasing transparency and consolidating the rule of law. The Government should work in collaboration with local and foreign companies and universities, to enhance innovation capacity and business education. It should also consider increasing investment in underdeveloped regions of the country.

► For more on proposed actions moving forward, turn to p.54

6 Increasing appeal



Source: Russia attractiveness survey (total respondents: 206), 2013, Ernst & Young.

The majority of investors surveyed believe that Russia's accession to the World Trade Organization (WTO), the formation of the Common Economic Space with Belarus and Kazakhstan, and a likely Eurasian Economic Union by 2015, will have a positive impact on Russia's attractiveness. Acceleration in privatization efforts and an improvement in demographic profile are also expected to improve the country's appeal as an investment destination.

► For more on Russia's investment enablers, turn to p.59

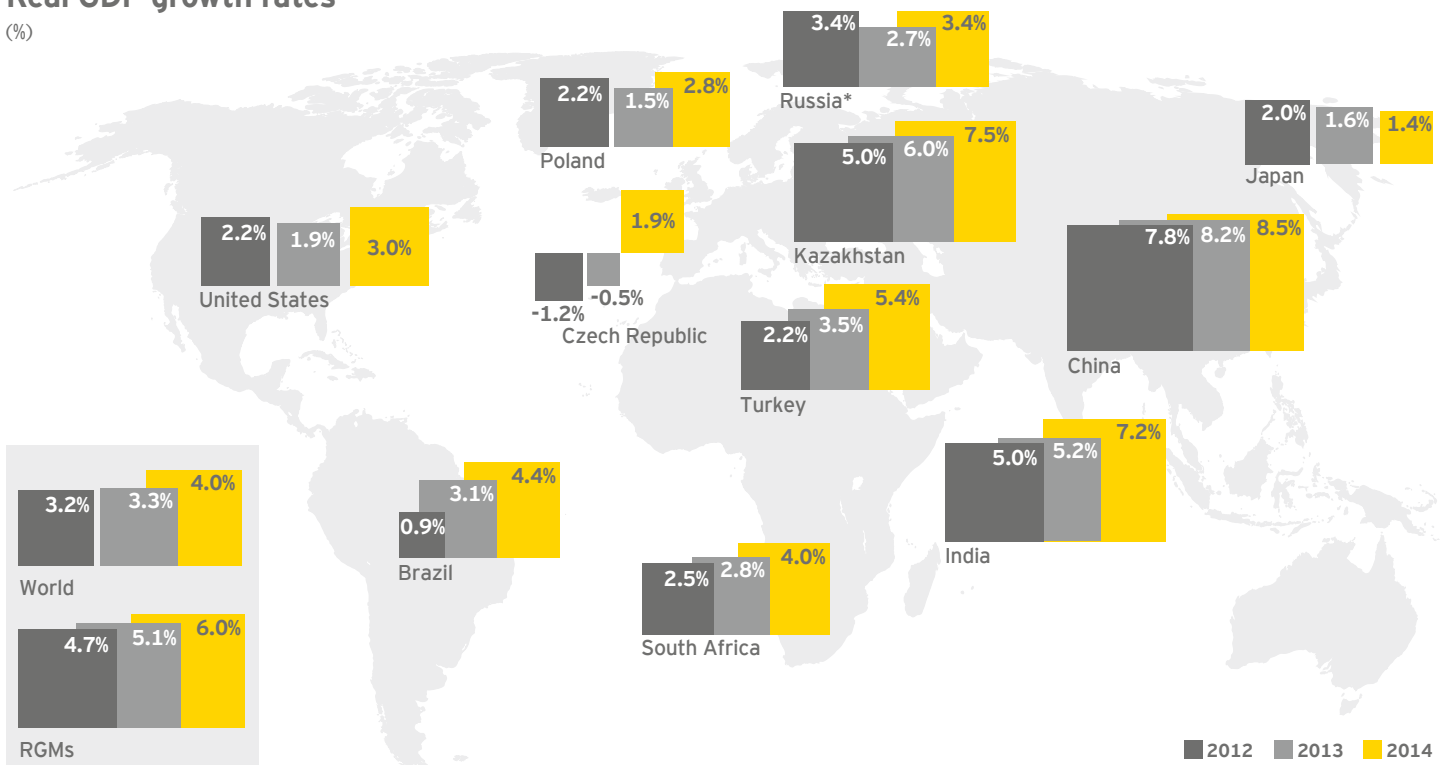
Russia in context

Russia in today's world

Global economy 2013, outlook for 2014, Russia's key economic data.

Real GDP growth rates

(%)



*European Bank for Reconstruction and Development (EBRD) estimation: 1.8% in 2013 and 3.0% in 2014.

Sources: *World Economic Outlook*, IMF, April 2013; *Rapid-Growth Markets Forecast*, April 2013, Ernst & Young; *Global Economic Databank*, Oxford Economics, accessed on 31 May 2013.

The shape of the global economy is changing. The centers of economic power are distributed across both the developed and the emerging world. Rising stars in Asian and Latin American economies are increasingly emerging as the economic powerhouses, as the Eurozone, Japan and the US have struggled to maintain growth.

Rapid-growth markets keep to a safe path

The global economy was in recovery mode in 2012. Global growth of 3.3% is projected for 2013, up from the 3.2% recorded in 2012. And growth is forecast to pick up further to 4.0% in 2014.¹

Global growth has been fueled by the rapid-growth markets (RGMs). Growth in Asian RGMs is set to accelerate from 6.4% in 2012 to 7.4% in 2014, and Latin American RGMs from 2.6% in 2012 to 4.5% in 2014. In contrast, RGMs in Eastern Europe are expected to lag behind their Asian and Latin American counterparts. Poland is expected to grow by 1.5% in 2013

and 2.8% in 2014, while the Czech Republic is estimated to grow by 1.9% in 2014 after witnessing a contraction this year (GDP expected to fall by 0.5% in 2013).²

Mature economies are growing slowly, but still account for half of global GDP and 40% of global FDI inflows

The major developed economies experienced disappointing economic performance in 2012 on the back of the recession in the Eurozone and Japan. Their recovery is set to remain weak in 2013. Nevertheless, improving bank balance sheets and stronger consumer finances have brought the US back on track. Overall, the advanced economies are expected to play a reduced role in the global recovery, growing at an estimated 1.2% in 2013 and 2.2% in 2014.³ Although growth in the developed world has been much slower than in the RGMs, they still hold 50.1% of the world GDP in terms of purchasing power parity.⁴

2. *Ernst & Young's Rapid-Growth Markets Forecast*, April 2013.

3. *Ernst & Young's Rapid-Growth Markets Forecast*, January 2013.

4. *World Economic Outlook*, IMF, April 2013; *Global FDI Recovery Derails*, Global Investment Trends Monitor, UNCTAD, January 2013, p. 6.

1. *World Economic Outlook*, IMF, April 2013.

Interview



Reconsidering the motor of economic growth

Sergey Naryshkin
Chairman of the State Duma

Good investment opportunities are what mainly attract investors throughout the whole world. Investors, for whom the relationship between risk and income generation is vital, should see that projects that are advantageous to that relationship are available for them in Russia.

The time of high income generation in the global economy has passed. In the global competition for investment, minimizing risk is ever more important, and we are no exception in this respect.

The country has a stable political system. Moreover, macroeconomic conditions have stabilized to a certain extent. But, if you intend to make 10-15 year investments, you need guarantees in relation to ownership rights and the fulfillment of agreements, as well as stable regulation. Naturally, investors should be allowed to act as they have become accustomed to and in a manner that is convenient for them. Therefore, investment tools are very important. For us, they are an issue in the development of our legal system.

Many of the reforms currently being implemented will have an impact on our economy's investment appeal. Such an effect will definitely be evident five to seven years from now, if not in the next few years.

However, Russia's appeal can be enhanced sharply by reconsidering the source of its economic growth. Private entrepreneurial initiative is of paramount importance in this respect.

The economic policy pursued in recent years has been aimed at maintaining stability, largely by means of state control. Apart from the obvious macroeconomic effect and the growing manageability and predictability of the economy, such an approach restrains private entrepreneurial initiative, because small and medium-sized businesses develop largely by receiving orders from organizations that are connected in some way with the state.

At the new, post-privatization crossroads, we have essentially again come across the problem of a nationalized economy, although the forms of such state participation are now more diverse.

Therefore, it is now necessary, as never before, to take well-considered steps to replace state control and the approaches based on manual control with modern tools for regulating industries and sectors. They should, on the one hand, increase the incentives for entrepreneurial activity. On the other hand, they should also protect the interests of the state, which is acting on behalf of individuals, employees, consumers, investors and other communities.

“It is now necessary, as never before, to take well-considered steps to replace state control and the approaches based on manual control with modern tools for regulating industries and sectors.”

Interview



Infrastructure as the basis of Russia's innovational development

Vladimir Yakunin
President of Russian Railways

Russia managed to overcome the acute phase of the global financial crisis without being seriously affected. Nonetheless, certain problems must still be resolved if the country is to develop steadily, socially and economically. The country's investment climate is the key to its development. However, the growth of the country's investment appeal and better business conditions largely depend on the development and quality of infrastructure.

According to the *Global Competitiveness Report 2012-13*, Russia is 47th in the world for competitiveness, in terms of infrastructure. But it is 136th for the quality of roads, 104th for airline infrastructure, 93rd for port infrastructure and 30th for railway infrastructure, although the country has risen three places since 2009 in relation to the latter indicator.

According to the plans for developing economic policy, Russia should be among the top 20 countries in *The World Bank's* rating by 2018. This can be achieved largely by developing the supporting infrastructure, such as transport, energy, utilities and communications. These fields require paramount attention, and are the basis for the development of innovation and greater effectiveness of other economic sectors. In China and many European countries, the growth of investment in the railways, particularly public railways, has become a powerful anti-crisis factor.

The country's attractiveness to foreign investors depends largely on such, determinants of the investment climate, such as legislative stability, the tax burden, the protection of ownership rights, court independence and the extent of infrastructure development.

An important indicator of the country's investment appeal is the intensity with which domestic capital investments, including state investments, are made. Foreign investments cannot be expected to grow if a foreign investor sees that the residents are not investing money in new production and are not renewing capital assets. In 2012, the level of investments in fixed assets to GDP in Russia was less than 20%, which corresponds to the level of investment in developed countries.

Russia's economy grew, in particular, because of the favorable market outlook in the 2000s, prior to the global crisis. Russian Railways played an important role in this respect, by ensuring uninterrupted export shipments, which were occasionally

“The growth of the country's investment appeal and better business conditions largely depend on the development and quality of infrastructure.”

detrimental to its own interests. Their share in the total volume of shipments increased from 24.6% in 2003 to 28.8% in 2012, when almost half of rail freight constituted exports. However, the current economic development model is no longer effective, and cannot ensure high economic growth rates. We are already observing negative tendencies in relation to the key indicator: shipments. Recently, internal demand for rail freight traffic has been lagging behind exports, where demand for raw material cargo has increased. At the same time, we see that Russia has great potential to develop.

Russia is unique with regard to its geographic location. Its foreign trade is based on partnerships with Asia and Europe. Currently, it is important for the country to integrate into the global economic system as deeply as possible, offering not only raw materials, but also unique products and technologies. Russia has great potential in this respect, including transportation.

The country should use a new economic model focused on other drivers of growth, greater financial sovereignty, a larger share of the real sector, the elimination of systematic disproportions in the structure of production and foreign trade, and the rapid development of transport infrastructure.

In turn, rail transport will provide access to the new industrial zones and safeguard the demand for products – and it will become an actual point of growth and the object of investments.

We see clearly what should be done, and have prepared the relevant programs and projects for developing the railway infrastructure. Business activity will increase substantially and the scope of investments will grow in the country by using public-private partnerships, issuing infrastructure bonds and attracting private investments in profitable projects.

Russia in numbers

Normal GDP in 2012:

US\$2 trillion

3.4%

real GDP growth in 2012

Government debt fallen from
70% of GDP to

9% of GDP

over the last 10 years

Unemployment rate of

5.4%

Record low for the last two decades

143 million

people

Ninth largest

consumer market in the world

US\$3 trillion

Consumer spending by 2025

2014

Largest automotive market in Europe

2020

Europe's largest and
world's fourth-biggest
consumer market

FDI hotspots

Moscow (capital)
and St. Petersburg

Western companies sell

6-12 times

more per capita on average
in Russia than in China and India

Skolkovo

innovation city

Doing business relatively easier

120th in 2012

112th in 2013

Up from 120th in 2012
in World Bank's
Doing Business Rankings

Moved up

10 places to 133

in Transparency International's
Corruption Perceptions Index 2012

Russia joins WTO;

intends Open Government
Partnership membership

World's Seventh

largest labor force (75 million workers)

73.8 million users

Largest online population in Europe

230 million phones

Biggest mobile phone market in Europe

Sources: Ernst & Young's Rapid-Growth Markets Forecast, April 2013, p.45; Ernst & Young's EIM, 2013; Russian Economic Report, The World Bank, 2013, p. 11; Ernst & Young's Rapid-Growth Markets Forecast, October 2012, p.23; Ernst & Young's Rapid-growth markets forecast, January 2013, p. 45; Kathy Lally, "Russia tries to improve life expectancy with laws curbing drinking, smoking," *The Washington Post website*, www.washingtonpost.com, accessed 9 March 2013; "Consumers to power Russian economy, stock market-study," *Reuters*, 5 February 2013, via Dow Jones Factiva © 2013 Reuters Limited; "Europe's great exception," *The Economist website*, 19 May 2012, via Dow Jones Factiva, © The Economist Newspaper Limited, London 2012; *The Global Competitiveness Report 2012-2013*, World Economic Forum, p. 305; "Russia's Digital Ecosystem Shaped by Market Nuances," *eMarketer website*, www.emarketer.com, 9 March 2013; *Smarter Regulations for Small and Medium-Size Enterprises*, The World Bank, 2013, p. 11.; *Doing business in a more transparent world*, The World Bank, 2012, p. 14; *Doing business in Russia*, The World Bank, 2013, p. 7; "Country Comparison – Labor Force," *The World Factbook website*, www.cia.gov, 9 March 2013; *Corruption*

Perceptions Index 2012, Transparency International 2012, p. 3; "EU welcomes Russia's WTO accession after 18 years of negotiations," *The Official website of the European Union*, www.europa.eu, 10 March 2013; "Russia – Developing Commitments," *Open Government Partnership website*, www.opengovpartnership.org, 24 March 2013; "Russia's Auto Market Shines amid Gloom," *The Wall Street Journal website*, 30 August 2012, online.wsj.com, accessed 13 March 2013; "Part One: Ten reasons for investing in Russia," *Modern Russia website*, www.modernrussia.com, accessed 6 April 2013; "Part Two: Another ten great reasons for investing in Russia," *Modern Russia website*, www.modernrussia.com, accessed 6 April 2013; "TABLE-Russian cellphone penetration rate 161.3 pct in 2012," *Reuters News*, 6 February 2013, via Dow Jones Factiva ©2013 Reuters Limited; *Russia is fantastic! 28 business and economic reasons why this is so*, CEEMEA Business Group, September 2012, p. 6; "Russia's 2012 GDP Growth Slowed to 3.4% from 4.3% in 2011 – Rosstat," *Dow Jones Global News Select*, 2 April 2013, via Dow Jones Factiva ©2013 Dow Jones & Company, Inc.

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Building for growth

Foreign direct investment in Russia – trends, key investors, sectors, key activities and regions.

Uncertainty for FDI in 2012

The global picture

The United Nations Conference on Trade and Development (UNCTAD) estimated that global FDI inflows totaled US\$1.3 trillion in 2012, down 18% on 2011. After rising in 2010 and 2011, the 2012 slump can be attributed to flagging investor confidence amid macroeconomic and political uncertainty. Developed economies bore the brunt of the downturn, accounting for nearly 90% of the US\$294 billion decline in global FDI. While investments in developing economies also lost some momentum, the decline was more moderate, at 3%.

FDI inflows by region

(2012 vs. 2011)

Latin America and the Caribbean	7.2%	
Africa	5.5%	
	-9.5%	Asia
	-34.8%	European Union
	-35.3%	United States
	-36.1%	Europe

Source: *Global Investment Trends Monitor*, United Nations Conference on Trade and Development (UNCTAD), January 2013.

Key findings

120+ investment projects in 2012, no change on 2011.

60% year-on-year increase in FDI job creation.

98% FDI jobs created in 2012 were in manufacturing.

21% of the projects and 35.9% of jobs created puts the automotive sector in the lead.

13% of FDI projects were in business services, demonstrating the sector's growing appeal.

64% of FDI projects came from European companies.

31% of FDI projects landed in Moscow.

2nd Russia ranked second in Europe in 2012 in terms of employment generated through FDI.

Russia in the headlines

Snapshot of developments

The Russian economy performed well in 2012. Output expanded in the first quarter before moderating only slightly in the second quarter. Strong domestic demand, supported by high oil prices, drove this growth. The economy slowed in the second half of the year, and overall growth eased to 3.4% in 2012, down from 4.3% in 2011. However, the economy still deserves credit for its resilience, while other countries were grappling with the effects of the global downturn and the euro crisis. Russia is projected to grow at 2.7% in 2013 and 3.4% in 2014.⁵

1 Conditions for business improvement

Russia climbed eight places to the 112th position in *The World Bank's* 2013 *Doing Business Rankings*, up from 120th in 2012. Tax payment and contract enforcement fueled this improvement. However, despite this progress, Russia's overall ranking for doing business remains relatively mediocre.⁶

2 WTO accession

After nearly two decades of negotiations, Russia became the 156th member of the WTO. This is a significant development in its integration with the wider global economy. The accession entails commitments on import duty reduction, simplification of technical regulations and protection of intellectual property rights. While this is expected to improve the business environment, facilitate trade and attract investment, the extent of the impact depends upon the policy measures adopted by the Russian Government.⁷

3 Russia's innovation city

Given the real need to promote innovation, as well as to reduce reliance on oil and gas, Russia is building the Skolkovo innovation city near Moscow. It is hoped that this will provide researchers, entrepreneurs and investors with a platform to focus efforts on IT, energy efficiency, biomedicine, space and nuclear technologies.⁸

4 International financial center

Developing Moscow into an international financial center would help to encourage the development of state-of-the-art financial infrastructure in Russia.

Moscow is already well on the way to becoming a financial center for the CIS region and Eastern Europe. The city has the largest financial market in the region, as well as the most equity and debt offerings.

5 Toward transparency

As part of ongoing efforts to create a more transparent and effective business environment, Russian Prime Minister Dmitry Medvedev has announced plans to join the Open Government Partnership (OGP). Russia will join more than 50 countries aspiring to create more transparent, effective and accountable governments. The Government first announced its intention to join the OGP in April 2012, voluntarily agreeing to ensure greater transparency. A national action plan for Russia's accession to the international initiative has also been agreed.⁹

6 Capital flow

Outflow of capital has been an issue for the Russian economy for many years, due to factors such as corruption and the country's perceived political risk.¹⁰ According to recent estimates by the Central Bank of Russia, approximately US\$54.1 billion of private capital was invested out of the country in 2012. This is an improvement on the US\$80.5 billion of outward investment recorded in 2011, which suggests that some of the Government's efforts to improve this situation have been successful.¹¹ The bank predicts a further decline in capital flight in 2013, to US\$10 billion, as the Government undertakes measures to improve the country's business and investment climate, develop infrastructure and expand the role of the private sector in its economy.¹²

5. *Ernst & Young's Rapid-Growth Markets Forecast*, April 2013; *Russian Economic Report*, The World Bank, 2013, p. 2, p. 3; *Reinvigorating the Economy*, The World Bank, 2012, p. 2, p. 3.; *Ernst & Young's Rapid-Growth Markets Forecast*, January 2013; "Russia's 2012 GDP Growth Slowed to 3.4% from 4.3% in 2011 – Rosstat," *Dow Jones Global News Select*, 2 April 2013, via Dow Jones Factiva © 2013 Dow Jones & Company, Inc.; *Global Economic Databank*, Oxford Economics, accessed on 31 May 2013 – EBRD estimation: 1.8% in 2013 and 3.0% in 2014.

6. *Smarter Regulations for Small and Medium-Size Enterprises*, The World Bank, 2013, p. 11; *Doing business in a more transparent world*, The World Bank, 2012, p. 14.

7. *Russia's success in the WTO: What the Opportunities*, Ernst & Young, April 2012.

8. "Can Russia create a new Silicon Valley?," *The Economist*, 14 July 2012, via Dow Jones Factiva, © 2012 The Economist Newspaper Limited, London 2012; "Innovation: Massive funds for a 'Silicon Valley' lookalike," *Financial Times website*, www.ft.com, accessed 14 March 2013; "Russia, The Next Silicon Valley?," *Forbes website*, www.forbes.com, accessed 15 March 2013.

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10. "Russian ministry raises capital flight expectations to 65bn dollars in 2012," *BBC Monitoring Former Soviet Union*, 2 October 2012, via Dow Jones Factiva © 2012 The British Broadcasting Corporation; "Europe News: Report Calls for New Russia Capital-Flow Measure," *The Wall Street Journal Europe*, 18 December 2012, via Dow Jones Factiva © 2012, Dow Jones & Company, Inc.; "World News: Capital Flees Russia, Dampening Official Hopes Over Putin's Win," *The Wall Street Journal*, 5 April 2012, via Dow Jones Factiva © 2012, Dow Jones & Company, Inc.

11. *Net Inflows/Outflows of Capital by Private Sector in 2012*, *Bank of Russia website*, www.cbr.ru, accessed 8 April 2013; "Russia FinMin Sees 2013 Net Capital Outflow At \$10B-\$15B -Report," *Dow Jones Global Equities News*, 4 March 2013, via Dow Jones Factiva © 2013 Dow Jones & Company, Inc.

12. "Medvedev Courts Davos Skeptics With Better-Than-China Pitch," *Bloomberg website*, www.bloomberg.com, accessed 24 March 2013; "Capital Flight from Russia Still on Rise," *The Wall Street Journal*, 3 October 2012, via Dow Jones Factiva © 2012 Dow Jones & Company, Inc.



7 Far East initiative

As part of its efforts to make the economy less reliant on offshore resources, the Russian Government is considering the establishment of special tax regimes in some territories, especially the Far East, which will serve as a “domestic offshore zone.” This will help to prevent capital flight, and also help to attract inward investment.¹³

8 Demographic improvements

There have been signs of improvement in Russian demographics, boosted by the host of policy measures implemented over the past years. During 2012, nearly 1.8 million births were recorded, up 5.7% from 2011, and the highest since 1990. The natural population loss recorded stood at 2,573 in 2012, according to the Ministry of Labour and Social Protection, lower than the population decrease of 687,000 in 2006.¹⁴ However, there has not been population growth in Russia since the collapse of the Soviet Union in 1991.

Government development scenarios

As part of its efforts to foster growth, the Russian Government has developed three forecasts for the country’s economic future:

- ▶ The Government’s most conservative projection sees real GDP growing at 3.2% until 2030. This would be driven by modernization of the resources sector only.
- ▶ A second, “innovative,” scenario projects annual growth of 4%–4.2%, driven by the creation of modern transport infrastructure and a more competitive technology sector.
- ▶ The most optimistic, “forced,” scenario aims to achieve 5.4% annual growth by means of structural transformation of the economy and real improvement of the investment climate.

Source: “PM okays long-term economic forecast,” *RosBusinessConsulting*, 25 March 2013, via Dow Jones Factiva ©2013 RosBusinessConsulting; “Russian economy to grow steadily until 2030 – ministry,” *ITAR-TASS News Agency*, 30 January 2013 via Dow Jones Factiva ©2013 ITAR-TASS.

13. “Medvedev proposes differentiated tax regimes for Far East, Eastern Siberia,” *ITAR-TASS News Agency website*, www.itar-tass.com/en, accessed 6 April 2013.

14. “Russia’s Demographics Continue to Improve, Natural Population Growth Likely in 2012,” *Forbes website*, www.forbes.com, accessed 15 March 2013; “Russian population continues to fall,” *The Moscow News*, 6 February 2013, via Dow Jones Factiva © 2013 Ria Novosti; “Russian government reports decline in natural growth of population in 2012,” *IHS Global Insight Daily Analysis*, 7 February 2013, via Dow Jones Factiva, © 2013, IHS Global Insight Limited; “Natural population decline in Russia decreases by 264 times over past 7 years,” *ITAR-TASS News Agency*, 26 February 2013, via Dow Jones Factiva ©2013 ITAR-TASS; “Russia economy: Quick View – Pause in Russia’s demographic crisis,” *Economist Intelligence Unit – ViewsWire*, 5 November 2012, via Dow Jones Factiva © 2012 The Economist Intelligence Unit Ltd.

Interview



Let's be realistic

Dmitry Peskov

Press Secretary for the President of the Russian Federation

It is my impression that Russia is perceived by the rest of the world in at least one of the two following ways. For some, our country by its very nature is enigmatic and mysterious. It evokes many fears, the reasons for which could be real or, more often, imaginary. Quite often, people do not wish to look deeper into the situation; they are more comfortable explaining to their shareholders that the activity in the Russian market is lacking because it is "unpredictable."

There is another Russia: the real one, the new one, the one that has taken shape in the past 15 to 20 years. It is vibrant and complex. Its citizens are traveling across the world. Its private and public companies are working on all continents. This Russia is continuously moving forward, learning from its ups and downs. This country – the real country – is the world's sixth-largest economy in terms of GDP, has the third-largest gold and foreign currency reserves and boasts a huge domestic market. It has a notably low unemployment rate and more high-skilled talent than many nations do.

Are the risks greater in Russia than in a lot of other countries? Yes, they are. So are the opportunities. In the past decade, the average ROE (return on equity) of companies working in Russia was 20.7%. Not only does it outpace the growth rate in developed markets, but it is also 1.5 to 2 times more than the other BRICS countries (China: 14.3%, India: 12.7%) and Mexico (10.3%). Almost all global majors are operating in Russia and working on expanding their businesses.

We are told that government involvement in many industries is considerable. I'll subscribe to this as well! But, who is a preferred partner for any major foreign company in Russia seeking to mitigate its risks? I'll tell you: a state-owned company, with unquestionable financial stability in the long term, willing to use new approaches and technologies. I am not saying that establishing a relationship with a large state-owned holding is an easy thing to do. But, once you have built that relationship and proven that your business is here to stay, you can count on much more robust, durable and efficient cooperation.

Are the quality of corporate governance and the level of corruption inadequate? Yes. An average international company has been in existence for some 50 years (or 100 years, in some cases) and, over that time, different groups of shareholders have learned to live together under the same roof. Good corporate governance means that the company is mature and capable of

“Receiving investment funds is thrilling, but what Russia is expecting most of all is an investment of ideas.”

resolving differences in an efficient manner. It takes more than the flick of a magic wand for good corporate governance to appear. In fact, it takes years of trial and error. Corruption is the flipside of immature governance, but mostly, an indication of the immaturity of the bureaucracy.

To address these issues, we are focusing on tackling these problems. Right now, we are aligning anti-corruption laws with international standards, streamlining the government procurement process and rooting out discriminatory access. As far as corporate governance is concerned, we are pursuing no-frills, determined efforts to harmonize legislation, improve reporting transparency and procedures to enable control by investors, and introduce independent directorship for corporate boards, including state-owned companies. There is nothing sensational about this work and it doesn't make the front pages, but it is laying the foundation of development for many years to come. In the past two years, a number of laws have been passed that regulate delisting procedures – a breakthrough in Russian corporate governance – protect the rights of minority shareholders, and govern the payment of dividends and mandatory disclosure of information to shareholders.

Do our laws require further improvement? There is no denying it. And this will take time. This is why, even now, we are targeting measures that help compensate for the imperfections in the law. Investor rights watchdogs (the Foreign Investment Advisory Council and the Business Ombudsman) have reviewed over 200 cases, and the majority of the final decisions went in favor of the foreign companies. Introduction of an arbitration court system, which should reduce the litigation time for business disputes, is under broad discussion.

Is bureaucracy hindering many processes? I think so, just as it is in other countries around the world. But look at individual regions, such as Leningrad Region, Kaluga Region or the Republic of Tatarstan. In 2011, Leningrad Region alone, without St. Petersburg, received around US\$2.5 billion in investment funds ... (continued on p.15)

(Let's be realistic, Dmitry Peskov, continued from p.14)

... and in 2012, it received over US\$2.6 billion. Think about how much public officials and government employees are doing to make it possible for foreign businesses to work there, to create jobs and to simplify the tax regime. All the key global automotive majors are there, as are major retailers; service companies are rapidly gaining market share. We are learning to work with them, as they are learning to work with us, while maintaining the balance between national and business interests.

There are plenty of resources in Russia. Both household and government savings are on a very high level. This creates huge growth potential for the domestic market (both through increased consumption and government investment) and macroeconomic stability. This is an attractive combination, don't you agree? And this helps when it comes to implementing ideas, which really is key. Receiving investment funds is thrilling, but what Russia is

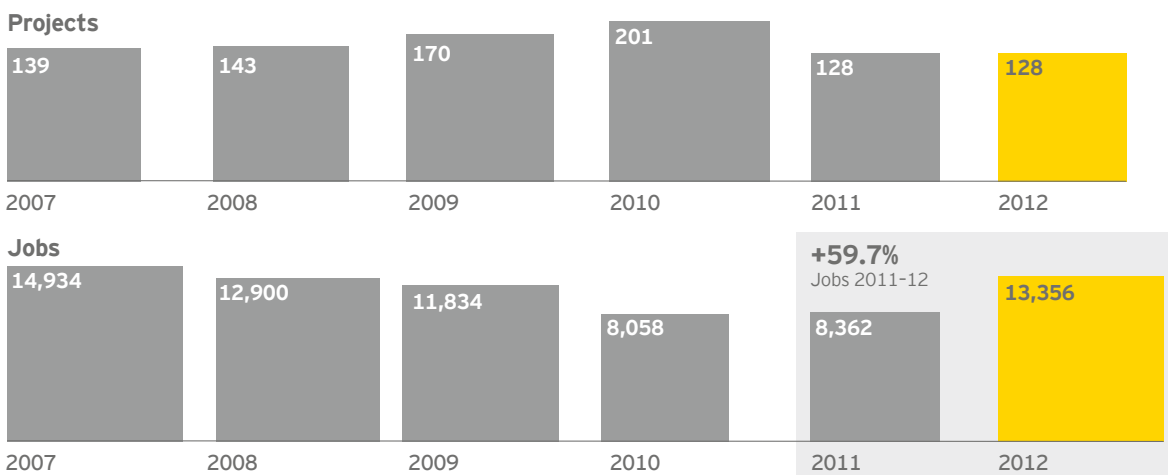
expecting most of all is an investment of ideas. You can come to this market with a new product, technology or project, raise finance in the domestic market and build your business from scratch. We also expect a lot of public-private partnership mechanisms. Whole sectors of the economy are ready to welcome new approaches and technologies.

To conclude, let me say that we can offer international investors a unique combination of political and economic stability, a predictable mentality and high-skilled talent. You may encounter certain difficulties when entering the Russian market, but they can be compensated for by the size of the market and its growth potential. What is most important is that we are not just sitting here waiting for a miracle. We are growing, we are changing, we are removing the hurdles that hamper business – and we are always happy to welcome new partners!

Stable projects, more jobs

FDI in Russia

Number of FDI projects and FDI jobs in Russia



Source: European Investment Monitor, 2013, Ernst & Young.

Russia received 128 FDI projects in 2012, exactly the same number as in 2011, but still substantially below the 2009 and 2010 levels. This is indicative of investors' continued cautiousness amid global economic uncertainty. Furthermore, a high level of exposure to the European Union is weighing on Russia's FDI potential. The slow

pace of institutional reforms and insignificant improvement in the business environment are also barriers to FDI. Nevertheless, in a year when FDI activity has declined globally, economic growth has been limited and unemployment figures have risen, there have been stable FDI project numbers in Russia.

Job creation from FDI projects continued to expand, reaching its highest level since 2008. In 2012, FDI projects created 13,356 jobs, an impressive 59.7% increase on 2011. On average, a single project created 104 jobs in 2012, up from 65 in 2011. This growth is primarily due to the large number of job-intensive manufacturing projects from Germany, Italy and Japan. This reflects the increasing number of Western Europe companies looking to shift manufacturing to nearby, cost-effective destinations, such as Russia and Poland.

Russia ranked second in Europe in 2012 in terms of employment generated through FDI, up from its sixth position in 2011.

The country accounted for 7.8% of the total jobs created in the region, resulting from a rise in labor-intensive industrial activities. In terms of FDI projects, Russia's position among its European counterparts remained the same as last year, with a share of 3.4%. Poland has witnessed an increase in interest as a destination for FDI from foreign investors. The country outshone Russia to become the largest recipient of FDI projects in the Central and Eastern Europe (CEE) region in 2012, and accounted for 3.9% of the total FDI projects initiated in Europe.¹⁵

15. "Increased Interest in Poland as a Destination for FDI," *Capital Finance International* website, www.cfi.co, accessed 30 March 2013.

Russia in the enlarged Europe

Rank	Country	Projects			
		2011	2012	Change	Share 2012
1	United Kingdom	679	697	2.7%	18.4%
2	Germany	597	624	4.5%	16.4%
3	France	540	471	-12.8%	12.4%
4	Spain	273	274	0.4%	7.2%
5	Belgium	153	169	10.5%	4.5%
6	Netherlands	170	161	-5.3%	4.2%
7	Poland	121	148	22.3%	3.9%
8	Russia	128	128	0.0%	3.4%
9	Ireland	106	123	16.0%	3.2%
10	Turkey	97	95	-2.1%	2.5%
11	Serbia	67	78	16.4%	2.1%
12	Finland	62	75	21.0%	2.0%
13	Czech Republic	66	64	-3.0%	1.7%
14	Switzerland	99	61	-38.4%	1.6%
15	Italy	80	60	-25.0%	1.6%
	Others	669	569	-14.9%	14.9%
	Total	3,907	3,797	-2.8%	100.0%

Rank	Country	Jobs			
		2011	2012	Change	Share 2012
1	United Kingdom	29,888	30,311	1.4%	17.8%
2	Russia	8,362	13,356	59.7%	7.8%
3	Poland	7,838	13,111	67.3%	7.7%
4	Germany	17,276	12,508	-27.6%	7.3%
5	France	13,164	10,542	-19.9%	6.2%
6	Serbia	13,479	10,302	-23.6%	6.0%
7	Turkey	7,295	10,146	39.1%	6.0%
8	Spain	9,205	10,114	9.9%	5.9%
9	Ireland	5,373	8,898	65.6%	5.2%
10	Romania	5,985	7,114	18.9%	4.2%
11	Slovakia	4,007	6,299	57.2%	3.7%
12	Czech Republic	5,168	5,508	6.6%	3.2%
13	FYRO Macedonia	3,040	4,670	53.6%	2.7%
14	Bulgaria	2,680	4,379	63.4%	2.6%
15	Hungary	5,237	3,941	-24.7%	2.3%
	Others	19,834	19,235	-3.0%	11.4%
	Total	157,831	170,434	8.0%	100.0%

Source: *European Investment Monitor*, 2013, Ernst & Young.

Manufacturing leads

FDI by activity

Manufacturing leads FDI activity in Russia, both in terms of project numbers and job creation. In terms of projects, however, sales and marketing is quickly catching up. Furthermore, strategic functions, such as research and development (R&D) and education and training, are emerging as popular recipients of FDI projects, albeit at a slow pace. However, FDI in strategic functions and sales and marketing is still not creating many jobs.

Manufacturing accounts for 98% of total FDI jobs creation in Russia

Undoubtedly, Russia's manufacturing capabilities remain the main attraction for investors. In 2012, foreign companies initiated 60 projects (62 in 2011) in Russian manufacturing units, accounting for 46.9% of FDI projects. In terms of employment, the labor-intensive manufacturing activity accounted for 98.2% of jobs created by FDI in 2012, up from 90.7% in 2011. On average, a manufacturing project in Russia created 219 jobs in 2012, in comparison to 122 jobs in 2011.

Companies from Germany, France and Japan were the most active investors in manufacturing. A large number of jobs were created in the establishment of plants and factories, particularly in the automotive and chemicals sectors. St. Petersburg, Kaluga and Nizhny Novgorod were popular destinations for FDI. Foreign companies set up base in these regions, to cater to both local demand and international requirements. Their interest is sustained by Russia's strategic location, relatively low labor costs and capacity for high-quality work.

Strategic functions

In 2012, Russia attracted seven projects in strategic functions, up from six in 2011. The country received four projects in R&D activity, two in education and training, and one data center-focused project.

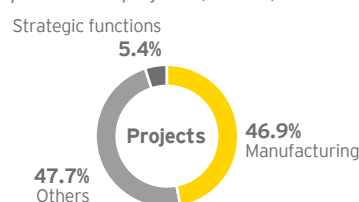
While project numbers are greater than 2011 levels, they are still lagging behind the benchmarks set in 2009 and 2010. Employment generated by FDI in strategic functions remained low. Strategic functions created a total of 120 jobs, up from 60 in 2011, primarily in R&D activity. Although strategic functions currently account for the low number of jobs created in Russia, they have the potential to generate significant employment in the future.

Other functions

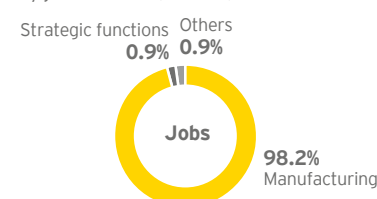
Sales and marketing's share of FDI projects has increased from 33.2% during 2007-11, to 38.3% in 2012. Employment generated through this activity remains low, with a share of 2.6% during 2007-11 and 0.5% in 2012, due to a lower number of employees required for such functions in comparison to manufacturing. Nearly half of the FDI projects in this activity came from the US. The majority of investments were in the form of branch offices for business services, as well as software and financial services firms. Moscow remained the most popular destination for FDI, receiving a sweeping 59% of the total projects in 2012. Many investors have also established their base in the country to take advantage of the

FDI activities

By number of projects (% share)



By job creation (% share)



Note: Strategic functions include R&D, education and training, IDC, shared services center, contact center and headquarters. Others include sales and marketing, logistics, and testing and servicing.

Source: Ernst & Young's European Investment Monitor, 2013.

opportunities being created as Russia prepares to host the Winter Olympic Games in 2014.¹⁶ Logistics and testing and servicing activities received six projects each in 2012, accounting for 9.4% of total projects during the year, a slight increase from their share in 2011.

FDI by activities

Rank	Activity	Projects				Jobs	
		2011	2012	Change	Share	2012	Share
1	Manufacturing	62	60	-3.2%	46.9%	13,110	98.2%
2	Sales and marketing	51	49	-3.9%	38.3%	69	0.5%
3	Logistics	5	6	20.0%	4.7%	-	0.0%
4	Testing and servicing	4	6	50.0%	4.7%	57	0.4%
5	Research and development	3	4	33.3%	3.1%	120	0.9%
6	Education and training	1	2	100.0%	1.6%	-	0.0%
7	IDC	1	1	0.0%	0.7%	-	0.0%
8	Contact center	1	0	-100.0%	0.0%	-	0.0%
	Total	128	128	0.0%	100.0%	13,356	100.0%

Source: European Investment Monitor, 2013, Ernst & Young.

16. "Retail- Sochi 2014," Sochi 2014 Winter Olympics website. www.sochi2014.com, accessed 31 January 2013.

Interview



Continued progress, expanding opportunities

Klaus Kleinfeld

Chairman and CEO, Alcoa, and Chairman, US-Russia Business Council

Alcoa has been operating in Russia since 1993, having acquired our Samara and Belaya Kalitva fabrication facilities in 2005. Alcoa has invested nearly US\$800 million to modernize the plants' casthouse, mill and forging capacities. Today, these facilities provide aluminum solutions for customers across multiple industries, and are driving innovation in Russia. We've introduced advanced alloys for offshore oil and gas pipes, developed lightweight and durable aluminum rail cars, and shared our leading environmental and safety standards with several Russian companies.

In recent years, on the regulatory front, our operations in Russia have witnessed improved customs and trade procedures, a better state procurement system, more efficient tax administration and streamlined visa requirements. Changes like these have helped cut red tape and strengthened the rule of law. In addition, 2012 was a historic year for US-Russia bilateral commercial relations. Following decades of negotiations, Russia's accession to the WTO and the normalization of trade relations with the US have opened new doors for economic expansion and diversification.

But, along with new opportunities come added responsibilities. Over the coming months, it will be critical for Russia to address governance and transparency challenges to ensure its long-term success. There is more incentive than ever for businesses to invest in Russia, but in order to win today's global competition for investment, Russia will need to increase the pace of reform. I am a firm believer that infrastructure development, a renewed focus on science, technology, engineering, and mathematics education and workforce development, as well as increasing transparency, will all bring about a stronger Russia.

I am optimistic about the country's ability to meet these challenges, and Alcoa looks forward to working with Russia's leadership to support an aggressive reform agenda and strong bilateral ties.

"Russia's accession to the WTO and the normalization of trade relations with the US have opened new doors for economic expansion and diversification."

Automotive prevails – business services gaining ground

FDI by sector

Manufacturing: automotive and chemicals

► **Automotive.** The automotive sector continues to receive the highest number of FDI projects in Russia. In 2012, the sector accounted for 21.1% of total projects and 35.9% of the jobs created. The majority of these projects came from Western European companies, particularly from Germany. St. Petersburg and Kaluga proved to be the most attractive regions for investment in the automotive sector. The automotive cluster of Kaluga, which was created five years ago following Volkswagen's decision to invest in this geography, positively influenced several other players to join the car maker. Kaluga now hosts some of the sector's biggest manufacturers, and has successfully transformed the region's industrial complex.

According to Ernst & Young's estimates, the value of Russia's car market increased by 21.9% to RUB2.3 trillion (US\$77 billion) in 2012. Unit sales increased by 10% to 2.94 million, touching the pre-crisis level of 2008. This is in stark contrast to Europe, where sales fell to a 17-year low. This performance was also reflected in FDI numbers. There was a 50% rise in investment between 2011 and 2012, with a substantial spike in projects from Germany and Japan.

In 2012, German carmaker Volkswagen continued to invest across the value chain. It set up new vehicle assembly operations with GAZ in Nizhny Novgorod,¹⁷ established a training center for car manufacturers and opened a new sales and marketing office.

During the year, PCMA Rus, a joint venture (JV) between PSA Peugeot Citroën (70%) and Mitsubishi Motors Corporation (30%), constructed a €550 million production plant to meet local demand.¹⁸ The presence of big carmakers improves Russia's reputation in the industry, and attracts investment from automotive servicing companies and component suppliers. Many global automotive companies – including GM-Avtovaz, Avtovaz-Renault-Nissan; and Sollers with Ford, Toyota, Mazda, and Isuzu – are now teaming up with local Russian companies to benefit from economies of scale and conduct joint R&D. The Avtovaz-Renault-Nissan alliance aims to gain a combined market share of 40% in Russia by 2016.¹⁹

17. "Volkswagen AG Launches Full-Cycle Production At Nizhny Novgorod Under Cooperation With Gaz OAO-Interfax," *Reuters website*, www.reuters.com, accessed 26 April 2013.
18. "PSA Peugeot Citroën and Mitsubishi Motors Corporation announce the start of full scale production at their Kaluga plant in Russia," *PSA Peugeot Citroën website*, www.psa-peugeot-citroen.com/en/media/press-releases, 17 March 2013.
19. "Through its cooperation with AVTOVAZ, the Alliance is assured of a key position on Europe's second biggest market (2.9 million vehicles), behind Germany," *Renault website*, www.renault.com, accessed 21 May 2013.

FDI by sectors

Rank	Sector	Projects				Jobs	
		2011	2012	Change	Share	2012	Share
1	Automotive	18	27	50.0%	21.1%	4,790	35.9%
2	Business services	12	17	41.7%	13.3%	59	0.4%
3	Chemicals	9	14	55.6%	10.9%	2,540	19.0%
4	Software	4	8	100.0%	6.3%	26	0.2%
5	Transport services	5	7	40.0%	5.5%	-	-
6	Computers	2	7	250.0%	5.5%	-	-
7	Food	13	6	-53.8%	4.7%	720	5.4%
8	Non-metallic mineral products	5	6	20.0%	4.7%	450	3.4%
9	Machinery and equipment	14	6	-57.1%	4.7%	1,300	9.7%
10	Plastic and rubber	5	4	-20.0%	3.1%	140	1.0%
	Others	41	26	-36.6%	20.2	3,331	25.0%
	Total	128	128	0.0%	100.0%	13,356	100.0%

Source: *European Investment Monitor*, 2013, Ernst & Young.

► **Chemicals.** After a weak performance in 2011, investors regained confidence in the chemicals sector in 2012. Chemicals received 14 projects in 2012, up from 9 in 2011. Half of these projects came from German companies. Export-oriented manufacturing sectors, such as chemicals, are expected to prosper from Russia's accession to the WTO, due to export-tariff reduction.²⁰ Such developments have enticed companies such as Dow Chemicals, BASF, Lanxess and Thyssenkrupp to set up plants and manufacturing facilities in the country. In 2012, Thyssenkrupp set up a polymer factory in the Nalchik province of Russia, creating employment opportunities for 2,500 people.²¹ Further, Germany's Linde entered into a JV with Russia's OJSC Kuibyshevazot to produce industrial gases.

Services

► **Business services.** Russia is shifting its focus from resources to services. And the increase in the number of FDI projects in business services, from 5 in 2007 to 17 in 2012, reflects this. The majority (89.6%) of these projects involved foreign companies setting up sales and marketing offices in the country. Unsurprisingly, investors had a clear preference for Moscow, Russia's most prominent and developed urban center, when investing in services projects. The greater part of this investment came from the US, Netherlands, Spain and the UK. Accelerated domestic business activity and the availability of a well-educated and skilled workforce are major drivers of investment in this sector.

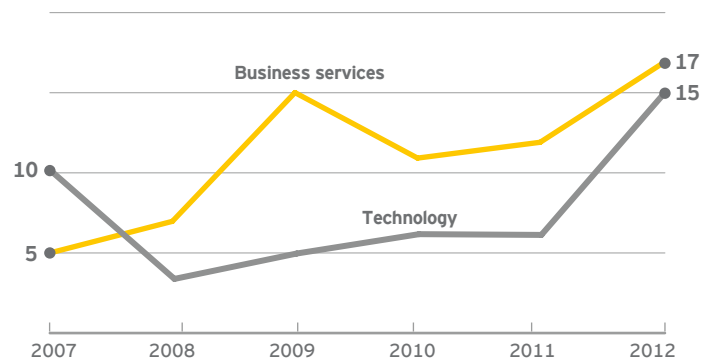
Russia's recent accession to the WTO has augmented Russia's services appeal for foreign investors. Furthermore, as part of the accession, Russia concluded 30 bilateral agreements on market access for services, which permit 100% foreign-owned business service companies to be established in the country.²²

► **Technology.** Tax incentives and subsidies in Russia's high-tech hubs are rapidly catching the attention of foreign investors, especially those from the US, who are increasing investments in Russia's technology sector. As a case in point, the number of projects in the computer and software sectors has increased from 6 in 2011 to 15 in 2012. Moscow and St. Petersburg are the hot spots for technology investment.

With almost half of its population using the web, Russia has become Europe's largest internet market.²³ In response to this, companies such as US-based eBay are expanding their Russian presence. In 2012, IBM invested in several branch offices across the country to

Services: business services and technology

Number of FDI projects



Note: Technology includes software and computers.

Source: *European Investment Monitor*, 2013, Ernst & Young.

tap new growth opportunities, and to serve its growing client base in and around the region.²⁴ In addition, the company has teamed up with the Skolkovo Foundation and leading Russian innovation companies – Rusnano, Russian Venture Company and ITFY – to foster a culture of applied research and commercialization, as well as give a boost to its microelectronics industry.²⁵

Sectors on a downward swing in 2012

► **Food.** The food sector received merely 6 FDI projects in 2012, compared with 13 in 2011. On a positive note, projects initiated in 2012 were relatively more job intensive, with one project creating an average of 120 jobs in 2012 against 64 in 2011. Companies from the US, Switzerland and Finland were the most active investors in the sector between 2007 and 2011. However, their interest seems to have waned in 2012, with no projects initiated during the 12 months.

► **Machinery and equipment.** This sector received 6 FDI projects in 2012 after seeing 14 in 2011. While the number of projects fell, the average number of jobs per project increased from 138 to 217 on the year. During 2012, Italian plant-maker Danieli signed an agreement to establish a machine-building factory for the production of metallurgical equipment. This initiative could create several jobs.

20. *The economic significance of Russia's accession to the WTO*, Directorate-General for External Policies of the Union Policy Department, 13 June 2012, p. 15.

21. "ThyssenKrupp AG approves ETANA deal in Kabardino-Balkaria," *ITAR-TASS News Agency*, 13 December 2011, via Dow Jones Factiva, © 2011 ITAR-TASS.

22. *The economic significance of Russia's accession to the WTO*, Directorate-General for External Policies of the Union Policy Department, 13 June 2012, p. 14, p. 19.

23. "Europe's great exception," *The Economist*, 19 May 2012, via Dow Jones Factiva, © 2012 The Economist Newspaper Limited; "Russia's Digital Ecosystem Shaped by Market Nuances," *Emarketer website*, www.emarketer.com, 9 March 2013.

24. "IBM Doubles its Presence in Russia and CIS Opening 10 New Branches," *IBM website*, www.ibm.com/press, 5 March 2013.

25. "IBM Collaborates with Russian Innovation Giants to Boost Microelectronics Industry," *IBM website*, www.ibm.com, 4 March 2013.

Interview



The real thing for investors

Muhtar Kent

Chairman of the Board and Chief Executive Officer, The Coca-Cola Company

Russia is one of the priority international growth markets for The Coca-Cola Company. The Coca-Cola business system in Russia is one of the country's largest foreign investors. We have invested more than US\$3 billion to date in the Russian economy, and will invest another US\$3 billion over the next five years. The Coca-Cola system directly employs more than 13,000 highly qualified individuals. Moreover, each job in the Coca-Cola system indirectly generates eight additional jobs in related industries, including a wide range of suppliers and a nationwide network of retailers.

We have fantastic results here (8% volume growth in 2012) and are absolutely committed to Russia for the long term. Today, we have 16 modern manufacturing facilities (including Multon and Nidan juice companies) and more than 70 distribution centers across the country. We believe that our success will contribute to building an increasingly positive environment for further investments in the country.

The largest positive change that affects our business is the growing middle class. Rising income levels have given more purchasing power to the increasing number of middle-class consumers who are emerging as a key driver of consumption spending. By 2015, we expect Russia to add around three million households to its middle class. This makes us very confident about the long-term economic and social prosperity of the country.

Another powerful trend is the role of women in Russian society and the world. The 21st century is going to be the century of women. There are definitely more positive changes, with more women in government, business and non-governmental organizations (NGOs). This is a positive trend in the country's recent development.

There is no denying that a perception of uncertainty exists. But, as a committed long-time member of the Foreign Investment Advisory Council in Russia (FIAC), I am working closely with the Russian Government on behalf of the The Coca-Cola Company, to help improve Russia's investment image by telling our business growth story.

I think the Russian Government is already doing a lot to attract FDI, but a gap remains between the welcome actions of the Government and communication of the changes. However, there has been a lot of balanced and positive coverage about Russia joining the WTO. Business results and investments, the Russian Direct Investment Fund and other factors will help improve the country's investment image.

Russia is a country where you have to understand the market and commit to a long-term investment strategy. I share the view that there are three focus areas needed to improve the country's attractiveness. First, reduce bureaucracy and red tape. Second, address corruption. And third, improve infrastructure.

“The Russian Government is already doing a lot to attract FDI, but a gap remains between the welcome actions of the Government and communication of the changes.”

I believe that Russia is well positioned for further economic growth and positive social development. This growth and development will support and ultimately lead to a more diversified economy, which will make Russia one of the world's major international FDI destinations, as well as an exporter of intellectual services and high-tech products. The 2014 Winter Olympics in Sochi will, of course, contribute to this by leaving a lasting legacy of improved infrastructure in Russia's southern region and active, healthy living across the country. The Sochi Games will also provide a wonderful opportunity for the world to experience first-hand what The Coca-Cola Company already knows: that Russia is truly an exceptional place in which to do business.

The West continues to lead

FDI sources

The US continues to lead

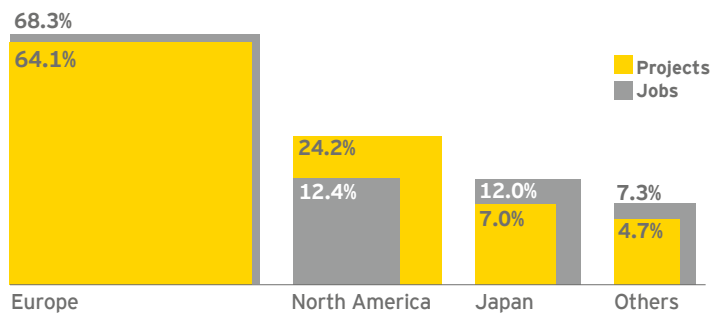
The US continues to be the leading investor in Russia. In 2012, the country invested in 29 projects, or funded 22.7% of total FDI projects. Moscow has frequently been the favored FDI destination among American companies. Nevertheless, companies such as IBM have also shown interest in the smaller provinces of Voronezh and Chelyabinsk, setting up branch offices in these regions. American investment activity was concentrated in the business services, software, computers and financial intermediation sectors in 2012. Large US companies, such as eBay, Dow Chemicals and Emerson Electric, also invested in Russia during the year.

Germany and France ramp up investment

► **Germany.** The country was the second-largest investor in Russia in 2012. Its share of 21.9% of total FDI projects put it close behind the US. In terms of job creation, Germany took the lead with 33.4% of all jobs created. In the long term, this substantial German investment will have the effect of integrating the Russian economy with an enlarged Europe. A German-sourced project created 159 jobs on average in 2012, up from 50 in 2011. The automotive and chemicals sectors together accounted for 67.9% of the projects, with Nizhny Novgorod, Moscow and Kaluga being the top investment locations. Continental, Volkswagen, Robert Bosch and Leoni were at the forefront of expansion in Russia in 2012. During the year, the Volkswagen Group announced a €250 million investment for the construction of an engine plant in Kaluga. The company

FDI by source region

2012



Source: *European Investment Monitor*, 2013, Ernst & Young.

acknowledged that Russia is its primary European strategic growth market, and committed another €1 billion to respond to the strong automotive demand. By 2018, it plans to sell half a million vehicles in the country annually.²⁶

► **France.** The number of FDI projects coming from France is also on a rise. In 2012, the country was the third-largest investor in Russia, putting money into 14 projects, up from 9 in 2011. French investments mainly went into the food and transport services sectors. In 2012, Sucden (Groupe Sucres Denrees) signed a deal to build a sugar plant in Rostov. Other French players that followed suit included La Poste, Schneider Electric and Porcher Industries. France and Russia have a long-standing relationship. In February 2013, both nations' state investment funds entered a cooperation pact to solidify their relationship and deepen investment and trade ties.²⁷

26. "Volkswagen Group lays foundation stone for new engine plant in Russia," *Volkswagen AG website*, www.volkswagenag.com, 15 March 2013.

27. "Russia, French state funds sign mutual investment pact," *CNBC*, 28 Feb 2013, via Dow Jones Factiva, © 2013 Reuters Limited.

Japan increases manufacturing presence

Russia's fourth-largest investor was Japan, which initiated nine projects in 2012, up from six in 2011. Nearly 56% of these projects in 2012 were directed at manufacturing sectors, particularly automotive. Japanese companies, including Toyota, Nissan and Mitsuba, were among the FDI generators. Moscow, St. Petersburg and Togliatti received two Japanese projects each in 2012. During the year, Nissan announced plans to double the capacity of its St. Petersburg plant by 2014, with an additional investment of €167 million.²⁸ It also entered into a JV with Russian Technologies, to accelerate product launches and technology transfers to AVTOVAZ, the largest local carmaker.²⁹ A Russian-Japanese investment forum, designed to foster bilateral cooperation, was held in Kazan in June 2012. The forum emphasized cooperation in the fields of

28. "Nissan announces major industrial expansion in Russia," *Nissan global website*, www.nissan-global.com, 15 March 2013.

29. "Renault-Nissan and Russian Technologies create joint venture to finalize strategic partnership with AVTOVAZ," *International press website of Renault Group*, www.media.renault.com, accessed 12 March 2013.



innovation, high-tech industries, R&D in priority areas and regional cooperation.³⁰

Emerging economies keep a low profile

Russia has received little FDI interest from emerging market investors. Between 2007 and 2012, only 30 FDI projects came from Brazilian, Chinese and Indian investors put together. The Middle East invested in only six FDI projects. To encourage further investment from the emerging markets, Russia is trying to create a mutually beneficial climate by pursuing joint initiatives. For instance, the Russian Direct Investment Fund (RDIF) has created the Russian-Chinese Investment Fund (RCIF) in collaboration with China Investment Corporation.³¹ RCIF will support Chinese investments in Russia, as well as promote job creation and technology transfer.

FDI by country of origin

Rank	Country	Projects				Jobs	
		2011	2012	Change	Share	2012	Share
1	US	24	29	20.8%	22.7%	1,064	8.0%
2	Germany	13	28	115.4%	21.9%	4,460	33.4%
3	France	9	14	55.6%	10.9%	666	5.0%
4	Japan	6	9	50.0%	7.0%	1,600	12.0%
5	Finland	6	5	-16.7%	3.9%	600	4.5%
6	Italy	6	5	-16.7%	3.9%	2,400	18.0%
7	Netherlands	7	4	-42.9%	3.2%	15	0.1%
8	Spain	1	3	200.0%	2.3%	6	0.0%
9	Switzerland	4	3	-25.0%	2.3%	-	0.0%
10	Sweden	3	3	0.0%	2.3%	30	0.2%
	Others	49	25	-49.0%	19.6%	2,515	18.8%
	Total	128	128	0.0%	100.0%	13,356	100.0%

Source: *European Investment Monitor*, 2013, Ernst & Young.

30. "Russia and Japan will hold an investment forum," *Investment portal Kalininsky district*, www.invest.kalininskaya-93.ru, accessed 17 March 2013.

31. "Rdif And Cic Launch Russia-China Investment Fund," *Russian Direct Investment Fund website*, www.rdif.ru/Eng_fullNews, 16 March 2013.

Interview



Russia needs investment in innovation technologies

Ksenia Yudayeva
Chief of the Presidential Experts Directorate

Following a 10-year period of sustained growth, Russia, as a member of the BRICS family and one of the world's fastest-growing economies, has a fairly large share of global GDP, as well as a considerable presence on global markets. Russia is regarded as a big, no-nonsense player, an equal member of the G20 and a country capable of influencing global market trends.

The G20 is fairly democratic in that it includes countries with different levels of development. It includes the world's largest countries, which account for 80% of global GDP, and Russia's membership in the G20 is very visible. The fact that Russia became the first country to preside over the G20 without being a member of the Organisation for Economic Co-operation and Development (OECD) is quite notable. Other countries that are not OECD members have pointed out that the first steps taken by Russia have demonstrated the very high level of its preparedness – and that it doesn't necessarily take an OECD member to preside efficiently over the G20.

Our membership in the OECD is not far off, though. It's becoming an increasingly widespread opinion that the situation in Russia is not as bad as some in the West try to depict it. Indeed, there is a big difference between the perception of Russia among investors who have been doing business in Russia for a while, and the companies who have never done business in the country.

Various political and business problems have been covered in a negative light. But these problems are not permanent, and are often quite solvable. One should admit, though, that Russia is a very diverse country, spread across a huge territory. Different regions face different problems. So there is a need to tell more about what's going on in the country, to provide more success stories from Russia that help to create an objective picture of the country's diversity – including its political diversity – and leave no room for idle speculation.

Access to investment and modern technology is of key importance to Russia. It is my deep conviction that one of the most crucial factors for Russia now – and that is a negative factor, to a certain extent – is the demographic situation. The population is

“Russia is regarded as a big, no-nonsense player, an equal member of the G20 and a country capable of influencing global market trends.”

aging, the number of people employed in labor-intensive industries is decreasing, the older generation is leaving the stage while the new generation is rising. The generations that I'd call the "last Soviet generations" are now entering a fairly old age. The post-Soviet generations are becoming part of the workforce, bringing in a completely different mentality, a completely different attitude to labor, seeking completely different kinds of jobs. Therefore, Russia now has a unique window of opportunity to diversify its economy and create jobs for the new generation. However, investments in advanced technology are needed to seize this opportunity.

As for Russia's geographic priorities in terms of building up long-term trade and economic relations, I think that Asia is starting to play an increasingly prominent role. In my opinion, Russia didn't pay enough attention to Asia in the past. It can build a strategy that allows Russia to produce high-tech products and services domestically, and then sell them in Asia. There is an opportunity to create an alliance with European companies for joint progress in the Asian market. On the other hand, we are likely to see considerable structural changes in the European economy in the next five to seven years, including changes driven by the implementation of completely new technologies. We need to study and understand these processes, and find a niche there that will be ours.

Urban and industrial appeal

FDI hotspots

FDI by region

Rank	Region	Projects				Jobs	
		2011	2012	Change	Share	2012	Share
1	Moscow	40	40	0.0%	31.3%	63	0.5%
2	St. Petersburg	16	11	-31.3%	8.6%	606	4.5%
3	Nizhny Novgorod	2	9	350.0%	7.0%	1,780	13.3%
4	Kaluga	11	7	-36.4%	5.5%	2,160	16.2%
5	Chelyabinsk	-	3	-	2.3%	1,000	7.5%
6	Ulyanovsk (Simbirsk)	4	3	-25.0%	2.3%	850	6.4%
7	Togliatti	3	3	0.0%	2.3%	-	0.0%
8	Lipetsk	2	3	50.0%	2.3%	80	0.6%
9	Voronezh	1	3	200.0%	2.3%	12	0.1%
10	Belgorod	1	2	100.0%	1.6%	180	1.3%
	Others	48	44	-8.3%	34.5%	6,625	49.6%
	Total	128	128	0.0%	100.0%	13,356	100.0%

Source: *European Investment Monitor*, 2013, Ernst & Young.

While Moscow and St. Petersburg continue to be FDI magnets, other, smaller cities, such as Kaluga and Nizhny Novgorod, are beginning to attract more and more foreign investment.

FDI is relatively concentrated in the western part of Russia. Moscow, St. Petersburg, Kaluga and Nizhny Novgorod, together accounted for 48.6% of the projects between 2007 and 2012. Their appeal is based on attractive local markets and a concentration of business activities.

Urban centers: Moscow and St. Petersburg

► **Moscow.** The Russian capital continues to be the most popular investment destination in the country. Between 2007 and 2012, the city took 29.8% of the total projects and 5.5% of the total jobs created by FDI in the country. Most of this investment was in the services industries; for instance, business

services, financial intermediation and software. A healthy business environment, a skilled and well-qualified workforce and developed infrastructure encourage investors to set up projects in Moscow.

In 2012, the US, Germany and France were the top three investors in the city. Most of these investments went into sales and marketing offices. Companies such as Citigroup, WPP group and Volkswagen set up centers in the capital in 2012. Moscow is also the primary home to more billionaires than any other city in the world.³²

Moscow has a population of more than 10 million people.³³ This means that there are a very large number of state bodies in

32. "Moscow Beats New York, London In List Of Billionaire Cities," *Forbes website*, 3 March 2012, www.forbes.com, accessed 10 March 2013.

33. "Moscow – the largest metropolis of Russia," Integrated body for urban design policy and development of Moscow, *The Construction World website*, www.stroi.mos.ru, accessed 11 March 2013.

the city, which is attractive to business.³⁴ Furthermore, superior living conditions, a developed infrastructure and higher salaries are natural attractions for many migrants. Preparation for the FIFA World Cup in 2018 has also created substantial investment opportunities in the city.³⁵

► **St. Petersburg.** The city is Russia's second most attractive FDI destination. St. Petersburg received 11.3% of total FDI projects between 2007 and 2012, and took 15% of total jobs created by inward investment. Western European and American companies are core investors in both services and manufacturing. St. Petersburg's proximity to European and Asian markets, as well as government incentives, has prompted many automobile companies, including Toyota, Fiat, Hyundai and General Motors, to set up manufacturing facilities and assembly plants in the region.

The city's investment policy hopes to encourage FDI in the automotive, transport and logistics, and pharmaceuticals sectors. Being the main port city in Russia, with a huge 65% share of exports,³⁶ means that the region is particularly well equipped to be a center for transport and logistics. Large local projects, such as Pulkovo Airport and the Western High-Speed Diameter toll road, are creating enormous investment opportunities in this sector.³⁷ In addition, global companies, such as AstraZeneca, have shown interest in the pharmaceutical sector. In line with this, a predictive science center was opened in 2011 to strengthen the city's innovative health care sector.³⁸

34. "Moscow population: capital may hold 17 million people," *Telegraph website*, www.telegraph.co.uk, accessed 5 March 2013.

35. "Russia united for 2018 FIFA World Cup Host Cities announcement," *Fifa website*, www.fifa.com, accessed 7 March 2013.

36. 10 reasons to invest to Saint-Petersburg," *St. Petersburg website*, www.st-petersburg.ru, accessed 18 March 2013.

37. "City projects focus on investment and development," *The St. Petersburg Times website*, www.sptimes.ru, accessed 6 March 2013.

38. AstraZeneca extends its investment in Russia with new



Sources: Russian Ministry of Economy report, January 2013, p. 3; European Investment Monitor, 2013, Ernst & Young.

Lately, investors have taken a cautious approach to putting their money into St. Petersburg. Between 2011 and 2012, the number of projects in St. Petersburg fell by 31.3%, and the number of jobs created by FDI fell by 70.9%.

This is the result of investors' caution after the city's administrative restructuring. This has delayed any plans for long-term projects. The Government has recently revealed plans to create an investment promotion agency, to enhance the city's appeal to both foreign and domestic investors.³⁹ This is likely to generate fresh interest in the region.

Russia's industrial appeal: Nizhny Novgorod and Kaluga

► **Nizhny Novgorod.** In 2012, the Nizhny Novgorod region pulled nine projects, up from two in 2011, which created 1,780

jobs. Although the majority of the projects were in manufacturing (66.7%), a few companies also invested in sales and marketing offices (22.2%). Danieli's plans to build an engineering facility for producing metallurgical instruments, with the first phase of construction set to begin in May 2013, is expected to fortify the production capacity of the region.⁴⁰ IBM and Heineken also initiated projects in the region in 2012. An abundance of natural resources and its strategic location in central Russia add to the attractiveness of the Nizhny Novgorod region. In addition, the regional government offers tax and other incentives to investors.⁴¹ On the other hand, the region's unstable tariff policies could be improved.

► **Kaluga.** Once a small provincial town, Kaluga is now the third most attractive FDI destination in Russia. Between 2007 and 2012, it attracted 5.1% of total FDI projects, creating employment

opportunities for 9,420 people. In 2012, while Kaluga received only seven projects (11 in 2011), there was a 56.5% increase in FDI job creation from 2011. An average project created 309 jobs in 2012, compared with 125 in 2011. The majority of the projects were initiated by Western European companies, and were focused on manufacturing. Kaluga's location in the heart of Russia, its proximity and good transportation links to Moscow, and the presence of industrial and technological parks have worked in its favor.⁴²

In addition to the above, cities such as Voronezh received the attention of foreign companies. Since 2008, Voronezh has been home to 15 FDI projects, mostly in the manufacturing domain. The location – in close proximity to Moscow and at Ukraine's border – acts as a strong attraction to foreign investors. Companies, including Pirelli and IBM, invested in Voronezh in 2012.

predictive science centre in St. Petersburg," Astra Zeneca website, www.astrazeneca.com/Media/Press-releases, 7 March 2013.

39. "New St. Petersburg Agency Targets Investment," Embassy of the Russian Federation in the Republic of India website, www.rusembassy.in, accessed 5 March 2013.

40. "Danieli Far East Grand Opening Ceremony," SteelOrbis Electronic Marketplace Inc website, test.steelorbis.com/steel-news/latest-news, 10 March 2013.

41. "Economy," Government of Nizhny Novgorod Region website, www.government-nnov.ru, accessed 1 March 2013.

42. "The Kaluga region in Russia offers economic opportunities," Telegraph website, www.telegraph.co.uk, accessed 10 March 2013.

Interview



Increase of investment attractiveness and trust of foreign investors is our priority task

Andrei Kostin

President and Chairman of the Management Board, Member of the Supervisory Council, VTB Bank

I would begin by saying that growth in labor productivity is essential for the further development of our country's economy. This requires large-scale investments – state and private, domestic and foreign – and a firm macroeconomic base has now been formed in Russia for the transition to an investment-based model of successful economic growth. In order to attract bigger investors, the Russian Government has developed a precise plan of action, with deadlines and interim goals – so-called roadmaps – in key areas for the development of the business climate.

One goal set last year was to become one of the 20 leading countries in *The World Bank's Doing Business* rating by 2018. And it's important to note that Russia's first successes in improving tax administration has already been recognized by the international investment community: in 2012, our country gained 30 places in this category.

The Russian Government continues to build on its success. An active and open policy to enhance the country's investment and business climate, and achieve higher rates of economic growth, is still a key principle, and a variety of measures are being taken to promote competition in various markets.

It's gratifying to note that Russia's image in the West is showing improvement. This has a lot to do with the country's domestic policy reforms, which are now under way, a marked improvement in macroeconomic stability, the introduction of the budget rule and transition to inflation targeting by the Bank of Russia.

Russia's image isn't changing fast enough, however, and this is largely because international investors don't see all the positive economic and legislative changes that are taking place. It is important now for the Russian Government to pursue a communication policy of maximum openness. Russia's creditworthiness is somewhat underrated, while our economic indicators are higher than in many countries with a rating of BBB and even A. The Russian Government understands this problem, and has formed a special task force to improve dialogue with foreign investors and rating agencies.

“Russia's image isn't changing fast enough, and this is largely because international investors don't see all the positive economic and legislative changes that are taking place.”

What else could bring investors to Russia in the next five years? First, we should note the progress that Russia has already made in the areas of monetary and fiscal policy, Russia's accession to the WTO in August 2012 and the freer access that foreign investors now have to the local bond market. All of this is already helping to attract investors, strengthen Russia's presence on global financial markets and intensify investment activity in the economy.

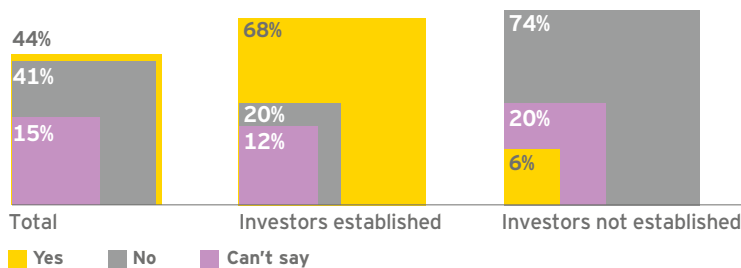
Although Russia has had impressive successes, the international community still needs to see serious improvements on the microeconomic and institutional levels. What is at issue here is investment appeal and the confidence of foreign investors – precisely what the country's leadership today sees as its priority. A large part of the preparatory work has already been completed and, next year, measures will be actively implemented that should change things for the better in the next few years.

Among the reforms capable of enhancing Russia's investment appeal, special attention should be paid to legislative reform. We need to protect creditors' rights, better improve bank regulatory mechanisms and organize public transactions. The Russian Government is continuing serious efforts to reform legislation and improve the effectiveness of the judicial system and the quality of the judiciary. I'm convinced that all of this will make Russia more attractive in the long run.

Existing investors remain confident

Investor plans

Investment plans over the next year



Sources: *Russia attractiveness survey* (total respondents: 206), 2013, Ernst & Young.

The number of foreign investors in Russia is growing, albeit more slowly than in previous years. When asked about investment plans for the next year, 44% of our respondents were positive about investing or increasing existing operations in the country. However, 41% of respondents said that they did not have any Russian investment plans for the coming year.

There was some marked discrepancy between the responses of existing and potential investors. Sixty-eight percent of existing investors plan to scale up their presence in Russia. On the other hand, investors not yet operating in the country remain cautious. Only 6% are considering an FDI project, while a considerable 74% are confident they would not be investing in Russia, remaining

cautious about entering a new market in the midst of global economic uncertainty. In addition, a common perception of pervasive corruption, lack of openness and the inefficient rule of law further dampen FDI interest.⁴³

Despite this seemingly bleak outlook, Russia's macroeconomic stability and its rapid growth have worked well for the country. The World Economic Forum's (WEF) *Global Competitiveness Report 2012-13* placed Russia at 22nd out of 144 countries on its macroeconomic situation index, and 67th for overall competitiveness.

43. "Davos 2013: WEF report urges Russia to tackle corruption and step up reform," *Financial Times website*, 23 January 2013, blogs.ft.com, accessed 14 March 2013.

What it means for businesses

Russia's relative economic strength in a weak external environment offers some security to investors, and the promise of good returns. FDI continues to flow into the country from across the world, with companies often using the country as a gateway to the CIS region, particularly Ukraine and Kazakhstan. However, companies should think very carefully about where and how to invest in Russia. Business leaders need to be prepared for operating challenges. While Moscow and St. Petersburg are the favorite destinations for investors, the cost of doing business remains high in these cities. *The World Bank's Doing Business index* ranks Moscow last of Russia's 30 cities, while St. Petersburg is only slightly better at 22nd. Business leaders should also consider other cities in Russia,

where regional governments have created more investor-friendly environments and efficient institutions. Companies should keep in mind the challenges of operating in an emerging market – competition, market volatility and pricing pressures – and develop strategies that drive predictable bottom-line growth. A cost-benefit analysis is critical for anyone hoping to invest in Russia.



Perception

How Russia is viewed by foreign investors

p.31 Increasing appeal

The world's sixth most attractive destination

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In close competition with China

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Russia's attractiveness profile

p.40 The perception gap

Calling for an image upgrade



Avenues for growth








Russia's competitive position, strengths, improvements needed and investments.

The world's sixth most attractive destination

Increasing appeal

► **China still in a league of its own.** China is still the world's most attractive destination for FDI, according to *Ernst & Young's European attractiveness survey 2013*. The percentage of respondents naming China the world's most attractive destination declined by one point this year, but nevertheless, China's strong internal market, political and operational openness for business, and cost attractiveness, continue to make it the envy of its competitors.

World's most attractive regions to establish operations

			Change from 2012 (points)
China	43%		-1
Western Europe	37%		+4
North America	29%		+8
CEE	28%		+7
Brazil	26%		+8
Russia	20%		+1
India	19%		-2

Source: *European attractiveness survey* (total respondents: 808), 2013, Ernst & Young.

Key findings

6th most attractive region for investment in the world.

44% of our respondents consider the country the most attractive in the CIS region.

42% see China as Russia's biggest competitor for FDI.

70% view Russia's domestic market as its most attractive asset.

33% think that Russia's innovation capacity isn't yet attractive for investors.

55% consider Russia's political, legislative and administrative environment to be a key concern.

45% highlight the need for the Government to implement sustainability initiatives.

► **Both Western Europe and CEE increasing investment appeal.** With an improvement of four percentage points, Western Europe has been voted as the world's second most attractive FDI destination. The attractiveness gap between Western Europe and China also reduced to only 6 points in this year's survey, from 11 percentage points last year. Investors drew reassurance and optimism from the European governments' willingness to keep the Eurozone intact. Efforts, such as the ratification of the European Fiscal Compact, an unlimited bond-buying plan and progress toward Eurozone banking union, have yielded positive results and boosted investor confidence.

CEE was voted the most attractive region by 28% of the respondents, a steep increase of seven points over last year. Local interviewees are particularly upbeat about the region's prospects, with 49% seeing it as the most attractive investment spot. Despite the uncertain macroeconomic climate in Europe, the continent's perseverance in putting its fiscal houses in order has worked well with investors. A large number of foreign multinationals, particularly from heavy industries and the automotive sector, are moving into countries such as Poland, the Czech Republic and Hungary.

► **North America is improving competitiveness.** The region remained at the third position this year, with its attractiveness score increasing by eight percentage points over last year. The resurgence of domestic manufacturing in the US, the discovery of new shale gas reserves, and increasing high-tech and export-fueled growth have been positive factors. As a result, a large number of American firms are returning home to set up a production base.

► **Increase in Russia's investment appeal.** In this year's *European attractiveness survey*, Russia's attractiveness score increased by one percentage point to 20%, the highest since 2009 and four times the 2006 level. Russia overtook India and was ranked as the sixth most attractive destination in the world. Beyond its inherent advantages of a large domestic market and cheap, yet educated, labor force, the country pulls investor attention from its BRICs economy status.

► **Brazil leaps ahead.** After an eight-point improvement in its attractiveness rating, Brazil has successfully overtaken Russia and India to claim the fifth spot. Investors recognize Brazil as a stable economy, with a burgeoning domestic market and huge untapped reserves of natural resources. Also, the fact that the country is hosting the FIFA World Cup in 2014 and the Rio Olympic Games in 2016 is luring investors.

► **Decline in India's attractiveness.** Infrastructure bottlenecks, lack of reform, widespread corruption and high interest rates continue to impede the country's progress. As a result, its attractiveness slipped by two points this year to 19%.

Interview



Reforming tax law helps to increase investment attractiveness in Russia

Glenn Waller
President of ExxonMobil Russia Inc.

Russia's business environment is undoubtedly more stable and predictable than 10 years ago. Several significant legislative initiatives related to the tax code and civil code are under way. For instance, new legislation has been drafted to attract investment in offshore oil and gas projects and difficult-to-extract tight oil, which promises to help maintain Russia's oil production in the future. There has been strong continuity in the Government, both in policy and personnel. Under this environment, ExxonMobil has executed one of its most successful projects anywhere in the world – Sakhalin-1. While attitudes toward production sharing agreement (PSA) projects have been mixed in the past, I would say today that there is a very strong recognition, both at the regional and federal government levels, that these PSA projects have been good for Russia. The media and public opinion are also far more supportive than in the past. Sakhalin-1 has contributed more than US\$7.5 billion in oil and gas, tax and royalty payments to the federal and regional governments, and more than 85% of the workforce are Russian nationals.

More recently, we have been very successful in implementing our strategic cooperation agreement with Rosneft, which will involve the establishment of JVs to explore, develop and produce from Rosneft license areas, particularly in the Russian Arctic, where we have recently agreed to add seven additional license areas to the scope of our cooperation. In this cooperative effort, we have received the strong support of the Russian authorities. Based on this experience, you can confidently say that Russia is welcoming foreign investment – of course, when the benefits of such investment to Russia are clear. For this reason, our investments have had a strong focus on supporting local industry. Sakhalin-1 has achieved more than a 66% Russian content level.

“You can confidently say that Russia is welcoming foreign investment – of course, when the benefits of such investment to Russia are clear.”

There is, of course, room for improvement, and many recognize that the regulatory regime should be streamlined. Several surveys, including those carried out by the Foreign Investment Advisory Council, have shown that companies not already doing business in Russia have a more negative view of the country than those that are already here. This is absolutely normal. Those outside the country do not have direct experience or information. Those working in the country have our own experience upon which to base our opinions. ExxonMobil's experience has been encouraging, and that is why we continue to increase our investments.

In our sector, the adoption of the fiscal legislation for offshore and tight oil projects that has been prepared by the Government would be a major step forward in creating a more competitive investment regime. Our expectation is that this legislation will be adopted in the very near future. Changes to the Subsoil Law will also help clarify the investment regime.

It is always unwise to predict the future. Barring unforeseen significant events, I would expect to see continuity going forward. We will be focused on the implementation of further stages of the Sakhalin-1 projects and our other joint projects with Rosneft under our strategic cooperation agreement.

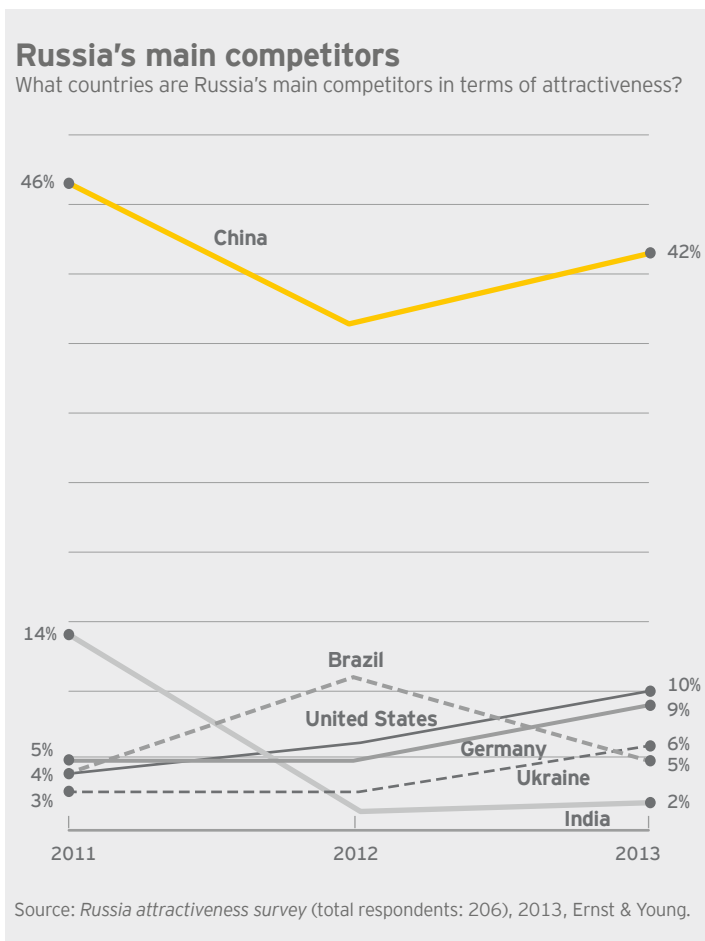
In close competition with China

Russia's competitive position

Investors consider China to be Russia's chief competitor for FDI attractiveness. Western countries, including the US and Germany, are also key competitors. Other than China, few investors see the emerging markets as major competitors for Russia.

The close competition between Russia and China could be attributed to their common characteristics. Both nations have plenty of economic potential and a burgeoning consumer market. China outperforms Russia in terms of population size, business environment and its enduring image as a low-cost production base. Russia's strength lies in its higher purchasing power and well-educated population.⁴⁴ Both countries are striving to grasp a greater share of world trade and export-oriented manufacturing projects. Competition between China and Russia for influence over the Central Asian markets has also intensified in recent years.⁴⁵ Moscow intends to uphold its dominance in the Central Asian energy-exports market, while Beijing hopes to strengthen its energy ties with Turkmenistan, Kazakhstan and Uzbekistan. A stronger strategic partnership between China and Russia, as both countries plan to advance their bilateral economic and security cooperation, has been fruitful, creating, for instance, the joint Russian-Chinese fund, managed and funded by the RDIF and the China Investment Corporation.⁴⁶

Responses to our survey highlight that Russia's competition with Western countries is on the rise. Ten percent of respondents view the US as the country's main competitor; while 9% consider Germany to be Russia's chief rival for foreign capital. The recent discovery and development of shale gas in the US puts it into direct competition with Russia. The possibility of the US becoming a major liquefied natural gas (LNG) exporter has increased. Germany, Europe's industrial powerhouse, mainly poses a threat to Russia in the manufacturing sector.



44. Ernst & Young's Rapid-Growth Markets Forecast, January 2013, Ernst & Young.
 45. Russia and China in Central Asia growing geopolitical competition, ISPI policy brief, 21 April 2011, p.8.
 46. "Beijing and Moscow to put \$1bn each in fund," Financial Times website, www.ft.com, accessed 15 March 2013.

Russia's attractiveness profile

Strengths and challenges

Market opportunities

► **Domestic market.** Russia's large, expanding consumer market continues to be its most attractive feature, as noted by 70% of our respondents. A large population,⁴⁷ rising disposable income and a burgeoning middle class is drawing global interest. Russia's GDP per capita of US\$14,105 is the highest among the BRICs.⁴⁸ The country also has the world's ninth-largest consumer market in terms of domestic size.⁴⁹ Furthermore, it is touted to become the largest consumer market in Europe and the fourth largest in the world by 2020.⁵⁰ Russia's middle-class population has increased substantially throughout the 2000s, with GDP per capita growing at more than 5% annually over the past decade.⁵¹ Consumer spending is slated to almost double to US\$3 trillion by 2025, increasing the country's competitive strengths.⁵²

► **Well-developed telecom infrastructure.** Sixty-four percent of respondents see Russia's telecommunication infrastructure as an attraction. The country has the largest online population in Europe, with 73.8 million users.⁵³ Internet usage is highest among the urban youth. Russia stood at the 56th of 142 countries on the *WEF Networked Readiness Index*, which measures a country's ability to tap opportunities offered by ICT, up 21 places from 2011.⁵⁴ Telecom operators are further modernizing infrastructure to provide improved services. On the other hand, 27% of our respondents do not see Russian telecom infrastructure as attractive, chiefly because there is regional variation in development. The Russian Government is considering initiating private-public partnerships to bring fiber access to rural areas to promote economic inclusion.

► **Abundant natural resources.** The oil and gas sector has been the cornerstone of Russia's economic growth. Unsurprisingly, 61% of the respondents think that natural resource endowment is Russia's most competitive feature. Russia holds the world's largest natural gas reserves, second-largest coal reserves and the ninth-largest crude oil reserves.⁵⁵ This wealth of natural resources attracts many foreign companies. However, the sector remains vulnerable to fluctuating

47. Kathy Lally, "Russia tries to improve life expectancy with laws curbing drinking, smoking," *Washington Post website*, www.washingtonpost.com, accessed 9 March 2013.

48. *Ernst & Young's Rapid-Growth Markets Forecast*, April 2013.

49. *The Global Competitiveness Report 2012-2013*, the World Economic Forum, p. 305

50. "Consumers to power Russian economy, stock market-study," *Reuters*, 5 February 2013, via Dow Jones Factiva © 2013 Reuters Limited.

51. *Scenarios for the Russian Federation*, The World Economic Forum, January 2013.

52. "Consumers to power Russian economy, stock market-study," *Reuters*, 5 February 2013, via Factiva Dow Jones © 2013 Reuters Limited.

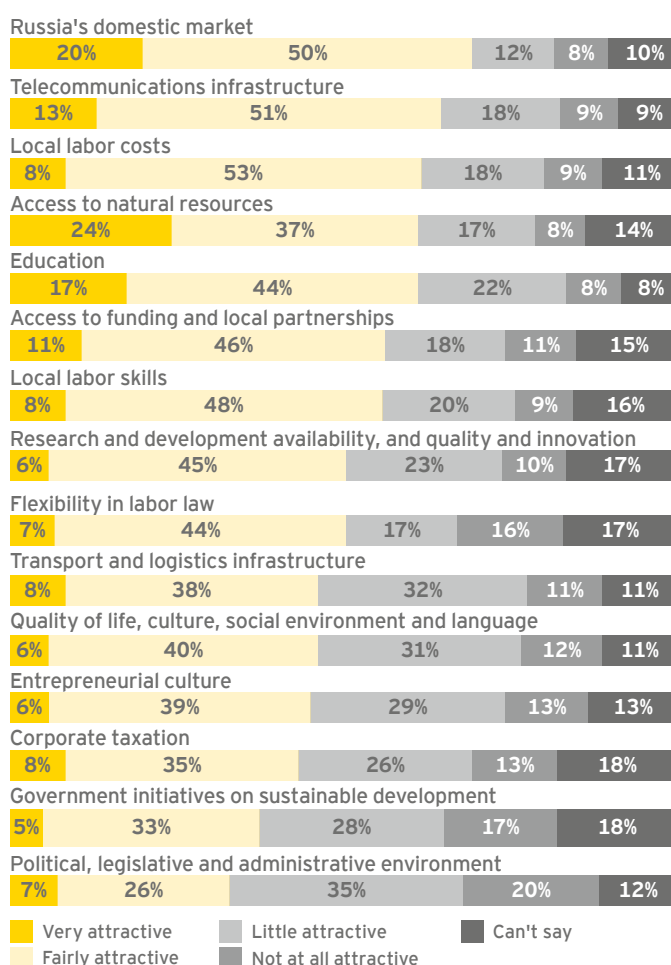
53. "Europe's great exception," *The Economist*, 19 May 2012, via Dow Jones Factiva © 2012 The Economist Newspaper Limited; "Russia's Digital Ecosystem Shaped by Market Nuances," *Emarketer website*, www.emarketer.com, 9 March 2013.

54. *The Networked Readiness Index 2012: Benchmarking ICT Progress and Impacts for the Next Decade*, The World Economic Forum 2012, p. 10.; *The Global Information Technology Report 2010-2011*, The World Economic Forum 2011, p. 21.

55. "Russia," *Independent Statistics and Analysis website*, www.eia.gov, accessed 9 March 2013.

New activities

How attractive is Russia as a location for establishing activities based on the following criteria?



Source: *Russia attractiveness survey* (total respondents: 206), 2013, Ernst & Young.

global oil prices. According to the OECD, Russia is one of the most energy-intensive economies in the world.⁵⁶ The Government needs to promote new, knowledge-driven sectors to ensure sustainable growth.

In addition to energy-based natural resources, Russia has one of the world's largest reserves of freshwater and vast high-quality arable land. Russia's strategic location should help it to benefit from the increasing global demand for food, water and land – and the ensuing spike in global prices.

56. "Modernizing Russia in a challenging global environment," *Organisation for Economic Co-operation and Development website*, www.oecd.org, accessed 10 March 2013.



Human capital and innovation

► **Favorable skills at reasonable cost.** Fifty-six percent of the investors we surveyed are attracted by Russia's skilled workforce, and 61% to the associated cost competitiveness. This advantage is linked to the sound education system, as noted by another 61% of the respondents. A literacy rate of 99.4% puts Russia ahead of other BRIC countries in terms of educated population.⁵⁷ Furthermore, Russia has the seventh-largest labor force in the world (and the largest in Europe), which is 75 million workers strong.⁵⁸ Compared with the talent pool in the US, Europe and elsewhere, a higher proportion of Russia's labor force is equipped with tertiary education.⁵⁹

While this is promising for the country, enthusiasm is limited to existing investors. Firms that are not doing business in the country have mixed views about the potential of its human capital, with only 32% highlighting Russia's local labor skills as a competitive advantage, and 46% identifying labor costs and education as an attractive feature. Despite a high level of educational achievement, Russia's educational performance ranks below most OECD countries. In addition, the lack of business education is fueling a widening skills gap.⁶⁰ To build a knowledge-based economy, Russia needs to integrate business elements into its education system.

► **Research, innovation and entrepreneurial environment.** Our respondents have mixed views about Russia's research and innovation capabilities. While 51% see this as an attractive feature, another 33% are less sure of R&D availability and innovation in the country. Furthermore, 42% of investors surveyed point out the need to improve Russia's entrepreneurial culture.

The lack of sufficient funding and a supportive environment for startups has translated into a shortage of new ventures. The perception is supported by Russia's poor performance on the innovation and business sophistication sections of the WEF's *Global Competitiveness Report 2012-2013*, placing 108th of 144 nations.⁶¹ The country has a need for new, scalable businesses built through innovation.

► **Transport and logistics infrastructure.** Respondents continue to have mixed views on Russia's transport and logistics infrastructure. While 46% of the investors find it attractive, a substantial 43% disagree. The development of Russia's infrastructure lags behind other emerging countries. The WEF's *Global Competitiveness Report 2012-2013* ranks Russia at 101 out of 144 on the quality of its overall infrastructure, significantly below China (69) and India (87). The quality of roads is ranked even lower, at 136 this year, down from 130 in 2011-12. According to estimates, the Russian economy loses out on 3% of GDP annually because of underdeveloped road infrastructure and the inability to capitalize on transit potential.⁶² However, railway infrastructure is much better – Russia sits at 30th in the *Competitiveness Report*. Infrastructure spending is expected to grow in the wake of the 2014 Olympics and the 2018 World Cup. The Government plans to spend over US\$1 trillion on infrastructure development before 2020.⁶³ It also plans to increase private participation in building, operating and financing infrastructure projects.

57. "Invest in Russia," *Invest in Russia website*, www.invest.gov.ru/en, accessed 9 March 2013.

58. "Country Comparison – Labor Force," *The CIA website*, www.cia.gov, accessed 9 March 2013.

59. "Education at a Glance 2012," OECD, p. 12.

60. "Modernizing Russia in a challenging global environment," *Organisation for Economic Co-operation and Development*, website www.oecd.org, accessed 10 March 2013.

61. *The Global Competitiveness Report 2012-2013*, World Economic Forum, p. 20.

62. "Russia loses out on 3% of GDP annually due to underdeveloped roads – minister," *Interfax: Russia & CIS Business and Financial Newswire*, 14 February 2013, via Dow Jones Factiva © 2013 Interfax Information Services, B.V.

63. "Infrastructure," *Invest in Russia website*, www.invest.gov.ru/en/, accessed 10 March 2013; "Special Report: Russia's \$50 billion Olympic gamble," *Reuters website*, www.reuters.com, accessed 10 March 2013.

Interview



Moving forward with reforms and the privatization program

Sergei Belyakov

Deputy Minister of Economic Development of the Russian Federation

Russia's domestic market is well supported by sustainable demand, and has traditionally been recognized as a key factor in the country's appeal to investors. Our economic policy is focused on social priorities. We invest in social programs, and it is thanks to this that personal income is growing, with the mortality rate going down and the birth rate going up. There are 143 million of us, which translates into a solvent, high-quality, sustainable market, with growing personal income. These parameters would be attractive to any investor.

Our other advantage is our lucrative geopolitical and geographic position. This is beneficial for deploying production facilities that focus not only on the domestic market, but also on Europe and Asia. Our macroeconomic indicators are strong: low sovereign debt, a growing economy, good investment appetite and an ability to digest large-scale investment projects.

The quality of human capital may also be referred to as a traditional advantage. Many investors note the availability of well-educated and creative professionals, and well-developed hi-tech sectors. Manufacturing businesses sometimes wish more engineers would be available. This issue is on the agenda, as we refocus educational priorities to train engineers, not lawyers and economists.

We need to pursue reforms and a privatization program in order to continue to move forward. We need to cut down on state involvement in the economy: we should be divesting assets, reducing our presence, simplifying market operations and the process of starting new businesses, and relaxing government control.

An important area of work is reform of the power industry. Reforms have progressed to a very serious stage. Both the Government and investors believe that this sector is lucrative, and that its assets may be privatized with investment from foreign companies. We know of positive cases of successful investment in the power industry complex. One of the key investment drivers in this sector is the potential development of public-private partnerships. Such arrangements are provided for in the respective draft law.

We are doing serious work to change legislation: migration laws have been made more liberal, allowing highly qualified foreign specialists with global experience to work in Russia. This is very

“Russia's rising position in The World Bank rating proves that we are moving in the right direction, and we expect more positive changes this year.”

important for us in terms of technology and knowledge exchange, and it makes project management in the Russian Federation a lot easier for foreign companies.

We continue to refrain from increasing the tax burden on businesses, unlike other countries that choose to increase both corporate and personal taxes. One of our priorities is the quality of tax administration. We are introducing electronic technologies that improve control and reduce costs for businesses.

A separate workstream in the reform of investment activity is the simplification of the procedures with which businesses have to deal. We use best global practices as benchmarks to reduce the communication time between business and the state, cut down on costs and make entering the market simpler, without negatively impacting control. Russia's rising position in The World Bank rating proves that we are moving in the right direction, and we expect more positive changes this year.

I want to touch upon Russia's image abroad. We speak loudly of our success, but the talk of our failures is louder. Bad news travels fast and, for some reason, is listened to more intently. We are working hard to make sure that no positive information about us is lost. We are not trying to look better than we are or mislead the public in any way. What is important is that the image of Russia perceived abroad – especially by those who do not know the country or who get their information from publications and expert opinions rather than their own experience – should correspond to reality. We have no desire to play down our problems; we tackle them. We don't want to be perceived in the light of the many myths about Russia, but rather on the things we do and how we perform.

Attention needed on operating environment

► **Political, legislative and administrative environment.** Doing business in Russia remains fraught with political, legislative and administrative issues, as pointed out by 55% of the respondents. Corruption and deficiencies in the rule of law limit Russia's FDI potential. The country ranks poorly, at 112 (out of 185), on *The World Bank's Doing Business report for 2013*, though still ahead of its BRIC counterparts, Brazil (130) and India (132).⁶⁴ According to the OECD, Russia needs to improve the efficiency of its public administration and business climate, as well as tackle corruption.⁶⁵ That said, the Government has made some improvement in the business climate lately. In *The World Bank's Doing Business 2013* survey, Russia jumped eight places to 112 out of 185 economies and achieved the highest possible gain in the "ease of paying taxes" category.⁶⁶ Nevertheless, there is still plenty of room for improvement.

► **Sustainable development.** Relatively, Russia continues to grow faster than the global economy, but much of this growth is supported by high oil prices and exports. The country's over-reliance on oil exports can raise questions about the sustainability of its economic model. Nearly 45% of investors highlight the need for initiatives to promote sustainable development. There is a need for the Government to roll out reforms that enable more sustained and balanced growth across a range of sectors. Increasing competition through privatization, and opening up of the economy

through its recent accession to the WTO, could provide the impetus required to increase the country's productivity and enable much-needed modernization.

Russia ranks poorly on parameters of environmental sustainability in the WEF's *Global Competitiveness Report 2012-2013*, particularly on three indicators: the strength of environmental regulations, the number of international environmental treaties ratified by the country, and the quality of the natural environment. Russia's performance on social sustainability lags behind the OECD economies, and is also ranked lower than China and Brazil, though higher than India.⁶⁷

► **Quality of life, culture, social environment and language.** On a regional basis, Russia's economic growth has been lopsided over the past decade. The country is plagued with substantial inter-regional disparities, particularly between Moscow and St. Petersburg, and other cities. Quality of life indicators are also disappointing in comparison with the country's GDP growth. The poverty rate is 17%, which is well above the OECD average of 11%.⁶⁸ Life expectancy is 66.5 years (60 for men and 73 for women), below countries with similar levels of GDP per capita.⁶⁹ There are also relative few English speakers. According to Education First English Proficiency Index 2012, Russia displays a low proficiency for the English language: it ranks 29th (and the lowest in Europe), though it is above China (at 36th) and Brazil at (46th).⁷⁰

64. *Smarter Regulations for Small and Medium-Size Enterprises*, The World Bank, 2013, p. 11.

65. "Modernizing Russia in a challenging global environment," *Organisation for Economic Co-operation and Development website*, www.oecd.org, accessed 10 March 2013.

66. *Smarter Regulations for Small and Medium-Size Enterprises*, The World Bank, 2013, p. 11, p. 150.

67. *Scenarios for the Russian Federation*, World Economic Forum, January 2013, p. 60.

68. "Modernizing Russia in a challenging global environment," *Organisation for Economic Co-operation and Development website*, www.oecd.org, accessed 12 March 2013.

69. "Russia tries to improve life expectancy with laws curbing drinking, smoking," *Washington Post website*, www.washingtonpost.com, accessed 12 March 2013.

70. *EF English Proficiency Index*, Education First, 2012, p. 5.

Interview



Healthy prospects for investors in Russia

Michael Warmuth

Executive Vice President, Established Pharmaceuticals, Abbott

Abbott has been established and growing in Russia for more than 30 years. Our long-term effort in Russia is aimed at providing Russian patients with better access to innovative and affordable medical solutions, and further contributing to the development of Russian health care.

In recent years, a lot of improvements have been put in place, creating very visible benefits for people, particularly increasing access to treatment, driven by increasing incomes of the population, increasing reimbursement in a number of critical diseases (e.g., through the "7 Nosologies" program), and creating and modernizing a number of key hospital centers.

Cooperation between Russian and international health care companies is expanding every year. Collaboration spans the discovery life cycle – from clinical trials to drug development. They include all forms of manufacturing partnerships – from secondary packaging to full-cycle production.

This clear trend of significant progress of the pharmaceutical industry and health care is also a result of the Pharma 2020 Strategy, which defines its main goal as "transitioning to an innovation-development model for the Russian pharmaceutical industry." This modernization drive makes Russia attractive and promising for companies such as Abbott, which strive to increase the availability of high-quality medicine to Russian patients, to bring new and innovative health care solutions to the Russian people and to partner with the Russian Government in the ongoing development of the national health care system.

For those of us who are long-term investors, the way to succeed is to understand the country's needs and the way to address them, in Russia, for Russia, while maintaining alignment with Abbott's worldwide standards. We see recent positive movements in the areas that are important to Russia's international partners: the transparency initiatives, support for collaboration between Russian and international business, a strategy to attract and increase FDI and a focus on new technologies. These factors strongly testify to Russia's image internally and abroad, and encourage us to continue growing our investments.

"There are exciting opportunities for the further development of the Russian economy and the health care industry, in particular."

Going forward, we believe that there are exciting opportunities for the further development of the Russian economy and the health care industry, in particular. Many economic factors support this assumption, namely: increased GDP growth, government efforts to spur innovation in many sectors, including technology, the focus of the Russian Government on building strong access to health care and the Government's efforts to transform the health care and pharmaceutical industry through the implementation of the Pharma 2020 Strategy.

In other words, we fully support the Government's efforts to modernize the Russian economy, and transform its health care and pharmaceutical industry through implementation of the Pharma 2020 Strategy.

We see a very promising future. Like other countries, Russia needs to find its own way, built on its needs and strengths through its own work and investment, as well as collaboration with international partners. We see Russia's future as providing a unique bridge between Asia and Europe. But really, Russia stands independently, drawing on the best from both Asia and Europe – talent, knowledge and experience. The strong scientific and technical tradition provides an excellent foundation for growth.

Calling for an image upgrade

The perception gap

Evidently, Russia is perceived very differently by existing and potential investors. This “perception gap” is visible across almost all of our parameters. This makes it difficult for Russia to attract foreign capital. Investors not yet established in the country have a limited awareness about the investment opportunities that Russia offers. This lack of knowledge is particularly prevalent at the regional level, with foreign companies only being aware of Russia’s biggest cities.

To increase FDI inflows, Russia needs to change the way that foreign investors, particularly potential ones, see the country. Russia needs to continue reforming and simplifying its economy to encourage new investors to enter the market. The country also needs to identify constraints limiting the growth of firms at the regional level, and undertake efforts to remove the issues pertaining to the business environments of these regions. Promoting the investment culture in Russia through

summits and conferences could help foreign companies garner increased knowledge about the country’s investment prospects. Encouraging reliable and supportive institutions, a facilitative business environment, modern infrastructure and strong innovation capacity is critical for Russia to improve its image among potential foreign investors. The country also needs to develop new sources of growth and economic attractiveness to increase its share of world FDI.

Location for establishing activities

Evaluation of criteria on how attractive Russia is as a location for establishing activities by established vs. not-established investors

	Established in Russia	Not established in Russia
Domestic market	82%	49%
Telecommunications infrastructure	80%	40%
Local labor costs	72%	46%
Education	71%	45%
Local labor skills	71%	32%
Access to funding and local partnerships	70%	35%
Access to natural resources	65%	56%
Flexibility in labor law	62%	34%
Research and development availability, and quality and innovation	60%	36%
Quality of life, culture, social environment and language	57%	30%
Corporate taxation	55%	24%
Entrepreneurial culture	54%	32%
Transport and logistics infrastructure	52%	37%
Government initiatives on sustainable development	45%	26%
Political, legislative and administrative environment	37%	27%

Source: *Russia attractiveness survey* (total respondents: 206), 2013, Ernst & Young.

What it means for businesses

Foreign investors already established in the Russian economy are optimistic about the country's future. However, lack of knowledge about the local market is often an obstacle for business leaders aiming to enter in Russia. The country's main challenge is the administrative burden of inefficient bureaucratic processes and widespread corruption. This substantially increases costs and makes it difficult for companies to operate. It also limits its competitive advantages. Although Russia has made some progress in improving its long-criticized rankings on *The World Bank's Doing Business index* and *Transparency International's Corruption Index*, operational challenges persist.

For new foreign investors planning to enter the Russian market, proper due diligence and a strategic cost-benefit analysis are imperative in ensuring that long-term returns more than offset the costs incurred. Partnerships with the Russian Government, a recent example being the Russian-Chinese fund, can help investors establish their base in the country. Business leaders could also potentially benefit from Russia's recent focus on high-profile projects, such as the Olympics and World Cup, which create opportunities through public-private partnerships (PPPs).



Actions

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Potential investment enablers



A sustainable future

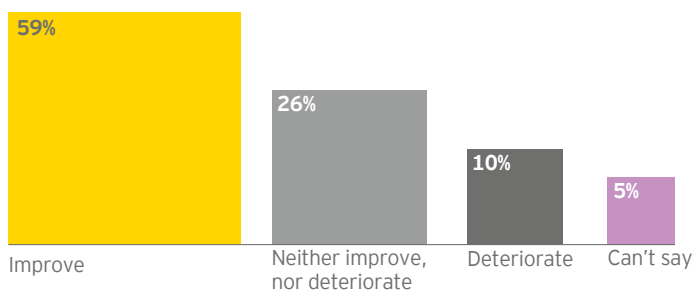
How investors perceive Russia's attractiveness; sectors that are important for growth and the way forward.

Investors are realistically optimistic

The outlook

Perception of Russia's attractiveness

Over the next three years, do you think the attractiveness of Russia as a place for a company to establish or develop activities will ... ?



Source: Russia attractiveness survey (total respondents: 206), 2013, Ernst & Young.

Business executives remain upbeat about Russia's growth prospects in the medium term: 59% see investment attractiveness improving over the next three years, up from 57% last year. Developments, such as a noticeable improvement in the business climate, the WTO accession, a possible

Eurasian Economic Union and privatization programs, have helped retain FDI appeal. While investors' faith in the Russian economy has improved since 2012, the 2011 levels remain unmatched – in that year, around 70% of the respondents vouched in the country's favor.

Key findings

59% of respondents believe Russia's attractiveness will improve over the next three years.

32% think energy will remain the key sector.

50% expect the WTO accession to have a positive impact on the country's investment appeal.

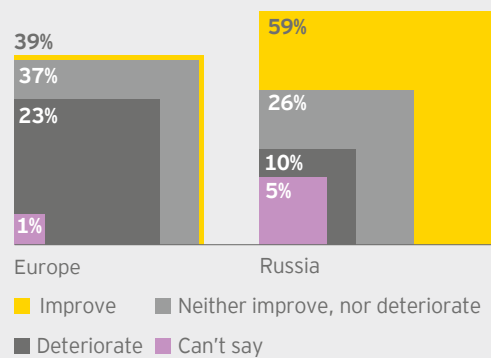
4 main actions to be taken: upgrade the investment climate, improve innovation capacity, enhance regional attractiveness and focus on business education.



Nevertheless, Russia has done well in comparison with Europe as a whole. According to *Ernst & Young's 2013 European attractiveness survey*, only 39% of respondents had confidence in Europe's attractiveness over the next three years.⁷¹

Ten percent of respondents to this year's survey believe that Russia's attractiveness would deteriorate in the next three years, up from 7% last year. While business leaders are aware of Russia's strong footing in the global economy, they also understand the risk of investing in a country where economic growth and energy prices are directly linked.

Russia's future attractiveness



Sources: *European attractiveness survey* (total respondents: 808), 2013, Ernst & Young; *Russia attractiveness survey* (total respondents: 206), 2013, Ernst & Young.

71. *Ernst & Young's 2013 Russia attractiveness survey*, Ernst & Young, 2013; *Ernst & Young's 2013 European attractiveness survey*, Ernst & Young, 2013.

Interview



Annual economic growth in Russia may reach 6%-7%

Sergey Glazyev
Advisor to the President of the Russian Federation

The Russian financial market is a key element of Russia's investment strategy. Much effort is being put into changing the current situation, in which the country acts as a donor on the financial market. In this case, Russia attracts much less investment than it makes. There is a need to change the model used by major Russian businesses today. This model means that the refinancing of operations from off-shore entities sometimes looks like foreign investments. This difference becomes vague over time, as many prominent Russian businessmen, after setting up offshore entities, change their place of residence, and even citizenship, becoming foreign investors to us.

In the financial aspect, we have become a part of the global market. It gives advantages to large Russian market players, but it also poses a threat to the stability of the financial system.

Ideas about the situation in Russia are distorted by international rating agencies. In the past decade, their ratings have become obtrusive. It is impossible to argue with these agencies; they are not revealing their methods. In my opinion, the reliability of their ratings is very low. They constantly overrate the United States and underrate everyone else, particularly developing markets. There is a need for universal international requirements to regulate the activity of rating agencies, such as with banks.

If you take an unbiased look at Russia as a country for investment, and consider not only the financial criteria but others such as the availability of natural resources, the qualifications and literacy of the population and its international influence, then Russia has a far better image.

The prospects of the Russian economy will depend on the investment solutions that the Government will enact in the next year or two. The political system is stable, and I see no serious risks for the rest of this decade. As for the economy, it will largely depend on how well the government plays its role of strategic investor. If the Government carries out its plans to build high-speed railway lines and motorways, and create a favorable business infrastructure, it is not unreasonable to expect annual economic growth of 6%-7%.

The second component of success is to encourage innovation activities. Today, Russian businesses are much less innovative than their European, Chinese and American peers. To turn the situation around, Russia needs to create financial infrastructure to support innovation. Some elements of this infrastructure have already been put in place: development institutes, venture capital funds and changes in the taxation system that help improve the

"The keys to further development are expanding domestic demand, diversifying the economy and encouraging innovation."

investment climate. But all this won't be enough. The capacity of the development institutes needs to be increased at least tenfold.

Monetary policy should be changed in such a way so as to finally encourage the long money to start flowing into the economy. Although the Central Bank has become more oriented toward monetary demand in the domestic market, refinancing continues to be performed on a short-term basis, aimed at supporting liquidity (as a rule, it means one-day or one-week transactions, and it's impossible to get refinancing for more than one year). We have to apply Europe's ideas and create tools for long-term refinancing (at least three years) with a low interest rate. If our companies get a chance to operate in this environment, we can expect a rise in investment activity. The results of all surveys of entrepreneurs show that the bottleneck of the Russian economy is the absence of long-term loans. Apart from the Central Bank, nobody is capable of dealing with this issue.

Every foreign investor wants to have a reliable local partner. This partner should be an independent entity. Expansion of the domestic source of money supply will significantly raise Russia's attractiveness as an investment destination, because it will give local businesses more opportunities to raise money abroad.

The era of expensive oil is nearing its end, and the minerals-orientation model, the one that allowed Russia to sustain a budget surplus throughout the last decade and increase its foreign exchange reserves, will no longer work in the decade to come. The key drivers to sustaining further development are expanding domestic demand, diversifying the economy and encouraging innovation. For Russia, it is very important to create a common economic space with its closest neighbors. The first priority is the successful transition from the Customs Union with Belarus and Kazakhstan (which, in the last two years, nearly doubled the volume of trade between the countries) to the Single Economic Space.

Services driving growth














The focus of the future

Ernst & Young's 2013 European attractiveness survey reflects a belief that the ICT sector will drive European growth over the next two years, while business leaders have varying views on promising sectors for growth in Russia. Energy is seen as having the most potential, followed closely by industrial sectors, such as heavy industry, the car industry and consumer goods.

There is also a striking difference between the responses for Europe and Russia on the significance of business-to-business services. Nineteen percent of respondents to our *European attractiveness survey* believe business-to-business services will be a future driver of growth in Europe, compared with only 4% of respondents on Russia.

















Well-developed infrastructure and a skilled workforce make European countries preferred destinations for investments in knowledge-intensive sectors. Russia remains viewed as an energy hub, due to its dependence on natural resources, and as a manufacturing destination. However, advancement in Russia's technology and services sectors is crucial if the country is to foster sustainable growth and development.

Sectors driving growth in the next two years in Europe

Information and communication technologies	31%	
Energy and utilities	28%	
Pharmaceutical and biotechnologies industries	23%	
Cleantech	20%	
Business to business services, excluding finance	19%	
Bank, finance and insurance	18%	
Transport industry and automotive	14%	
Consumer goods	14%	
Logistics and distribution channels	10%	
Real estate and construction	8%	
Heavy industry	1%	
None	1%	
Can't say	3%	

Source: *European attractiveness survey* (total respondents: 808), 2013, Ernst & Young.

Sectors driving growth in the next two years in Russia

Energy and environment	32%	
Heavy industry	23%	
Automotive	13%	
Consumer goods	12%	
High-technology equipment	12%	
Transport	10%	
Chemical industries	10%	
Pharmaceutical industries	9%	
Banking, finance and insurance	8%	
Telecommunication services	8%	
Telecommunication infrastructures and equipments	7%	
Real estate and construction	6%	
High-technology services	5%	
Business to business services	4%	
Eco-activities	3%	
Can't say	17%	

Source: *Russia attractiveness survey* (total respondents: 206), 2013, Ernst & Young.

Energy and manufacturing lead growth

Sector opportunities

1 Energy and environment sector set to drive growth ...

Thirty-two percent of our respondents believe that the energy and environment sector will lead growth in Russia over the next two years. This was the unanimous view of both existing and prospective investors. It is unsurprising, given the country's abundance of natural resources and its dependence on extraction activities.

The energy sector has been central to Russia's economic growth. Oil and natural gas account for almost 70% of exports and about half of the budget revenue. Russia is currently inviting global oil majors to tender for Arctic oil contracts. In line with this, Russia has also started to liberalize investment regulations for the oil and gas sector, by offering tax incentives on offshore production, canceling export duties and introducing a reduced mineral extraction tax.⁷² These initiatives have triggered investment from companies such as ExxonMobil, Eni and Statoil. In April 2012, ExxonMobil entered a long-term "strategic cooperation agreement" with Rosneft, the Russian state oil company, for joint development of the vast offshore reserves in Russia's Arctic and Black Seas.⁷³

2 ... however, Russia urgently needs to balance out economic development

Russia's substantial endowment of natural resources has been a mixed blessing for the country. While it has led to substantial growth in the past, overdependence on this single resource

has skewed the country's model for economic growth. The consequences of Russia's heavy reliance on energy exports became clear during the global financial crisis.⁷⁴ Oil prices and the Russian GDP are too closely related, which leaves the country vulnerable.⁷⁵ In addition to this challenge, Russia does not have sufficient resources to sustain growth based primarily on extraction. The European Bank for Reconstruction and Development has estimated that Russia has another 20 years of production in its known oil reserves. Realizing that this could soon become a growth handicap, the Government is trying to diversify away from energy. It has undertaken a series of state-led initiatives to direct investment to other sectors, but these have not proven very successful. China and India have both been able to increase exports of ICT goods and services in recent years. But, sadly, Russia has not been able to make the same changes: only 20% of Russia's manufacturing exports are products with high-skill content.⁷⁶

To foster sustainable long-term growth, Russia needs to focus its efforts on creating buoyant entrepreneurial manufacturing industries and new sectors that add high value.⁷⁷ There is a clear and urgent need for Russia to broaden and refocus its diversification strategy. According to the World Economic Forum (WEF), Russia might have to use its energy revenues to finance its diversification efforts.⁷⁸

72. "Russia Mulls Friendlier Investment Laws," *Arctic wells website*, www.arctic-wells.com, accessed 13 March 2013.

73. "Rosneft and ExxonMobil Announce Progress in Strategic Cooperation Agreement," *Rosneft website*, www.rosneft.com/news/pressrelease, 13 March 2013.

74. "Russia Faces Economy Trap as Oil Decline Looms, EBRD Says," *Bloomberg website*, 14 December 2012, www.bloomberg.com, accessed 10 March 2013.

75. "Russia's Three Biggest Problems," *Forbes website*, 24 January 2013, www.forbes.com, accessed 13 March 2013.

76. "Diversifying Russia," European Bank of Reconstruction and Development, October 2012, p. 4.

77. "Diversifying Russia," European Bank of Reconstruction and Development, October 2012.

78. *Scenarios for the Russian Federation*, the World Economic Forum, January 2013, p. 17.

Interview



What the Russian economy needs is long money

Alexei Moiseev
Deputy Minister of Finance of the Russian Federation

The radical changes that have taken place in Russia in recent years have often been underestimated. First of all, I mean changes in the macroeconomic policy. New budget rules have been introduced and budgetary policy has been institutionalized. The critical events, such as the disintegration of the USSR and the 1998 default, have proven that fiscal security is key to macroeconomic stability. While important on its own, institutionalization has been twice as important when accompanied by the dramatic shift in the Bank of Russia's policy, which switched from targeting the currency rate to targeting inflation, thus making interest rates more predictable. Our monetary system is now normalized. A combination of the new budgetary rules and the targeting of inflation represent a macroeconomic reform of great importance. Nothing of this sort has ever taken place in Russia before, not to my knowledge.

We still have a lot to do to continue improving the non-banking financial system. As for banks, however, 10 years ago, Russia didn't have banks as institutions that would lend to individuals and sectors of the real economy. But now, such institutions are very much in evidence, and doing quite well in performing these tasks, too. A whole range of measures has been implemented, such as introducing supervisory measures, rooting out doctored financial statements, establishing a deposit insurance system and granting access to the Russian market to a large number of foreign banks (while preventing them from prevailing). We have seen Western banks assuming dominant roles in some Eastern European countries, but those countries have been known to regret it, as they have faced a large scale de-capitalization of their banking systems – the European banks have been withdrawing cash from those countries. In my opinion, Russia has achieved an optimum balance of Russian and foreign banks.

And, finally, there is another crucial factor – Russia has removed foreign exchange controls. Russia is the only BRICS country that doesn't have them.

Another thing that Russia doesn't have is harsh protectionist policies. There are industries in the Russian production sector in

“Russia has achieved an optimum balance of Russian and foreign banks.”

which foreigners occupy dominant roles. We see this in the food industry, automotive industry and some other industries in which foreign companies, which have come to Russia to start production, have been operating quite successfully.

On the other hand, there are problems, too, such as the high cost of the workforce and its low mobility. It's not only foreign businessmen who argue that it's very difficult to hire adequately qualified workers at an acceptable price. Serious labor market reforms are needed. The problems that are mentioned most often in various surveys include corruption and the protection of the rights of business owners. But it seems to me that the situation isn't much better in the other BRICS countries.

The successful development of the Russian economy in the next five years will require the sustained input of large investment resources. We are providing a practical solution to this problem and expect to have good results in five years' time. One of the countries we have been studying in this respect is Poland. This country reformed its pension system in such a way that they managed to attract a big pool of long-term investors through pension funds and, at the same time, create an efficient financial markets structure that allows pension savings to be channeled into the right places.

The Russian leadership has already made some important decisions on modernizing the financial sector and improving the financial market infrastructure, as well as concerning the sources of long money (primarily, I mean private pension funds and life insurance companies). It is by using these tools that Russia can achieve a satisfactory economic growth rate.

The majority of the “ideological decisions” have been made already, and our job now is to use the right techniques to put them into practice.

3 The heavy industries and automotive sectors

The industrial sector is expected to be a key driver of Russia's growth, as confirmed by 23% of our survey respondents. The growth of the industrial sector and the modernization of infrastructure have spurred demand for machinery and equipment. Furthermore, to encourage greater investment, the Russian Government is incentivizing participation in various heavy industry sectors. For instance, it plans to provide subsidies amounting to US\$74 million to agricultural machinery manufacturers.⁷⁹ As part of this new regulation, which extends to several types of machinery, including tractors, harvesters and planters, agricultural equipment manufacturers will have the option to subsidize the total cost of production and sales.⁸⁰ The country is also investing in modernizing and expanding its medical equipment industry.

Potential manufacturing strengths include aircraft, helicopters, engines, turbines, industrial products and, inevitably, military equipment. New investment and strong management, coupled with the likely benefits of Russia's WTO entry, are set to gradually improve the nation's industrial productivity. Russia's key energy and metals magnates, such as Oleg Deripaska and Alexei Mordashov, are investing in manufacturing. However, several more raw material and metal processing initiatives are further required to attract more component manufacturers in the country, who often lack the internal resources on the ground to localize part-manufacturing activities.

Thirteen percent of our respondents felt that Russia's car industry could drive FDI growth. Russia has Europe's second-largest automotive industry. Furthermore, the waiver of import tariffs for car manufacturers and suppliers is expected to help the country enhance its automotive industry, with the support of foreign original equipment manufacturers (OEMs) and original equipment suppliers (OESs). Russia is expected to overtake Germany and become the Europe's largest automotive market by 2014.⁸¹

79. *Federal Agricultural Budget in 2013*, USDA Foreign Agricultural Service, March 2013, p. 3.

80. "Subsidies for Agricultural Machinery Manufacturer," *Agroinfo website*, agroinfo.info/en, accessed 13 March 2013.

81. "Russia's Auto Market Shines amid Gloom," *The Wall Street Journal website*, 30 August 2012, online.wsj.com, accessed 13 March 2013.

Global auto companies, hurrying to Russia to benefit from the incentives, even if they are only temporary, remain enthusiastic.⁸² Approximately 33% of the cars on Russian roads are more than 15 years old (significantly older than in the US and Europe). Furthermore, car ownership stands at 200 per 1,000 people, much lower than in the developed markets, but higher than in the other BRICs.⁸³

The unsaturated car market, coupled with the country's fast-growing middle class, is expected to push up automotive growth. As a result, many global automobile companies, including General Motors, Ford, Renault, Nissan and Volkswagen, have expanded or are planning to expand their capacity in Russia to benefit from duty-free incentives. Renault recently announced that Russia is challenging Brazil as its second most important market. General Motors has announced plans to invest US\$1 billion in Russia over the next five years, in order to intensify production.⁸⁴

To ensure sustainable commitment from foreign automakers, and achieve modernization of the existing supply base, Russia should focus on expanding innovation-led industrialization. This can be accomplished by increasing investment in technology and R&D, promoting entrepreneurial ventures, and implementing clearly defined mechanisms to support the transformation of metals and other raw materials within the Russian Federation. By taking such steps, the Russian Government would increase the level of attractiveness for the entry of world-class vehicle component manufacturers. Opening the economy to global companies in recent years has been a good idea, as it intensifies competition and prompts domestic companies to step up productivity and quality levels. For this to evolve, the Government should now focus on creating supportive industrial activities to help companies further localize their manufacturing activities within the Russian Federation.

82. "Autos parts makers eye Russia ahead of WTO deadline," *Reuters website*, 23 April 2012, www.reuters.com, accessed 10 March 2013.

83. "Russia's Auto Market Shines Amid Gloom," *The Wall Street Journal website*, www.online.wsj.com, accessed 15 March 2013.

84. "Auto makers flock to Russia in search of growth," *Reuters website*, 29 August 2012, www.reuters.com, accessed 13 March 2013.

4 Consumer goods

Around 12% of our survey respondents believe that the consumer goods sector will drive FDI in the next two years. Growth in this sector would be driven by both supply-side and demand-side factors. A large population with rising disposable income could mean huge market opportunities for global consumer goods majors. Russia's middle class (with an annual income of US\$6,000-US\$15,000) accounts for 55% of the population, substantially more than in the other BRICs (Brazil 30%, China 21% and India 11%). Russia also has a bigger share of high earners (annual income above US\$50,000). Fifteen percent of households fall into this bracket, three times more than that in Brazil.⁸⁵

Driven by such encouraging data, several global food companies are aiming to broaden their presence in Russia. Danone-Unimilk Group plans to invest around US\$700 million in the country to increase its production capacities over the next five to seven years. The Coca-Cola Company and its bottling partner, Coca-Cola Hellenic, have plans to invest US\$3 billion over the next five years to broaden operations in Russia, starting in 2012. Unilever aims to spend US\$70 million to expand its Russian food plant by the end of 2014.

Several international clothing companies have plans for expansion in Russia in the near future. For instance, the UK-based Marks & Spencer aims to expand to 55-65 stores in Russia by 2016 (up from 36 currently). Spanish clothes-products company Inditex is planning to continue its aggressive expansion in the Russian market; it intends to open 50-60 stores annually. Japanese high-end cosmetics firm Shiseido hopes to open four or five locations in Moscow and St. Petersburg by 2016. In addition, 15 international brands from different segments of the consumer market, including clothing, accessories, optical and footwear, are expected to enter the Russian market in 2013-14 through franchising partners in the country.⁸⁶

Western-style retail outlets have also rapidly scaled up their presence in recent years, particularly in and around Moscow and St. Petersburg. The share of mass grocery retail in the overall food market is expected to increase to 81.2% by 2017, from 42% in

2013.⁸⁷ McDonald's plans to open almost 150 restaurants in Russia over the next three years. Other global fast-food chains including Yum! Brands, Subway and Burger King are also actively expanding operations in the country.⁸⁸

The WTO accession and the Eurasian Customs Union could further widen market access for consumer goods companies. The WTO accession will remove import tariffs and encourage the entry of foreign firms. The Customs Union would provide access to the markets of Kazakhstan and Belarus.

5 Transport infrastructure

Nearly 10% of our respondents see transport infrastructure as a promising area for investment over the next two years. Recognizing its potential, the Russian Government has pledged to allocate the equivalent of US\$445 billion for building transport infrastructure in the country until 2015.⁸⁹

The 2014 Winter Olympics and the 2018 FIFA World Cup are also likely to intensify infrastructure construction and modernization efforts. The Government has also planned a large number of projects to support international events, such as the APEC summit in Vladivostok and the Summer Universiade in Kazan in 2013.

Russian Railways has created a subsidiary, High-Speed Rail Lines, to manage PPPs for greenfield high-speed rail projects in Russia in the coming years. The Government has also planned tenders for the design, construction, financing and maintenance of new high-speed lines for routes between Moscow and Nizhny Novgorod, Kazan, Samara and Yekaterinburg (all of which are playing a part in hosting the World Cup).⁹⁰

Russia has also initiated the US\$6.5 billion Western High-Speed Diameter road, one of the world's largest PPP projects in the toll road construction sector. This will be the country's first urban toll road connecting St. Petersburg's northern, central and southern districts.⁹¹

85. "Consumers to power Russian economy, stock market-study," *Reuters website*, www.reuters.com, accessed 15 March 2013.

86. "Marks & Spencer to expand chain in Russia to 55 stores by '16," *Prime News*, 19 March 2013, via Dow Jones Factiva © 2013 Prime; "Russian market to see 15 int'l brands enter market in next 2 years," *Interfax: Russia & CIS Business and Financial Newswire*, 22 November 2012, via Dow Jones Factiva, © 2012 Interfax Information Services, B.V.; "PRESS: Inditex plans to open 50-60 stores annually in Russia," *Prime News*, 22 October 2012, via Dow Jones Factiva © 2012. Prime; "Japan's makeup firms hope Russians say 'da'," *Nikkei Weekly*, 10 December 2012, via Dow Jones Factiva © 2012 Nihon Keizai Shimbun, Inc.

87. *Market Overview – Russia – Retail- Q2 2013*, *Business Monitor International*, March 2013, p. 1.
88. "Consumers to power Russian economy, stock market-study," *Reuters website*, www.reuters.com, 15 March 2013.

89. *Industry Forecast – Russia – Transport Infrastructure – Q2 2013*, *Business Monitor International*, February 2013; *Industry Forecast – Consumers And Games Underpin Growth – Infrastructure*, *Business Monitor International*, February 2013, p. 1.

90. *Industry Forecast – Russia – Transport Infrastructure – Q2 2013*, *Business Monitor International*, February 2013; *Industry Forecast – Consumers And Games Underpin Growth – Infrastructure*, *Business Monitor International*, February 2013, p. 2.

91. "Financial Closing of Western High Speed Diameter toll road project achieved," *Gazprombank website*, www.gazprombank.ru/eng, accessed 18 March 2013.



6 Chemicals and pharmaceuticals

A total of 10% of our respondents see the chemicals sector as most likely to attract FDI interest. Russia's chemicals market, which has remained underdeveloped due to insufficient investment, is expected to receive much-needed aid and report capacity expansions in the next few years. The Ministry of Energy has identified six main clusters – the North West, West Siberia, East Siberia, the Volga region, the Caspian, and the Far East – for the development of the chemicals industry. To aid in the development of these zones, the Government plans to provide the supporting pipe, road and railway infrastructure. Russia's WTO membership, which requires reduction in import tariffs on most polymers from 10% to 6.5% in 2013, is expected to add to the chemicals market's increased competitiveness.⁹²

Another 9% of the investors think that the pharmaceuticals industry will attract investment in the near future. The Russian Government has also been offering incentives to multinationals undertaking local production. As a result, the pharmaceuticals sector has enjoyed increased investment in recent years. Russia's efforts to modernize health care have caught the attention of many foreign investors. Initiated in 2011, the country's health care modernization program provides for an improvement in the quality and accessibility of medical help and the repair of medical establishments across the country. It also aims to promote high-tech medicine, enhance the quality of medical education and

92. "Russia gets to work," *ICIS website*, www.icis.com, accessed 18 March 2013; *Industry Forecast – Russia – Petrochemicals – Q2 2013*, Business Monitor International, February 2013, p. 1; *Industry Trends And Developments Russia – Q2 2013, Russia – Petrochemicals*, Business Monitor International, February 2013, p. 3.

establish medical research clusters. As part of its Pharma 2020 strategy, the Russian Government plans to develop and modernize its domestic pharmaceutical industry. The program aims at transitioning the country's pharmaceutical sector to an innovative model by increasing investment and fostering collaborations with international organizations. This is expected to attract increased interest from global companies.⁹³

In addition, there have been more JVs and partnership agreements between Russian companies and foreign manufacturers. For instance, Swiss-based Novartis started constructing its production facility in St. Petersburg in July 2011. British-Swedish multinational AstraZeneca is constructing a plant in Kaluga, which is scheduled to be completed in 2016-17.⁹⁴ Indian pharmaceutical company Cadila Pharmaceuticals intends to build a factory in Russia's Astrakhan region. And India-based Elder Pharmaceuticals has signed an agreement with Russia's Holding PharmEco to establish a JV in Russia to set up manufacturing facilities for pharmaceutical formulations.⁹⁵

93. "Russia plans 33-fold increase in biotechnology production by 2020," *IHS Global Insight Daily Analysis*, 24 April 2013, via Dow Jones Factiva © 2013, IHS Global Insight Limited; "Russian parliament approves programme for pharmaceutical and medical industry development until 2020," *IHS Global Insight Daily Analysis*, 7 November 2012, via Dow Jones Factiva © 2012, IHS Global Insight Limited.

94. *Survey of the pharmaceutical industry in Russia*, Ernst & Young, 2012, p. 4.; "Novartis begins construction of new state-of-the-art pharmaceutical manufacturing plant in St. Petersburg, Russia," *Novartis website*, www.novartis.com, accessed 18 March 2013; *Industry Trends And Developments – Russia – Pharmaceuticals & Healthcare – Q1 2013*, *Business Monitor International*, January 2013, p. 1.; "AstraZeneca to begin production in Russia's Kaluga region in 2014," *IHS Global Insight Daily Analysis*, 26 November 2012, via Dow Jones Factiva © 2012, IHS Global Insight Limited.

95. "Cadila considers building production facility in Russia," *IHS Global Insight Daily Analysis*, 14 February 2013, via Dow Jones Factiva © 2013 IHS Global Insight Limited; "Elder Pharma signs MoU with Holding PharmEco," *MoneyControl*, 24 December 2012, via Dow Jones Factiva © 2012.

7 Services and technology industry

The Russian services sector has enormous potential. The availability of a well-educated workforce could position the country as a hub for business services projects. In fact, the most significant impact of Russia's WTO accession will probably be greater FDI in the services sector.⁹⁶ However, for now, only a few of our respondents see the sector as a growth driver. Only 8% voted for banking, finance, and insurance as most likely to attract FDI in the next two years.⁹⁷ Nevertheless, the Government's attempt to establish Moscow as a global financial hub to compete with cities such as London, New York and Tokyo, could lead to increased FDI in financial services.

Meanwhile, only 8% of investors saw the telecommunication sector as having immediate investment potential. And, despite Russia's significant advancements in technology in recent years, only 5% saw the potential of high-technology services. The country also faces a shortage of technology personnel, with less than 1% of the country's workforce currently employed in this sector. The Russian Government is addressing this challenge and working toward making this profession more popular.⁹⁸

On a positive note, several Russian technology start-ups, such as Workle, NETGEN, and Agent Plus,⁹⁹ and business incubators established in Skolkovo are thriving. Furthermore, the technopark near Kazan has become one of the largest in Eastern Europe. The economic zone in Tomsk has also attracted big technology companies, such as Nokia Siemens Networks, Darim International and Rovi Corporation.¹⁰⁰

Technology has become a priority sector for the Government, because the industry's development would translate into steady growth in almost all sectors. The Government has rolled out various state and federal programs that provide funding support to new initiatives in this area. This could help position technology as the major growth driver for the Russia of tomorrow.

The appeal of Russia's services sector is underappreciated in the international business community. This is chiefly due to the country's unfavorable business environment and administrative barriers to entry. While some improvements have been made in the past, they have had a limited effect on weak investor perceptions. The Government needs to establish a new image for the country. But, in order for this to happen, there needs to be greater awareness of policy reforms, diversification programs and, most importantly, the incentives and other support mechanisms available to foreign investors.

96. "The Economic significance of Russia's accession to the WTO," Directorate General for External Policies, Policy Department, 13 June 2013.

97. "Moscow Seeks Financial Hub Status With Bourse Listing," *CNBC website*, www.cnbc.com, accessed 18 March 2013.

98. "IT specialists should be role models for the young," *Telegraph website*, accessed via www.telegraph.co.uk, 26 April 2013.

99. "Russian startup enables 150,000 people to work online," *Russia Beyond The Headlines website*, accessed via rbth.ru, 26 April 2013.

100. "Russia's technology boom attracts foreign investors," *Telegraph website*, 3 April 2012, www.telegraph.co.uk, accessed 13 March 2013.

Interview



The country's future lies in growth through innovation

Vladimir Mau

Rector of the Russian Academy of the National Economy and State Service under the auspices of the President of the Russian Federation

In 2012, the Russian economy was positioned favorably against the backdrop of global problems and, especially, the situation in developed countries. The economy continued to grow, but at a low rate. GDP rose roughly 3.4% and industry grew by about 3%. An important observation is that economic growth is largely the result of internal demand: investments grew by around 7% and consumption by approximately 6%.

Although inflation increased somewhat, it remained controllable and tended to decrease as the year progressed. Public debt remained low, and the budget stayed balanced. The account balance for current operations remains positive. Foreign direct investment is increasing, although there is a substantial outflow of capital.

However, real interest rates became more favorable and public loans surpassed deposits in volume. This indicates a change in household attitudes toward savings and a switch-over to the loan model of consumption. In short, most macroeconomic parameters did not change substantially from 2011, and that's not a bad result in a global crisis.

The slowdown of economic growth at the end of 2012 became a macroeconomic problem that is alarming for several politicians and economists, who maintain that growth under 5% does not allow the country to be stable socially, economically and even politically. I think that the growth rates themselves are not crucial. On the one hand, it would be strange to expect high growth rates when the EU – Russia's main foreign economic partner, accounting for 60% of trade turnover – is in recession. On the other hand, it is not just the rates of growth that are important – quality, structure and the ability to ensure modernization are also key. The situation can be improved. But this will take time, and there should be a willingness to implement serious institutional reforms.

“In the modern world, Russia remains a country with good growth potential. It has strong domestic demand, a balanced budget, a small national debt, substantial foreign currency reserves and favorable interest rates.”

In the modern world, Russia remains a country with good growth potential. It has strong domestic demand, a balanced budget, a small national debt, substantial foreign currency reserves and favorable interest rates. Russia took account of its past experience and now has considerable financial reserves. The country's budget policy takes into account the risk of fluctuations in the global market. However, as a result of the crisis, the federal budget now depends on revenue from the export of energy resources that previously went in part to the foreign currency reserve fund.

Public debt is far less than it was during the Soviet era. Russia does not depend on foodstuff supplies to the extent that the Soviet Union did. The situation is qualitatively changing due to the existence of private property. The political system is certainly far more flexible than it was. The Government understands the importance of radically improving the investment climate and stimulating private entrepreneurship. This is evident in Russia's goal to climb from 120th place to the top 20 in *The World Bank's Doing Business* rating.

Russia's path to sustainable growth

Proposed actions moving forward

1 Reduce operational barriers







Russia's strengths as an investment destination are often obscured by its operating environment, which is marred by high levels of corruption and bureaucracy. In addition, the country's political, legislative and administrative setup got the lowest scores from our respondents when asked about Russia's attractive features. Russia's poor institutional system is not only problematic for new investors, but is also a matter of concern for existing businesses – as is evident from the high level of capital leaving the country. Administrative burdens and the ineffective rule of law also hamper the development of small and medium-sized enterprises (SMEs) in the country.

Investors argue that reforms are required to reduce bureaucracy (44%), improve the effectiveness of the rule of law (43%) and increase the transparency of business regulation (30%). Recognizing this urgent need, the Russian Government has undertaken various initiatives efforts in the past year, including ratifying the OECD Anti-Bribery Convention and announcing its intention to join the OGP. In the fight against corruption, President Vladimir Putin has recently proposed a law that restricts high-level officials from holding bank accounts, stocks or real estate outside Russia.¹⁰¹ In 2012, the Russian authorities

101. "Russia joins OECD Anti-Bribery Convention," *Organisation for Economic Co-operation and Development website*, www.oecd.org, accessed 15 March 2013; "Russia May Restrict Investing Abroad," *New York Times website*, www.nytimes.com, accessed 15 March 2013; "Russia needs a post-industrial revolution," *Russia Beyond The*

Investment climate

Which are the three priority measures to take to improve Russia's investment climate?

Reduce bureaucracy	44%	
Improve the effectiveness of the rule of law	43%	
Improve the transparency of business regulation	30%	
Lighten companies' legal and fiscal obligations	20%	
Promote economic growth and SME development	20%	
Renew the training and education system	17%	
Stimulate R&D and innovation	12%	
Encourage companies' initiatives in environmental protection	10%	
Reform the social model	10%	
Promote an entrepreneurial and initiative-taking culture	9%	
Improve transport infrastructure	1%	
Reform the political system and have political stability	1%	
None in particular	2%	
Can't say	14%	

Source: *Russia attractiveness survey* (total respondents: 206), 2013, Ernst & Young.

prosecuted 889 officials (including 244 city mayors and 114 lawmakers) and 1,159 law enforcement officials on corruption charges.¹⁰² These efforts have already enjoyed some success, with the country's rating jumping 10 places in *Transparency International's Corruption Index 2012* and eight places on the *World Bank's ease of doing business rankings*.¹⁰³ Despite the

Headlines website, www.rbth.ru, accessed 15 March 2013; "World Bank: Russia improves investment climate, can do more," *Prime News*, 17 January 2013, via Dow Jones Factiva ©2013 Prime.
 102. "No 'untouchables' in fight against corruption ' Kremlin," *Philippines News Agency*, 22 February 2013, via Dow Jones Factiva.
 103. *Corruption Perceptions Index 2012*, Transparency

improvement, the overall ranking remains poor. The Russian Government's target, to climb up the *Doing Business index* to 50 by 2015, and to 20 by 2018, looks fairly unrealistic. For this goal to be achievable and to make the country a more attractive FDI destination, the Government needs to build an investment climate based on transparent and predictable rules, and reduce corruption.

International 2012, p. 3; "Russia politics: The anti-corruption campaign," *Economist Intelligence Unit – ViewsWire*, 21 December 2012, via Dow Jones Factiva ©2012 The Economist Intelligence Unit Ltd.

2 Collaborate to innovate

Russia needs to focus on encouraging research and innovation, and move toward a modern, knowledge-driven economy. The country spends less on technology and innovation than other leading European economies. It ranked 51st (five places up on 2011) in the Global Innovation Index 2012, published by INSEAD and the World Intellectual Property Organization. This puts it above BRIC counterparts Brazil (58th) and India (64th), but behind China (34th).¹⁰⁴ Notable changes to Russia's innovation policy in recent years have put R&D at the center of the Government's agenda. The establishment of innovation clusters is also noteworthy.¹⁰⁵

104. *The Global Innovation Index 2012, Stronger Innovation Linkages for Global Growth*, INSEAD and the World Intellectual Property Organization 2012, p. 121, p. 122, p. 123, p. 124, p. 125, p. 126, and p. 127.

105. "Russia needs a post-industrial revolution," *Russia Beyond The Headlines website*, www.rbth.ru, accessed 15 March 2013;

Unfortunately, all these initiatives have, so far, had only limited impact on enabling sustainable economic growth. Responses to our survey suggest that a shift to a more collaborative approach would help to improve Russia's innovation and technological capacity.

► Facilitate R&D collaborations between foreign and local companies

Twenty-five percent of our respondents recommend R&D partnership between foreign investors and local companies. A number of these partnerships have been forged in the recent past; for example, Alcatel-Lucent signed an R&D pact with

"Russian government pledges \$40 million to support regional innovation clusters," *SKRIN Newswire*, 19 December 2012, via Dow Jones Factiva © 2012 SKRIN; "Russia's subsidies for 25 innovation clusters on the table," *SKRIN Newswire*, 12 September 2012, via Dow Jones Factiva © 2012 SKRIN; "Russia improves its position in Global Innovation Index," *ITAR-TASS News Agency*, 5 August 2012, via Dow Jones Factiva © 2012 ITAR-TASS.

SC Rostekhnologii, Russia's largest high-technology corporation, to accelerate the deployment of advanced long-term evolution (LTE) or 4G mobile services, new network systems and ground-breaking transmission technologies.

► Strengthen links between universities and industry

Another 19% of our respondents thought that encouraging collaboration between industry and academia would help to improve Russia's innovation climate. This would strengthen the foundation of entrepreneurship and innovation.

Russia's technology and innovation capacity

Which are the main measures to improve Russia's technology and innovation capacity?



Source: *Russia attractiveness survey* (total respondents: 206), 2013, Ernst & Young.

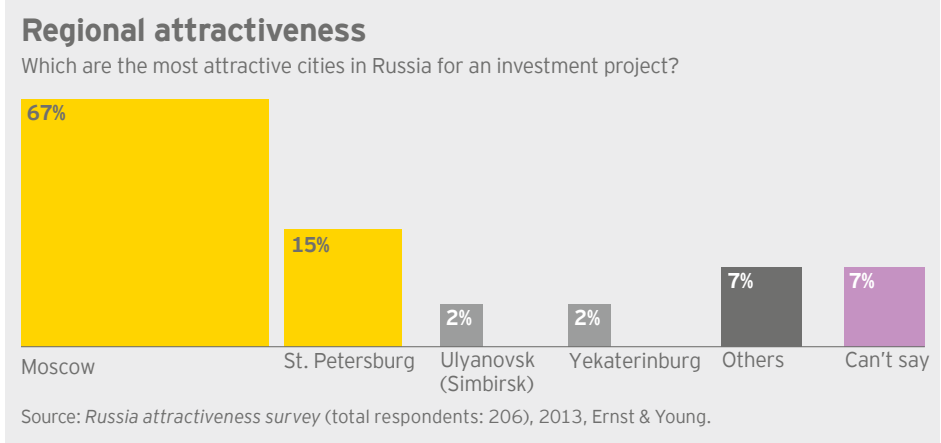
3 Enhance regional attractiveness

Moscow (67%) and St. Petersburg (15%) came out as clear favorites for FDI among investors. These were followed, at some distance, by Ulyanovsk and Yekaterinburg, with a vote of 2% each. This explains the extent of regional disparity in the country. The Economist Intelligence Unit's *Benchmarking global city competitiveness 2012* report lists Moscow (58) and St. Petersburg (100) among the top 120 cities worldwide.

Regional disparity in Russia also leads to large regional differences in income. Unfortunately, this inevitably leads to other discrepancies. For instance, in health and social care, the life expectancy of someone living in Moscow is 74. In the remote Chukotka Autonomous Okrug, life expectancy is only 58.4.¹⁰⁶

Enhancing the investment appeal of regions other than Moscow and St. Petersburg, and so balancing regional development, is a critical action point for the Government. Russia's far east has enormous economic potential, with rich mineral resources and proximity to the Asia Pacific region. Despite having one of the largest gas reserves in the world, living standards in this region remain low. In fact, over the years, the disparity

¹⁰⁶. "What's next for Russia's Economic Future and Global Role? Lecture by World Bank Group President Jim Yong Kim," *The World Bank website*, www.worldbank.org, accessed 9 April 2013.



between western and eastern Russia has sharply increased. To achieve more balanced growth, the Russian Government is working toward the revival of these long-overlooked regions. The Asia Pacific economic summit conference (APEC) 2012 was held in Vladivostok in eastern Russia, and had the objective of strengthening ties with Asian countries.¹⁰⁷ Another positive measure has been setting up The Ministry of Development of Russian Far East. This Ministry is designed to implement state programs to develop the far eastern regions.¹⁰⁸ There has also been a substantial increase in government funding

¹⁰⁷. "Putin's Ambitions Turn to the Far East," *The New York Times website*, 6 September 2012, www.nytimes.com, accessed 18 March 2013.

¹⁰⁸. "Ministry for the Development of the Russian Far East," *Government of the Russian Federation website*, government.ru/eng, accessed 15 March 2013.

for these regions.¹⁰⁹ Russia's Ministry of Regional Development's transport strategy aims to develop the Northern Sea Route, the shortest route between Europe and Asia. The modernization of other cities will require greater investments in the social sphere – in this, local governments will have a bigger role to play than the federal one.¹¹⁰ Tax income from natural resources should be channeled back into upgrading infrastructure and improving the health care and education system. In addition, authorities need to formulate region-specific campaigns to attract investors.

¹⁰⁹. "Russia's Far East struggles to modernize its economy," *Russia Beyond The Headlines website*, 9 February 2013, rbth.ru, accessed 16 March 2013.

¹¹⁰. "No need to direct Siberia's development from Moscow," *Russia Beyond The Headlines website*, 21 February 2013, rbth.ru/opinion, accessed 16 March 2013.



4 Improve business education

Although Russia's education system is well respected, it still needs to cover more material relevant to businesses. Low internationalization and English proficiency are other challenges.¹¹¹

Respondents suggest that innovative joint programs with foreign universities would help to address the skills gap. Russian universities could invite foreign faculty

111. "Business Schools in Transition Societies: Russian Experience and Vision," 20th CEEMAN Annual Conference, 27 September 2012

and researchers to business schools and conduct international conferences. The Skolkovo Institute of Science and Technology, set up in partnership with the Massachusetts Institute of Technology, is one example of such collaboration. Working with leading foreign universities would also help to make graduates more employable.

Investors have also suggested widening the scope of qualifications available in Russia's business schools. The Russian Government has recently initiated a project with the aim

of creating business schools fit for the 21st century.¹¹² In addition, the Government's Research and Pedagogical Cadre for Innovative Russia is designed to improve proficiency in mathematics and science.¹¹³

112. "Creating business-schools of the world level," Ministry of Education and Science of the Russian Federation website, eng.mon.gov.ru accessed 16 March 2013.

113. "Improving higher education in Russia – a French insight," Modern Russia website, 17 February 2011, www.modernrussia.com, accessed 15 March 2013.

Russia's business education

Which are the measures to be implemented to improve Russia's business education and increase its qualified labor to match business needs?

Collaborate with leading foreign universities	33%	<div style="width: 33%;"></div>
Increase availability of public education and qualifications in business fields	26%	<div style="width: 26%;"></div>
Offer government incentives for internship and apprenticeship programs in the private sector	19%	<div style="width: 19%;"></div>
Increase science and technology courses in public universities	17%	<div style="width: 17%;"></div>
Invest in industry-government partnerships in education	16%	<div style="width: 16%;"></div>
Capitalize on programs for the development of managerial and soft skills	12%	<div style="width: 12%;"></div>
Reinstaurate the education system of the Soviet Union	1%	<div style="width: 1%;"></div>
Others	1%	<div style="width: 1%;"></div>
Can't say	24%	<div style="width: 24%;"></div>

Source: Russia attractiveness survey (total respondents: 206), 2013, Ernst & Young.

Interview



Russia seeks reputational change

Andrei Nikitin
General Director, Strategic Initiatives Agency (SIA)

In my opinion, Russia is going through positive changes right now. The business climate is improving and investors are receiving greater protection. Corruption remains a problem, but, on the whole, it's been going down. There are several areas that require closer attention, though. First, there is low demand for innovation in the economy. State-owned companies, which often play a dominant role in the Russian economy, lack incentives that could prompt them to make innovative products or use such products in their business. We need to do more to implement and promote innovation, and increase penalties on those who use outdated technology. For instance, governments in the developed economies of Western Europe encourage the use of biofuels, solar and wind energy, through what is known as a green tariff.

Second, we need to upgrade infrastructure. Considering the size of Russia, the state of its infrastructure is directly responsible for the rate of GDP growth and the quality of life of the Russian people.

To boost investment, we need to keep working on improving Russia's image abroad. On the other hand, Russia's image is probably a factor that is more important for potential investors pondering whether or not to invest in Russia. Large multinational companies from industrially developed countries have long been present in Russia in a variety of sectors. Their representatives know the real situation in the country; they see both challenging, unresolved issues and positive trends.

At this stage, we need to attract new investors, maybe SME investors from the countries that haven't had a business presence in Russia so far. How do we attract them to Russia? Apparently, it's not by a cheap workforce, which until recently was China's strong suit. Prices for electricity in Russia are no lower than elsewhere in the world. We may spend a lot of time in debate over the reasons for this and whether this is right, but the facts are what the facts are. In this respect, I don't see any substantial benefits that Russia could offer new investors. Businessmen who don't work in Russia tend to believe what the foreign press says about this country and, in the eyes of this type of investor, Russia has a negative

"We need to identify our philosophy and our goals for the foreseeable future, both within the country and abroad."

image. This is a problem, no doubt. There is a need to work harder to create and promote a positive image of this country abroad. To achieve this, it would help if we identified our philosophy and our goals for the foreseeable future, both within the country and abroad. And only after that should we get down to designing a plan of action.

The future of our economy depends on whether we are able to improve labor efficiency and the volume of equity investments. Why are equity investments so important? In my opinion, this type of investment is a barometer of the level of confidence businesses have in the stability of a nation's economy. If the level of confidence is sufficient, investments will flow in, triggering economic growth. In order to foster this kind of confidence, we need appropriate measures, a long-term policy and productive day-to-day work. This is exactly what we are doing, together with entrepreneurs, experts and academic communities, as part of the National Entrepreneurial Initiative (NEI). The goal is to make entrepreneurial activity less dependent on bureaucratic procedures and remove unnecessary administrative barriers. If we succeed, the image of the country will change. We have already seen some positive shifts in this respect in many Russian regions and at the federal level as a whole; we have seen the efficiency of the activities set forth in the roadmaps designed within the NEI framework. But, of course, a lot is still to be done here.

Potential investment enablers

Developments and initiatives

1 The WTO accession

After 18 years of negotiations, Russia became the 156th member of the WTO in August 2012. Respondents to our survey have a mixed view on the impact of the accession, as the chart indicates.

Underlying commitments

As part of the WTO accession, Russia has five significant economic commitments:

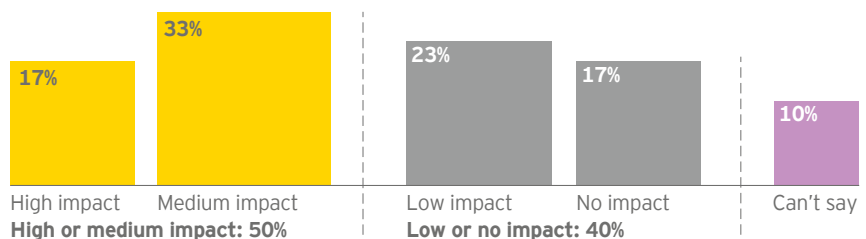
- ▶ Tariff reductions and efforts to decrease technical barriers to trade
- ▶ Improve markets access in services
- ▶ Reduce or fix export duties in a wide range of products
- ▶ Ensure the protection of intellectual property rights
- ▶ Reduce trade-related investment tools

▶ What this means for Russia

Half of our respondents believe that Russia's WTO membership would have a high or medium impact on increasing the country's investment appeal. The membership should increase FDI, facilitate trade, and accelerate modernization and diversification.¹¹⁴ Although economic benefits of the move might not materialize in the short run, substantial effects are anticipated in the medium to long term. The World Bank anticipates Russia's GDP increasing annually by US\$49 billion in the near term, with additional long-term gains amounting to US\$162 billion per annum on account of greater trade and increased FDI inflows, resulting from the WTO accession.¹¹⁵

Accession to the WTO

What impact does Russia's recent accession to the WTO have on increasing the country's investment appeal?



Source: Russia attractiveness survey (total respondents: 206), 2013, Ernst & Young.

The reduction in import duties could initially have a negative impact, with a possible increase in the budget deficit. Domestic companies in industries such as automotive and agriculture are bound to suffer from foreign competition, unless they can reform quickly. To protect themselves from the anticipated increase in competition from abroad, domestic manufacturers will need to upgrade their existing facilities. This is likely to translate into better local productivity.

The WTO membership is also expected to give Russia a much-needed image lift through the enforcement of measures to protect intellectual property, the adoption of trade dispute mechanisms and the implementation of a rules-based system to ensure greater transparency.

The extent of the impact depends on policy measures adopted by the Russian Government, and may vary considerably on a regional basis. The accession will only have a transformative effect on the whole economy if it is backed by a broad, fully fledged reforms program.

Benefits

- GDP impact per year
- ▶ Short term: US\$49 billion
 - ▶ Long term: US\$162 billion

Enhanced market access and global integration

Productivity growth and sector diversification

Increased intellectual property rights (IPR) protection

Challenges

Possible increase in budget deficit due to lower import duties

Domestic companies (particularly SMEs) to face higher competition from foreign companies

Source: *The economic significance of Russia's accession to the WTO*, Directorate-General for External Policies of the Union, June 2012; "Russia and China in WTO – a world apart," Reuters website, www.reuters.com, accessed 13 March 2013.

114. "Russia won't make China's WTO gains," *The China Post website*, www.chinapost.com.tw, accessed 11 March 2013; Europe cools on Russia's WTO accession," *The Financial Times website*, www.ft.com, accessed 12 March 2013.

115. "Russia and China in WTO – a world apart," *Reuters website*, www.reuters.com, accessed 13 March 2013.

2 Common Economic Space and likely Eurasian Economic Union

The recent creation of the Customs Union and Common Economic Space (CES) with Kazakhstan and Belarus is a noteworthy initiative. It should ensure deeper regional economic integration. In November 2011, Russia, Belarus and Kazakhstan also agreed to form the Eurasian Economic Union by 2015. The community would be based on the Customs Union and the CES among the three countries.

► What this means for Russia

The CES is designed to facilitate business among investors and entrepreneurs from the three countries by enabling the free movement of goods, services, capital and labor. The move is expected to allow participating countries, including Russia, to gain equal access to internal infrastructure. It would also enable closer cooperation in research and innovation. The integration could give the member countries, Russia, Kazakhstan and Belarus, the chance to reach a market of

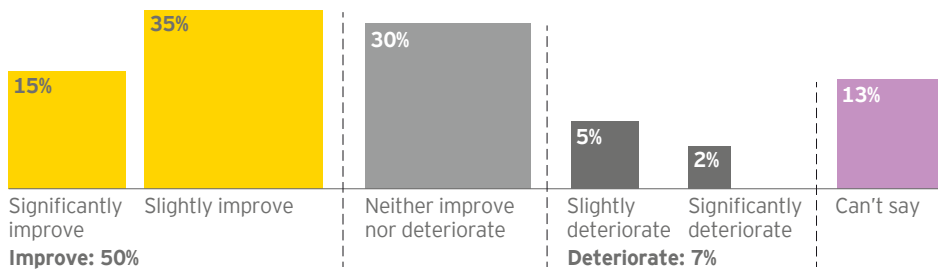
170 million people, attain a GDP of US\$2 trillion, achieve US\$900 billion in trade and build capacity for 90 billion barrels of oil reserves.¹¹⁶

Half of our respondents expect these integration initiatives to bring significant opportunities for Russia, helping the country boost its exports and gain access to new markets. As part of the agreement, Russia is also entitled to receive 88% of import tariff revenues.¹¹⁷ Since the creation of the Customs Union, trade among the three countries has doubled, mainly due to the reduction of non-tariff barriers and, to some extent, driven by common tariffs.¹¹⁸ Only 7% of respondents think that these integration initiatives will not be beneficial in improving Russia's attractiveness, while 30% remain neutral.

116. "Russia, Kazakhstan, Belarus launch a customs union," *The Hindu website*, www.thehindu.com, accessed 10 March 2013.
 117. *Integration Across Borders, Transition Report 2012*, European Bank for Reconstruction and Development, p. 66, p. 67.
 118. "Customs Union of Russia, Kazakhstan and Belarus is First Success in CIS Integration, Says EBRD," *European Bank for Reconstruction and Development website*, www.ebrd.com, accessed 11 March 2013.

Common Economic Space

How does the Common Economic Space between Russia, Belarus and Kazakhstan, and a likely Eurasian Economic Union by 2015, affect your perception of Russia's attractiveness?



Source: *Russia attractiveness survey* (total respondents: 206), 2013, Ernst & Young.

Benefits

- Lower-tariff and non-tariff trade barriers leading to increased trade
- Easier or completely abolished customs procedures, resulting in reduced costs and increased competitiveness
- Diversified FDI inflows due to an enlarged market
- Improvements in cross-border regional infrastructure and equal access to internal infrastructure
- Stronger economic and political institutions
- Closer cooperation in research and innovation
- Access to new markets. Higher value-added goods that are initially exported within the Customs Union can subsequently be exported to other countries

Challenges

- Negative impact on economic links with other countries
- Regional union dominated by commodity exporters
- Shocks to world trade permeate quickly through regional economic blocs
- Disparity in the economic size of the three countries, with Russia being the largest

Source: *Transition Report 2012 – Integration Across Borders*, European Bank for Reconstruction and Development, p. 66, p. 67



3 Privatization efforts

The Russian Government plans to sell stakes in state-owned assets to private firms. It expects to raise US\$10 billion from asset sales in 2013.¹¹⁹

► **What this means for Russia**

A small majority of respondents (54%) are positive about Russia's privatization efforts. Increased private participation is expected to create several benefits for Russia, including a boost

in FDI, higher productivity levels through increased competition and accelerated modernization.¹²⁰ All the plans are in place, but executing them seems to be a challenge. Sales of stakes in strategic assets have been delayed, due to political infighting and market volatility.¹²¹

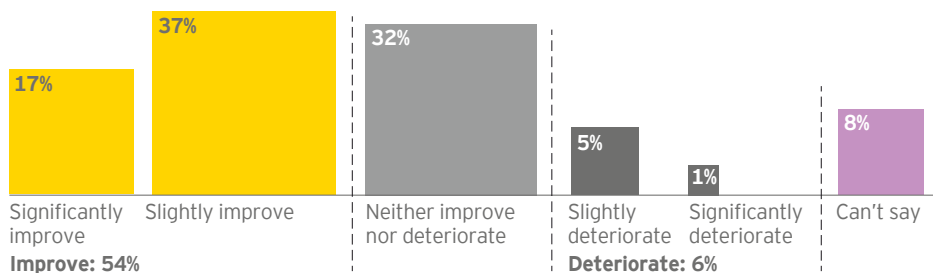
119. "Russian House to Raise 5 Billion Rubles in Asset Sales," *Bloomberg website*, www.bloomberg.com, accessed 12 March 2013.

120. "Russia Approves Privatization Plan," *The Wall Street Journal*, www.wsj.com, accessed 11 March 2013; "Medvedev Courts Davos Skeptics With Better-Than-China Pitch," *Bloomberg website*, www.bloomberg.com, accessed 13 March 2013.

121. "Russian Privatization Plan Raises Questions," *The Wall Street Journal website*, www.wsj.com/home-page, accessed 13 March 2013; "Factbox: Russia's privatization plan," *Reuters website*, www.reuters.com, accessed 13 March 2013; "Russia moving ahead with diamond, port stake sales," *Reuters website*, www.reuters.com, accessed 13 March 2013; "To privatise or not to privatise," *The Economist website*, www.economist.com, accessed 13 March 2013.

Privatization plans

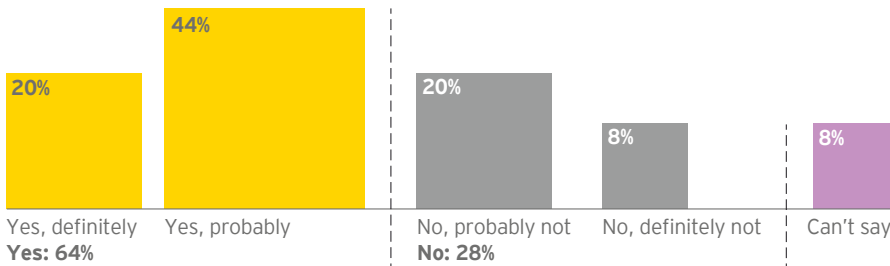
How would the acceleration of the Russian Government's privatization plans affect your perception of the country as an investment destination?



Source: *Russia attractiveness survey* (total respondents: 206), 2013, Ernst & Young.

Russia's demographics trends

Do you consider that an improvement in Russia's demographic trends will increase the country's appeal as an investment destination?



Source: *Russia attractiveness survey* (total respondents: 206), 2013, Ernst & Young.

4 Improving demographics

Russia has been facing the serious demographic challenges of a dwindling labor force and an aging population (resulting from low birth and high mortality rates, and poor medical care).¹²² The high emigration rate makes this situation worse. Many bright young Russians prefer to migrate to other countries, due to security risks and lack of differentiated benefits.¹²³ According to the latest census, the Russian population has decreased by almost 2 million over the past decade – from around 145 million in 2002 to about 143 million in 2012.¹²⁴ Russia's Labor and Social Security Ministry estimates the country's labor force will decrease by one million people annually in 2013-15 as a result of the demographic situation. This is expected to constrain economic development. The

122. "Russia's Demographics Continue to Improve, Natural Population Growth Likely in 2012," *Forbes website*, www.forbes.com, accessed 15 March 2013.

123. "Lurching into the fast lane," *The Economist website*, www.economist.com, accessed 15 March 2013.

124. "Russian government reports decline in natural growth of population in 2012," *IHS Global Insight Daily Analysis*, 7 February 2013, via Dow Jones Factiva © 2013, IHS Global Insight Limited. All Rights Reserved.

share of migrant workers is expected to rise to 2.9% of the entire workforce in 2015, up from 2.1% in 2011.¹²⁵

► **What this means for Russia**
Improving demographics is an important enabler for Russia's future growth. The country needs to meet the demand of its labor market through a young and productive labor force. The recent implementation of a range of measures has enhanced the demographic situation somewhat. This is welcome news, given that nearly 64% of our respondents believe that better demographics would increase the country's FDI appeal. The country's population has grown by more than 200,000 people from January to September 2012.¹²⁶ During 2008-11, over seven million children were born in Russia. The number of families having a second child has increased by 45%, and

125. "Labor force projected to dwindle," *RosBusinessConsulting*, 22 January 2013, via Dow Jones Factiva © 2013 RosBusinessConsulting.

126. "Natural population decline in Russia decreases by 264 times over past 7 years," *ITAR-TASS News Agency*, 26 February 2013, via Dow Jones Factiva, © 2013 ITAR-TASS.

the number of families having a third or subsequent children exceeded 62% in the same period.¹²⁷

On the other hand, almost 28% of investors do not see a correlation between improvement in demographics and Russia's attractiveness. Furthermore, the Government has seemingly been overambitious in setting targets. The country's fertility rate, 1.5 children per woman, is among the lowest in the world. The share of women aged 20-29 years (the most fertile age group) is forecast to fall from 8.6% currently to 4.8% in 2020. Reforming the health care system, tackling high levels of inequality and raising living standards will also help to improve Russia's demographic situation.¹²⁸

127. "Putin praises gov't for stabilization, demography (Part 2)," *Interfax: Russia & CIS Business and Financial Newswire*, 11 April 2012, via Dow Jones Factiva © 2012 Interfax Information Services, B.V.

128. "Adoption ban may be way to boost population," *The Washington Times*, 14 January 2013, via Dow Jones Factiva © 2013 Washington Times Library: "Russia economy: Demographic profile," *Economist Intelligence Unit – ViewsWire*, 27 July 2012, via Dow Jones Factiva © 2012 The Economist Intelligence Unit Ltd.

What it means for businesses

Russia's economic progress over the last 10 years has been impressive. However, most of this growth has come from high oil prices. The economy urgently needs to diversify away from its dependence on natural resources. This would help to convince investors that Russia has the potential for long-term, sustainable growth. While investors are positive about the country as an investment destination, this optimism has been based on the energy sector. Business leaders with an FDI portfolio focused on Russia should look beyond energy, toward manufacturing and knowledge-based sectors.

The Russian Government has a critical role to play here. It needs to create a facilitative environment for foreign investors, improve its R&D and innovation capacity, and enhance its business education. Recent integration initiatives, such as accession to the WTO and the formation of the CES, and likely Eurasian Economic Union by 2015, are set to have a powerful impact on the country's business appeal. Business leaders can also use Russia's privatization efforts to increase their presence in the Russian economy.



Methodology

Ernst & Young's 2013 Russia attractiveness survey is based on a twofold, original methodology that reflects:

1 The real attractiveness of Russia for foreign investors

Our evaluation of the reality of FDI in Russia is based on Ernst & Young's European Investment Monitor (EIM). This database tracks FDI projects that have resulted in the establishment of facilities and the creation of new jobs. By excluding portfolio investments and M&A, it shows the reality of investment in manufacturing or services operations by foreign companies across the continent. Data is widely available on FDI. An investment in a company is normally included if the foreign investor has more than 10% of its equity and a voice in its management. FDI includes equity capital, reinvested earnings and intracompany loans.

However, many analysts are more interested in evaluating investment in physical assets, such as plant and equipment. These figures, rarely recorded by institutional sources, provide invaluable insight. They show how inward investment projects are undertaken, in which activities, by whom and, of course, where. To map these real investments carried out in Europe, Ernst & Young created the EIM.

Ernst & Young's EIM, researched and powered by Oxford Intelligence, is a highly detailed source of information on cross-border investment projects and trends in Europe, dating back to 1997. The database focuses on investment announcements, the number of new jobs created and, where identifiable, the

associated capital investment. Thus, it provides exhaustive data on FDI in Europe. It allows users, such as governments and private sector organizations, to monitor trends, movements in jobs and industries, and identify emerging sectors and cluster developments. Projects are identified through the daily monitoring and research of more than 10,000 news sources. For validation purposes, the research team aims to make direct contact with 70% of the investing companies. This process of verification ensures that real investment data is accurately reflected.

The following categories of investment projects are excluded from EIM:

- ▶ M&A or joint ventures (unless these result in new facilities or new jobs)
- ▶ License agreements
- ▶ Retail and leisure facilities, hotels and real estate investments
- ▶ Utility facilities, including telecommunication networks, airports, ports or other fixed infrastructure investments
- ▶ Extraction activities (ores, minerals or fuels)
- ▶ Portfolio investments (pensions, insurance and financial funds)
- ▶ Factory and other production replacement investments (e.g., a new machine replacing an old one, but not creating any new employment)
- ▶ Not-for-profit organizations (charitable foundations, trade associations or governmental bodies)

2 The perceived attractiveness of Russia for foreign investors

We define the attractiveness of a location as a combination of image, investors' confidence and the perception of a country or area's ability to provide the most competitive benefits for FDI. Field research was conducted by CSA institute in January and February 2013, via telephone interviews, based on a representative sample of 206 international decision-makers. Business leaders were identified and interviewed in 24 countries. Globally, of the 206 companies interviewed, 48.5% operate in Russia.

Our survey was conducted among business leaders who had considered views and experience of Russia. They were drawn from businesses across six regions. The geographic representation was as follows:

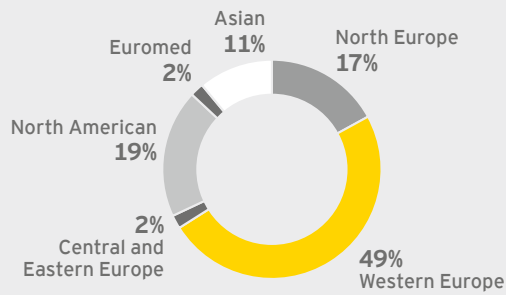
- ▶ 17% North European businesses
- ▶ 49% Western European businesses
- ▶ 2% Central and Eastern European businesses
- ▶ 19% North American businesses
- ▶ 2% Euro-Mediterranean (Euromed) businesses
- ▶ 11% Asian businesses

These businesses are representative of seven key economic sectors:

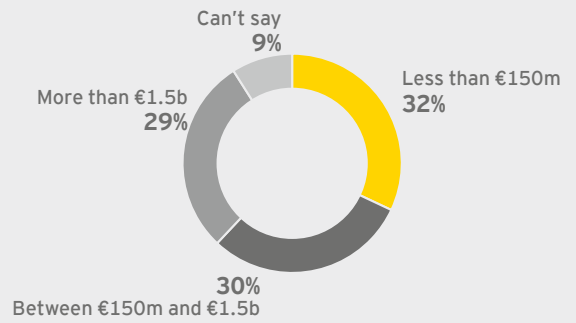
- ▶ Private and business services
- ▶ Retail and consumer products
- ▶ Energy and heavy industries
- ▶ Hi-tech and telecom infrastructure and equipment
- ▶ Life sciences
- ▶ Transport and automotive
- ▶ Real estate and construction

Profile of companies surveyed

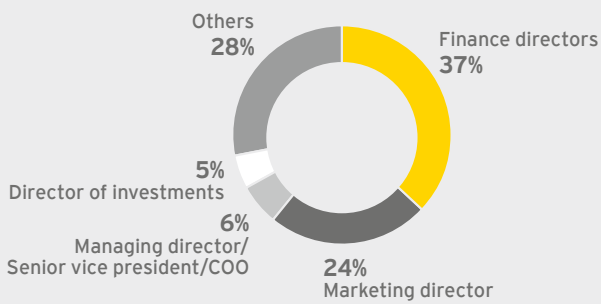
Geography



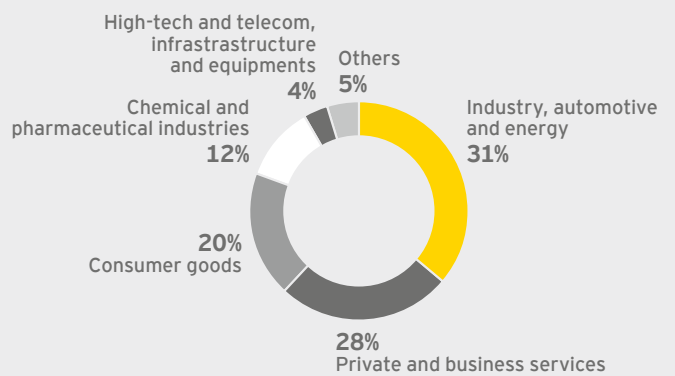
Turnover



Job title



Sector of activity



Source: *Russia attractiveness survey* (total respondents: 206), 2013, Ernst & Young.

Ernst & Young in Russia

In 1989, Ernst & Young was the first professional services organization to establish operations in Russia. Our Russian practice has 3,000 employees working in nine offices located in Moscow, St. Petersburg, Ekaterinburg, Novosibirsk, Togliatti, Kazan, Krasnodar, Vladivostok and Yuzhno-Sakhalinsk.

Ernst & Young is dedicated to helping its clients identify and capitalize on business opportunities throughout Russia and the world. Our key market sectors are: financial services; retail and consumer products; industrial products; energy; technology and communications; government, real estate, transportation and infrastructure.

Our professionals are recognized for their leadership, know-how and understanding of our clients' business. In more than 20 years in Russia, we have provided critical information and resources to improve business performance and profitability.

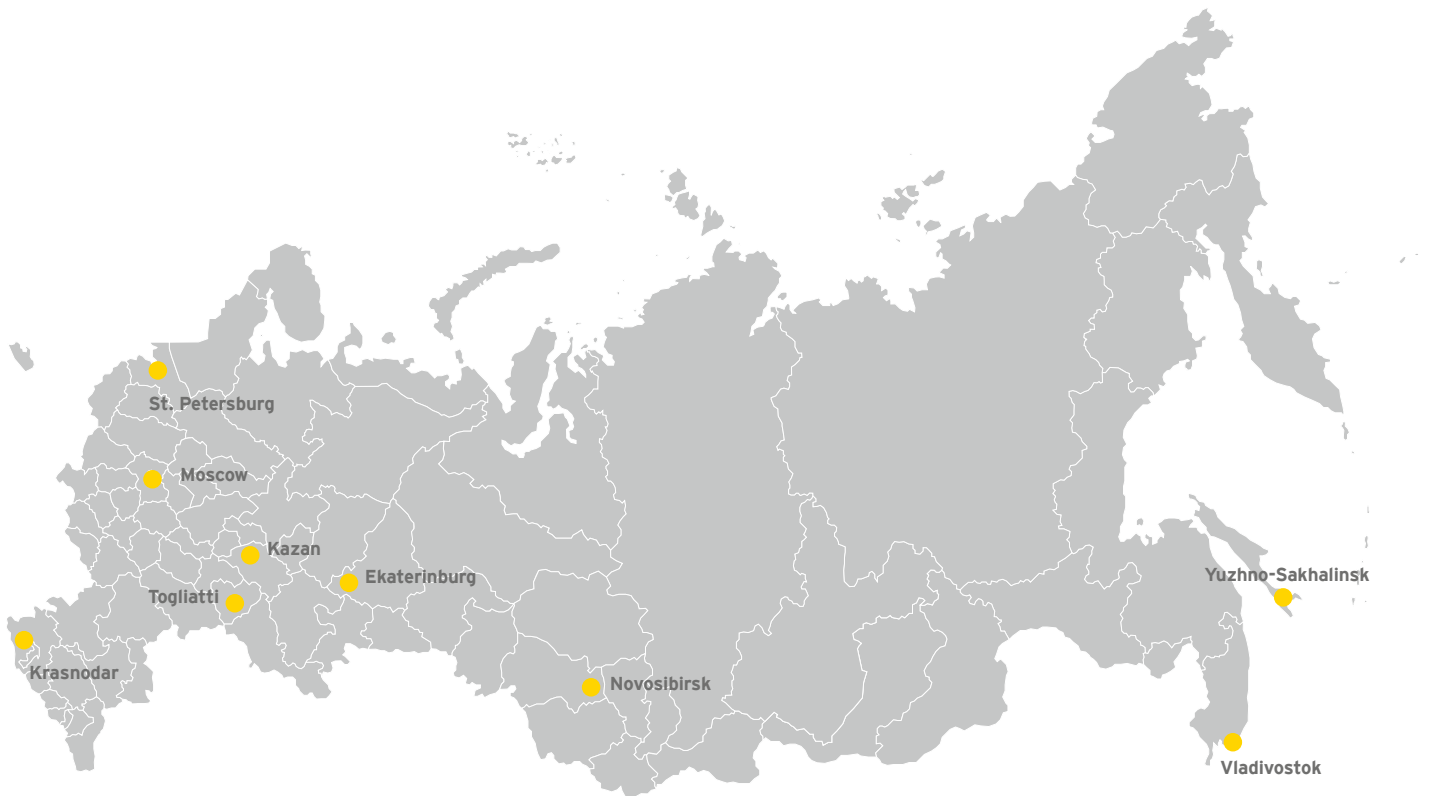
Country and institutional development

Ernst & Young actively supports the development of the institutions and economics where we operate. We participate and support the Foreign Investment Advisory Councils (FIAC) in Russia, which Ernst & Young co-chairs with the Prime Minister of the Russian Government.

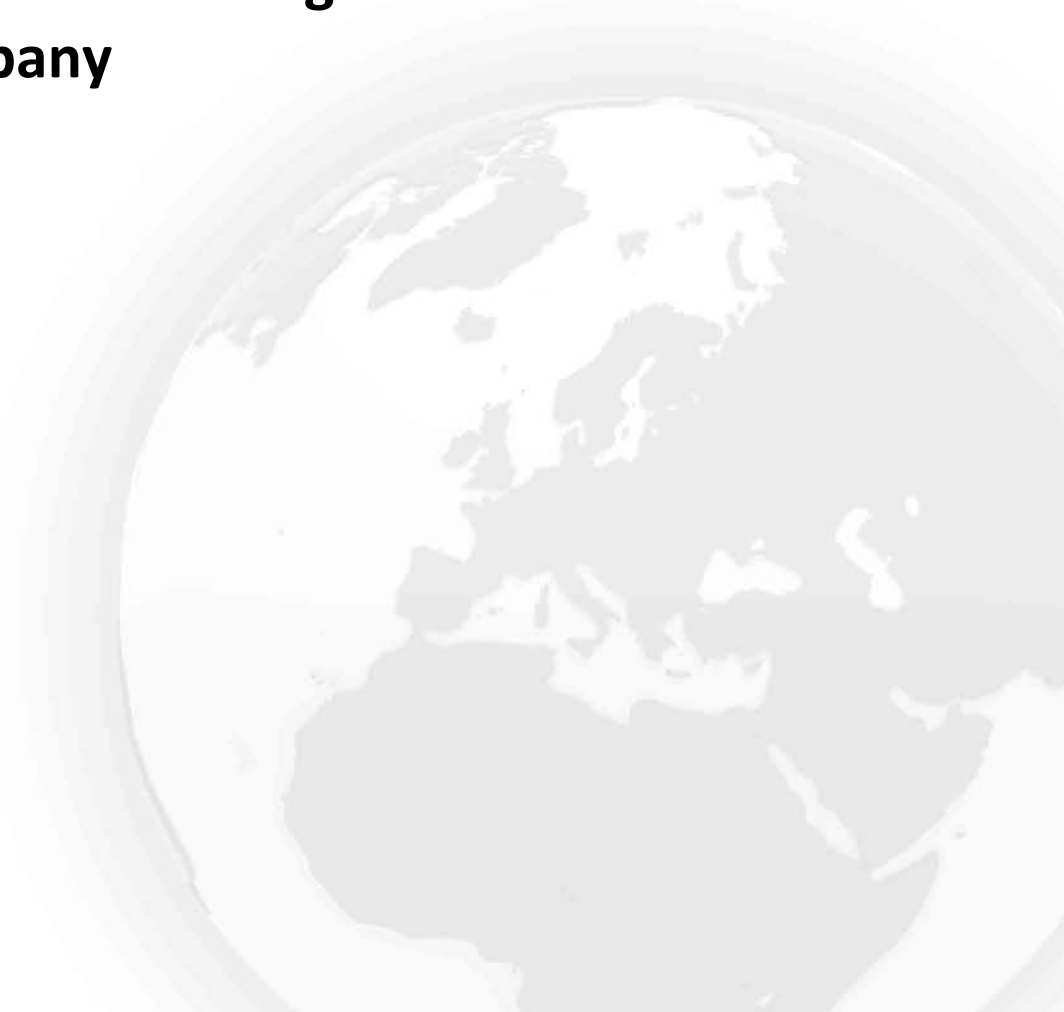
Ernst & Young also demonstrates its leadership by being involved in the Russian business community, as an active member of the Russian Union of Industrialists and Entrepreneurs, the Association of Russian Banks, the International Tax and Investment Center, the Association of European Businesses, the American Chamber of Commerce and the US-Russia Business Council. We also play an important role in the Russian legislative and ministerial processes affecting business.

Our clients

We know that growing markets require innovative thinking and evolving practices for businesses to succeed. Many leading companies in Russia and the CIS have chosen Ernst & Young to advise them on the most demanding aspects of the fast-evolving business climate. Ernst & Young provides audit services to a large number of Russian and CIS companies listed on Forbes Global 2000.



Why Russia can still be a good market for your company



by Dr. Daniel Thorniley
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October 2013

IN ASSOCIATION WITH:

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Executive summary

- Russia remains comparatively a very good market for western companies in terms of sales and profits
- But Russian economic/business trends decelerated in 2013 along with many other emerging markets
- In fact compared with nearly all markets, except China, Russia has come off relatively well in the 2013 economic and currency downturns: India, Indonesia, Brazil, South Africa and Turkey have taken worse knocks this year
- We do not hide the fact that there is a slowdown and that 2% GDP growth in 2013 when oil is averaging about \$105/108 this year is a disappointing result
- Shale gas developments and consequential lower oil and gas prices could undermine the Russian economy in the mid-term
- Western companies sell 3-10 times more per capita in Russia than in China and India
- Russian GDP per capita is 2-8 times larger than in China and India
- Most western companies are out-performing other Central European markets and all developed western markets in terms of top-line sales growth and Russia remains an exceptional profitable market for the large majority of western companies
- While automotive sales are struggling this year (as across the world), Russia remains a key investment market in this sector and will be the largest auto market in Europe in the next 1-2 years. This August Russian auto sales topped those in Germany
- Russia is expected to become the largest consumer products market in Europe in the next 8-10 years
- Nominal wages and real wages (after inflation) are the highest in Europe and among the highest in the world
- Unemployment at 5.3% is close to record lows
- New bank loans have fallen from 2012 levels but will rise about 15-20% this year, one of the highest levels in the world. Banks in Russia are lending money
- Inflation was at a 20-year low in spring 2012 and then popped up to 7% earlier this year but could end 2013 at about 6%; the trend is downward
- But fixed investment and industrial output have disappointed this year and exports, like most economies, are running negative (but recovered in late summer)
- At about \$510bn Russia has the third largest foreign currency reserves in the world after China and Japan and this allows protection for the rouble
- The Russian government, like those of China and Turkey, is not obsessed with austerity and is willing to pump-prime the economy and is doing so in autumn 2013
- This makes consumers confident that their government is not one of “cutting and burning” like so many in the world
- The Russian government can afford this stance because the budget deficit last year was -0.02% (!) and is close to zero (-0.5%) in autumn 2013
- Russia’s budget balance is only bettered by Sweden and Switzerland
- Russia’s financials are among the best in the world with public debt at about 10%
- In 2008-09 many Russian corporations were caught with their pants down when the rouble tumbled. Now the amount, structure and duration of corporate debt is much better: more in roubles and more long-term than short-term
- Russia remains profitable because Russian consumers appreciate quality and will spend on quality and brands when they have the disposable income
- Many companies report that their brands are holding up well in Russia
- But Russian consumers too are demanding value for money and companies are turning to affordable innovation
- Russia offers an excellent premium price market but also provides existing and future opportunities for moderate quality and discount items: “good enough to have” products and services
- Western companies have had a solid experience of being able to raise prices in Russia in recent years without losing market share but some companies question the sustainability of such pricing policies
- The demographics of the country are finally improving and quite notably
- Companies are extending their regional development strategies and going further into the 83 Russia regions
- There is tremendous scope in the regions: some 28mn middle class households (85mn people) live outside Moscow and St Petersburg

- Russia is the middle class BRIC: 68% of households in Russia are middle class (over \$16,000 annual household, income), while only 31% are middle class in Brazil, 28% in China and 18% in India
- Russia is also the third richest CEE country with median average household incomes at \$23,200 dollars

Introduction: What's the problem?

The western media portrays too black a picture of the economic and business environment in Russia.

If you do business in Russia, you will lose all your money because your business partner will steal it from you! And, you will die, because when you visit Moscow the Russian mafia will murder you in your hotel bedroom!

This is the standard view in the western media about business in Russia and it's about 97.3% wrong and inaccurate. Because of many prejudices and misconceptions, the cost of capital for Russia used to be an illogical 14-16%, which was damagingly high. Thankfully some companies are reverting to a lower discount rate of 12-13% in recent months.

This paper is designed to help country and regional managers explain the positives of the Russian market. It is clear that Russia is a good, but not easy, market. While parts of this paper will tend to whitewash the Russian market, my advice to readers is to take this whitewash, then combine it with the regular blackwash that you see daily in the western media and mix it together: you will end up with "greywash", which is exactly what Russia is.

Russia is a big, fat, normal, difficult, emerging market. It is not the Wild East and I know 200-300 western companies who run highly successful, solid-growth and high-profit businesses in a compliant fashion.

We are NOT being naïve. This is not a blind apologia for Russia and we will address some of the concerns and reservations about the market. There is no hiding for example that Russian GDP has decelerated sharply this year against a back-drop of high oil prices; industry and investment are performing poorly and structural reforms are needed. Russia, like other big emerging markets, needs to tackle institutionalised corruption.

In addition we have to add that the market is also slowing down in a number of sectors such as B2B and IT and country and regional managers are obliged to manage expectations downwards after several bumper years. The trouble is that just when global management makes more demands on the Russian results to compensate for global weakness, some sectors are falling in back in their rate of growth.

But remember this:

If you don't invest in Russia, where will you invest?

If your company has a global strategy, then Russia has to be a part of it; if your company has a European strategy, then Russia has to be a priority in any growth strategy.

Part 1: Business and market dynamics

1. Russia is the largest market in Europe, with 142m people

The demographics have improved remarkably in the last 7-10 years with the average mortality for Russian men rising from a pitiful 57 years a decade ago to 63 years in 2011 (while average mortality for white men without university education in the US has sunk to 67 years over the same period!).

If current trends continue in the next 10 years, then by 2022 the average Russian man will be living longer than the average white American male (without university education).

Life expectancy in Russia has now reached 75 for women (the same as in China; in Brazil it's 77). The overall death rate has also fallen from a high of almost 18 per thousand in 2000 to 13 per thousand last year (in Hungary it's 12, Poland, 10, China, 6, and Brazil, 6).

2. Russia is one of the better GDP growth prospects in Europe

GDP trends for Russia have decelerated markedly in the last 12 months but the consensus view is for 2013 to finish at about 2% with growth increasing by 2.6% to 3.4% in the subsequent 3-4 years. This ranks Russia as a relative winner in Europe.

The outlook for the Eurozone is bleak and it will only grow at best by 0.5-1.2% annually over the next five years. Core CEE is struggling in its wake with projected GDP of about 2.0% to 2.4%.

Global factors have pulled down Russian growth in recent months along with the emerging market wobble this summer due to potential rises in US interest rates. Slower global trade has reduced Russian exports with negative impacts on industrial output. But Russia does suffer from structural issues of its own and these are reflected in weaker investment. But, as we note below, the Russian government is one of only a few willing to react with pump-priming thanks to its solid budget position.

There are mid-term risks out there: if investment does not rebound and/or if shale gas starts to knock oil prices down below \$90 per barrel, then the growth and currency outlook will deteriorate sharply.

3. Russia is the best sales growth market in Europe

While western Europe becomes a market where sales are flat or rising a mere 1-2%, and with sales in CEE invariably in LOW single-digits for 80% of all companies operating across all sectors, Russia will retain good sales potential in 2013 and for several years. None of our Group members foresees flat/negative sales in Russia in 2013, whereas this percentage rises to 5-20% of members across the rest of the CEE region.

For 55-60% of consumer product and pharmaceutical companies, Russia is shaping up as a growth market of 6-12%. In the B2B sector, which is weaker globally, 48% of firms expect single-digit growth in Russia, but 52% foresee average double-digit sales growth of about 12-16%.

Russia is a market where 50% of companies are still able to manage double-digit growth and where the rest are growing in HIGH single digits.

In terms of the rate of organic top-line sales growth across sectors in the CEE region, Russia ranks as follows:

	2013	2014
All sectors	1	1
Consumer products	2	1
Food & beverages	1	2
B2B	1	1
IT	3	2
Pharmaceuticals/health	1	2

Source: CEEMEA Business Group, Business Benchmarking Survey, June 201

But this applies to the rate of sales growth only and when you consider the volume of the market, then Russia stands always in number one position.

Bear in mind: for most manufacturing companies Russia accounts for 85% of CIS revenues, Ukraine accounts for 10% and the remaining markets take 5% (with Kazakhstan some 4% of that). There are some exceptions in the food & beverages sector to these proportions, but these numbers apply to hundreds of western companies.

Downward risks have increased in 2013 and some sectors face different challenges of tariffs, excise duties and regulations such as tobacco, beer and spirits and these segments are growing in low single digits.

4. Western companies sell on average 6-12 times more per capita in Russia than they do in China and India

With their much larger populations, sales volumes in China and India can match or exceed the business in Russia, but not on a per-capita basis.

5. Russia is one of the best profit markets in the world

Because companies can invariably charge premium prices and raise prices to consumers, Russia ranks among the top three profit markets in the world and in Europe for around 80% of companies. We have seen some growing pressure on profits lately but this still applies to only 10-15% of companies.

Return on Equity by sector, 2013 estimates

	Russia	Europe
Chemicals	19	14
Base metals	22	17
Transport	16	7
Consumer products	20	17
Banks	15	3
Media	18	13
Retail	16	13
Telecom	15	14
Energy	14	14
Steel	6	1
Real estate	5	-2

Source: Citi Research

The huge importance of the Russian market is shown in that some major companies report that this market accounts for 15% of their global sales and for as much as 30% of their global profits. These are not typical numbers but they do apply to some significant manufacturers in several sectors.

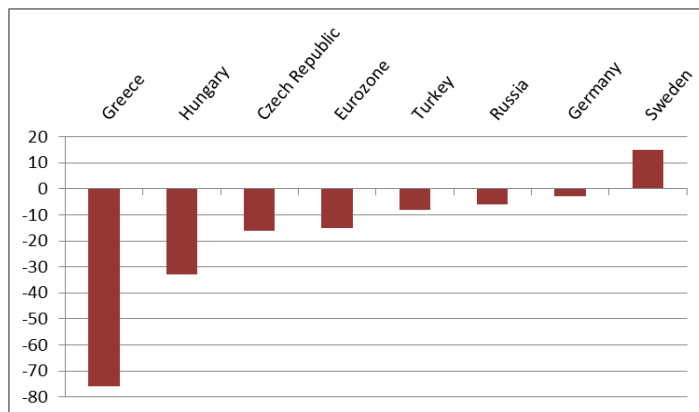
6. Consumers are among the most confident in the world and by far the happiest in Europe!

Consumer confidence in Europe plummeted in autumn 2011, then stabilised at weak levels across the entire continent: people got used and accustomed to being very miserable. However, in recent months there has been some noticeable improvement as the Eurozone’s economy has at least turned the corner.

The Russians have been relatively very confident over the last three years and today rank the third most upbeat nation after the Swedes and Germans.

In the chart below, a score of zero reflects very strong consumer confidence and a positive score reflects very happy people indeed! A score of -15 or lower indicates a strained and negative consumer outlook.

Consumer Confidence Indicators August 2013



Sources: Eurostat; Rosstat

7. If you think you have problems in Russia, then phone a colleague somewhere else

The markets have slowed; executives talk about a “new/slower normal” which has to be communicated to headquarters. Many executives expect this slower trend to continue for 6-15 months.

But as the snows start to fall in Moscow, if a Moscow-based western executive is feeling sorry for him/herself, then all they need to do is pick up the phone and talk with their colleagues in New Delhi, Istanbul, Rio de Janeiro, Mexico City or Djakarta. After chatting for 15 minutes about economic, business and currency trends, the Moscow manager can put the phone down and really feel very much better!

The relative success of the Russian market is conveyed in recent remarks from the regional director of one major service company:

“Some 80% of our business in CEE is now coming from Russia. The CEE region as a whole is very challenging and south-east Europe is almost dying for us. We are not closing offices there but we are almost freezing them and transferring the staff to Russia or using the staff to work on Russian projects.”

The regional manager of another global service sector player echoed this thinking last week in Vienna:

“If current trends continue, we will have to let some staff members in CEE and SEE go, or transfer them to Moscow where the business is.”

8. Russia is the second-largest automotive market in Europe (2.7m in car sales in 2011, behind Germany with 3.1m)

On current trends Russia will be the largest market in 1-2 years. In fact monthly sales in August this year in Russia topped those in Germany (as both markets slowed): August sales in Russia were reported at 235,000 while German sales came in at 215,000.

9. Russia will be the largest consumer products market in Europe in 10-12 years' time

10. It is the largest mobile phone market in Europe today, with a saturation of 230m phones (compared to 100m in Germany)

11. Companies can still hope (just) to double the business in five years

While top-line sales are among the best in the world, several sectors are reporting slowdowns in the rate of growth, e.g. in the IT sector from 40% in 2011 to 5-10% in 2013 and in B2B from 35% to 10-18% in 2013.

But Russia is still one of the very few markets in the world where companies in some sectors can double the business in 5 years, i.e. grow at 20%+ per annum.

Admittedly this is now more the case for small companies without sizeable market share and is confined to some sectors and depends on investment. But even with these provisos, it is a true statement and makes Russia quite distinct. The recent deceleration does make this target just that harder to achieve.

12. Russia is becoming a strategically important market for a growing number of companies

Given trends in developed markets and in the neighboring CEE region, Russia stands out as a growth market. Companies from Western Europe and the US are reviewing their Russia options more closely. For most of the major global MNCs it is already in the top three, five or 10 global markets for expansion and priority.

After major acquisitions for companies like Danone and PepsiCo, Russia ranks as their No 1 or 2 markets in the world, with multibillion dollar sales.

For companies such as Japan Tobacco International, Tele 2, Raiffeisen and OTP Bank, the Russian market represents a significant share of global profits.

For Oriflame, it makes up more than 50% of global sales.

For Inchcape, Oriola and Gedeon Richter, it accounts for a sizeable proportion of global sales.

For Metro, Scania and MAN, it brings in a solid part of global sales.

13. There is huge scope for further market penetration and brand development

In comparison with the EU market in 2011, several sectors in Russia have minimal levels of penetration given population and capacity:

Less than 5-7%	Mortgages, credit cards, office space per capita, health spending per capita, retail loans as % of GDP, container traffic, retail space, hypermarket space
Less than 30%	Broadband, smart phones, cars per 1,000 population, quality housing in square metres, supermarket space
Less than 60%	Internet usage, corporate loans
100% or more*	Cigarettes, alcoholic spirits, beer consumption, meat, cement, media spending as % of GDP, mobile phones

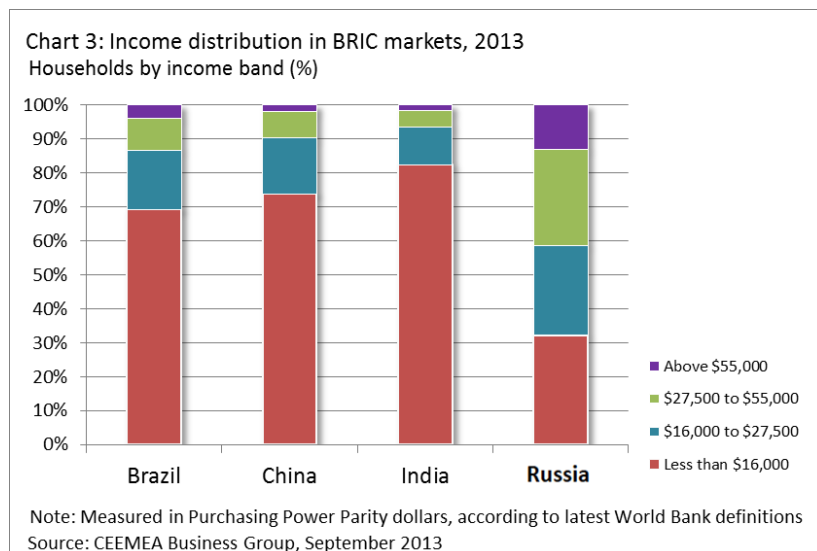
Source: Citi Research

*Perhaps Russians consume too much of the wrong stuff!

14. Russia is the middle class BRIC

This is proven by the fact that western companies sell so much more per capita in Russia than in China and India, and noticeably more than in Brazil.

Income distribution in BRIC markets, 2013

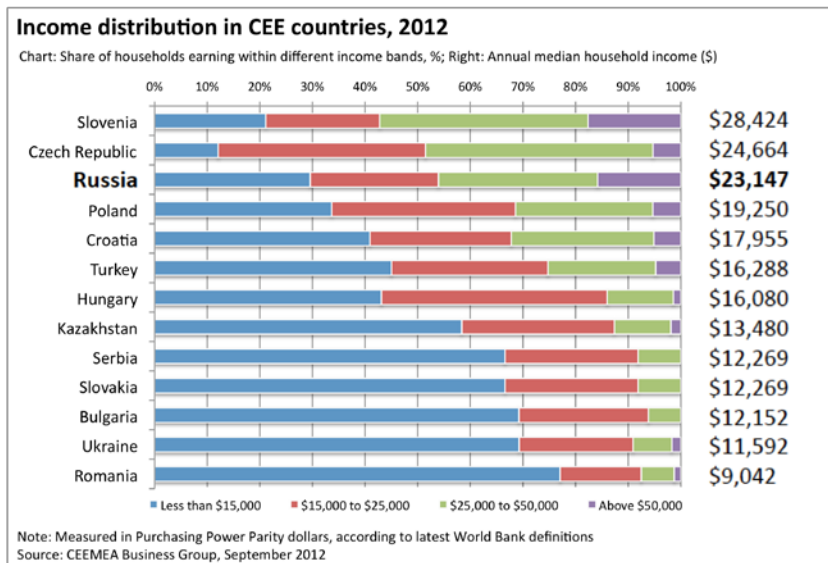


Based on \$16,000 annual median household income as defining a middle class household, then in Russia fully 68% of households are middle class, whereas this segment represents only 18% in China, 18% in India and 31% in Brazil.

Wealthy households are more predominant in Russia compared with other BRIC countries, with 15% recording incomes of more than \$55,000; in China this is a mere 3%, while it is barely 2% in India and is just 3% in Brazil.

These numbers mean that Russia is already a premium price market, but also has the potential for being/becoming an affordable innovation market where companies can aim at the aspiring lower middle class. There are very few markets in the world today that can combine premium market with affordable innovation opportunities.

Income distribution in CEE countries, 2012



Even within the CEE region, Russia is a wealthy economy and lies third in terms of annual median household income of \$23,147 and lags only behind Slovenia and Czech Republic (two markets which are currently struggling).

Things to know about the Russian middle class and incomes:

Did you know that net household incomes in Russia are now 18% above levels in 2008 while in core CEE markets and Brazil they are still below the 2008 level and up in India by 9%?

Did you know that Russia is the third richest CEE country with median average household incomes at \$23,200 dollars?

Did you know that Russia has almost 50% of all middle class households in the CEE region? (middle class defined above \$16,000 per household)

Did you know that 28mn middle class households live outside Moscow and St Petersburg?

Did you know that there are more middle class households in Bashkortostan than in Bulgaria and that the Krasnodar region has 40% more middle class households than all of Croatia?

Did you know that Moscow has more middle class households than in all of Hungary and twice as many as in the whole of Slovakia or the whole of Romania?

Did you know that Russia is the middle class BRIC: 68% of households in Russia, 31% in Brazil, 28% in China and 18% in India?

The rich middle class are also to be found in Russia: 76% of all households in the CEE region with household income above \$55,000 are located in Russia.

Between 2008 and 2013 3.3mn households entered the middle class in Russia and we estimate another 2.8mn will do so by 2017.

There are lots of middle class families outside Moscow, Moscow oblast and outside St Petersburg: these three regions hold 6.8mn middle class households but the rest of Russia contains 28mn households over \$16,000 income.

Admittedly the richer middle class do find themselves in the "3 Top regions" but remarkably still 60% of households with income over \$55,000 find themselves in the rest of Russia outside the main centres.

This means there are massive opportunities outside the main cities. The only issue is that these “rest of Russia” are scattered over the country. But on the plus side they tend to find themselves in 10-15 major urban centres and not scattered over the wilds of Siberia.

Many Russian regions outside Moscow and St Petersburg have more middle class households in absolute terms than most CEE countries: Bashkortostan has more middle class households than Bulgaria; Krasnodar has 40% more middle class households than all of Croatia. Moscow with 3.28mn middle class households has more such families than all of Hungary and twice as many as the whole of Slovakia or the whole of Romania. In fact 14 Russia regions have more middle class households than nearly all the entire countries taken individually in the CEE region with the exception of Poland: 21 Russian regions each have at least 0.5mn middle class households.

Russia is the middle class BRIC: 68% of households in Russia, 31% in Brazil, 28% in China and 18% in India. In absolute terms China does dominate of course but when you get to above \$55,000 Russia stands above Brazil and India in absolute numbers and is only just behind China.

15. Consumers did downtrade during the 2008-09 crisis, but less so than in other markets, and they started to uptrade more quickly than elsewhere

We have noticed some return to downtrading in 2013 which explains some of the softening in consumer spending but this is far from critical proportions.

16. Russian human resources are still among the best in the world

Russia is still one of the best markets in the world for local human resource talent and more than 90% of companies agree with this. The quality of Russian staff places it invariably among the top three to five markets in the world. The Soviet education system contributed a lot to this and of course the effects of that system are diminishing with time. Companies have reported deterioration in the quality of local staff over the years, but this still remains at the margins. Local staff now want challenges, career progression, work-life balance...and also a lot of money!

Part 2: The economy is in fair shape (but with medium-term risks)

As long as oil remains at about \$100 per barrel or above, then the Russian economy trundles along reasonably well and western companies will see their business out-perform other markets with steady, sustainable growth. Even at \$93-95 per barrel, the economy can survive. The economy does come under much greater strain below \$90 per barrel, but the country has enough reserves to protect it from the worst impacts on the currency.

The Russian economy is looking a bit twin-tracked in that consumer-related indicators (wages, unemployment, retail sales, and household consumption) are performing relatively stronger than industrial/manufacturing output and fixed investment and this weaker performance stems in part from negative exports.

17. Russia's GDP has performed well during the last three years among BRIC markets

China is going through a managed downturn, which is causing concern among western CEOs; India has had a desperate 18 months with GDP falling to a 10-year low; and Brazil has struggled as a consequence of weaker exports to China. Comparatively, Russia has survived but with growing disappointment through 2013. The trend is reflected if we look at the fall in the rate of GDP growth for the BRIC markets and Turkey since 2010:

GDP growth and decline in growth 2010-12, %

	2010	2013	fall in GDP growth in two-year period
China	10.3	7.5	-2.8
India	8.4	5.0	-3.4
Brazil	7.5	2.6	-4.9
Turkey	9.8	3.3	-6.5
Russia	4.3	2.0	-4.3

18. GDP per capita is 2-8 times that of China and India

At current US dollar exchange rates, GDP per capita is two-and-a-half times that of China and more than nine times that of India. Even accounting for differences in costs of living it is twice that of China and four times that of India!

GDP per capita in 2013

	Russia	China	India
In US dollars	\$14,200	\$6,100	\$1,500
In PPP dollars*	\$18,000	\$9,300	\$3,900

* Accounts for differences in cost of living, Source: IMF

19. Russia has one of the best budget balances in the world

The budget balance was -0.02% last year (that's zero!) and is running close to zero in August 2013. We expect the deficit to increase to about -0.6% with some extra spending in the last quarter. Such a deficit compares with -10% in Japan, -3% in the Eurozone, -5% in the USA and UK, -7% in India and -2% in China; only Switzerland and Sweden are in better shape than Russia.

This has huge business consequences because the Russian government has the CHOICE whether to increase spending or not. In fact, a very public debate is currently taking place about future budget spending with some government ministers, as well as President Putin, calling for more public/social and infrastructure spending. We also expect the government to dip this autumn into the two major welfare funds (totaling about \$160bn) in order to prop up infrastructure spending.

This makes Russia a positive exception in a world where some 80 governments are planning continued austerity packages of slashing expenditure and destroying public and private consumption.

20. New bank credit growth is one of the strongest rates in the world

Russian banks are lending, unlike in some 70 other markets of the world. New bank credits are down -2% in the Eurozone and growing just 1-2% in most developed markets and in much of CEE. Banks are not financing any recovery. Other markets where bank lending is up 15-20% include China, India, Brazil and Turkey. This testifies that bank lending is one prerequisite for GDP recovery.

In Russia new lending is very strong: bank lending to consumers was rising 38% in 2012, with lending to corporations up 20%. New bank lending is trending downwards in Russia, which is applauded by the Central Bank: we expect new lending to slow to an average rate of 20-25% this year to consumers and to about 12-15% for corporates which are of course still very solid numbers.

21. WTO entry last year will be a positive, but perhaps not a big, quick one

Estimates suggest that the growth potential could amount to an extra 0.2% to 0.5% addition to annual GDP growth, providing the Russian government adopts the right attitude and legislation: average tariffs will fall, trade ought to increase, Russian companies ought to see improved allocation of resources to stay competitive,

and portfolio inflows should rise. Eventually WTO entry could reduce the cost of capital (as imports will be cheaper). But most companies have factored WTO accession into their planning and most agree that big, positive short-term impacts will be limited.

22. Inflation is under control

Inflation in spring-summer 2012 was at a 20-year record low of 3.6%. Since then, administrative and food prices have climbed upwards and inflation was rising more than 7% earlier this year but seems to be heading to 6% by December 2013. The trend in the next 18 months will be for softening to about 5.5% in 2014-15. There are few inflationary threats. .

23. Thanks to its energy earnings, Russia will retain a positive current account balance of 3.0% this year and 1.5% next year and China is in the same ball-park but India suffers from a deficit of minus 4-5%.

24. Russia holds the third-largest hard currency reserves in the world

Russia's FX reserves currently amount to \$510bn, and the Central Bank also holds some \$150bn in domestic reserve funds. As in 2008-09 it can turn to these funds to protect the rouble.

25. Unemployment, at 5.3%, is one of lowest rates in Europe

26./27./28. Russia usually ranks the lowest and BEST in the world for the following indicators:

Lowest level of household debt	Russia, 8% of GDP (Germany 65%, UK 100%, Netherlands 120%)
Lowest level of government debt	Russia, 8% of GDP (Sweden 39%, Poland 55%, Germany 80%, UK 93%, Italy 133%)
Lowest level of corporate debt	Russia, 48% of GDP (Poland 80%, Germany 160%)

But a word on the Russian economy during any future global crisis

Our central scenario is that the global economy outlook will muddle through the next 3-5 years, avoiding a deep major crash because the major central banks of the world will pump in unlimited liquidity and buy unlimited amounts of sovereign bonds under threat.

As we argue above, Russia's economic position ought to protect it in any worse global crisis, but this is not the track record.

The weakest link in the Russian economy in 2008-09 was Russian corporate borrowing abroad: Russian companies did not use Russian banks for loans, the rouble crashed and they were caught with their pants down – essentially the Kremlin bailed them out. The very good news is that Russian corporate debt held with western banks as a proportion of GDP has diminished significantly, and the structure of corporate debt is much better (i.e. more long-term than short-term). Does this mean that Russia will ride out the next global crisis with ease? Unfortunately not. When any global crisis occurs, output slumps, and the oil price with it. The western financial markets then attack Russian assets and the rouble. Thus Russia will have a roller coaster crisis again, but perhaps marginally less volatile.

Executives should note that the Russian Central Bank has warned that in any future crisis it will let the rouble fall more than it did in 2008-09. This is bad news for executives and in this unlikely global scenario, executives would face a few uncomfortable weeks as the rouble fell to 34, 36 or 37 to the US dollar. The Russian Central Bank will not be focusing on the FX wishes of western companies. But there is significant good news in that the Bank also has the option thanks to its FX reserve levels to choose when to step in to hold the currency at a line of its own choosing. Many other emerging markets do not have this option and can only protect their currency with brutally high interest rates which further damages their economies.

The rouble outlook

The rouble seems to have become detached (temporarily) from the oil price! The rouble and emerging market currencies were deeply affected by comments from US Federal Reserve Chairman Ben Bernanke when he mooted the idea of less quantitative easing and eventual higher US interest rates. The financial markets over-reacted this summer and attacked all emerging market currencies including the rouble. Remarkably on August 21 the oil price rose that day by 3.4% and the rouble fell by 0.4%. Ben Bernanke was having a greater effect than the oil price on the rouble.

The markets may have started to factor in eventual higher US rates and we are witnessing some appreciation among EM currencies including the rouble during September.

The rouble has fallen less than other major emerging market currencies: this year the rouble has fallen about 10% against the US dollar but the currencies of India, Indonesia, Turkey, Brazil and South Africa have collapsed by 12-19%. The rouble is also protected by its positive current account balance (+3-4%) and its almost balanced budget (-0.6%). Other markets such as Turkey and India do not have these luxuries and suffer from severe double deficits in the range of -3% to -6%.

We mentioned above the two big points about the rouble: in any global crisis the Central Bank will let the rouble fall (bad news) but it has the funds to protect the rouble at a level of the Bank's choosing (good news).

What's less good or needs to be better understood?

The oil price

The oil price is the biggest potential threat to business in Russia and we have addressed that above. It goes without saying that if the oil price sinks below \$90 or \$80 per barrel, then Russia's economic situation deteriorates badly. But if oil ever sinks to these levels, it means the global economy is crunching downwards in tandem.

There are risks for the Russian economic and political outlook, but most of these now stem from abroad, such as the threat from the Eurozone, the US fiscal cliff, and the Middle East.

And shale gas is the biggest potential game changer of all. The Russian government and companies such as Gazprom must accelerate contingency plans for lower energy prices possibly kicking in from the end of 2014/2015.

Politics

Politics has changed in Russia since December 2011 and the fixed stability that companies were accustomed to has altered. However we do NOT envisage significant political risk in Russia. We do not foresee significant social strife (unless there are irrational government knee-jerk reactions) given that the government has the resources to pump-prime the economy in the next 1-2 years and has done so effectively in recent years with more social spending directed at mothers, pensioners, teachers, civil servants and military personnel, all of whom represent significant political constituencies for the government. This financial cushion for its political constituents combined with a socially conservative program proves popular.

The Russian administration (like that in China) has aimed for:

- Stability
- High GDP growth
- Solid consumer spending (to buy-off the middle class with consumer goods, property and foreign travel)
- A nice amount of nationalism to make the country look strong

Putin has been a lucky politician because when he arrived in 2000, oil prices started to rise as well.

The authorities are also tapping into a socially conservative vein within Russian society and combining government support for religious orthodoxy and socially conservative programs along with pro-nationalist policies. Such programs often draw negative commentary in the western media but less so in the Russian heartlands.

But a major factor which alienates a very large proportion of the population, including the above constituents, is corruption: institutionalised corruption at most layers of society is frustrating and angering the majority of people. Poorer people, who have benefited from social policies, still see officials cream off fortunes in corrupt practices. Small, petty corrupt actions by junior officials and police officers alienate people daily. And the educated middle classes are dissatisfied when they see manifest corruption. The middle class has done well in Russia but they want something better from the state than daily graft and malpractice.

Corruption/compliance/ethics

Corruption and non-compliant activities have diminished consistently every year over the last 10 years. The business operating environment for western companies has improved in terms of distribution and cross-border customs, etc. The environment is not perfect, and paperwork and bureaucracy is endemic in the system. But the consensus is that western companies, by following their global compliance programs and taking advice from their legal and accounting partners, can run successful and compliant businesses in Russia. There are some sectors such as aerospace and clearly the energy sectors where political/commercial risk enters the equation, but this is not the norm in other business sectors. The trend of diminishing malpractice may have slowed or stabilised this year given the solid improvements of the past.

What we say above applies to western companies, but Russian ones are not always so fortunate and cannot rely on western compliance procedures. They can face a variety of extortion approaches.

Capital flight (good news, bad news)

Much is written about so-called capital flight, presenting the image of millions of people walking across the border with suitcases stuffed with dollars or pressing a button on a computer bank console to transfer funds. Official numbers for capital flight in 2011 were \$84bn which then fell to about \$55bn in 2012 and is expected to rise again to some \$75bn or more this year. But when you look more closely at the definition of these numbers you find that such transactions as Russian corporate debt repayment to foreign banks and transfers to finance legal cross-border M&A activity is included. We therefore conclude that at least 50% of so-called capital flight is normal business financing. That's the good news. On the downside of course is the fact that these official numbers will not capture all the black, illicit transfers.

Demographics

The demographic profile of Russia 10 years ago was disastrous. As we note above, the picture is far from perfect, but trends are moving strongly in the right direction.

Operating environment

Russia is an expensive place to do business and real estate, advertising, logistics, warehousing and salaries are expensive. Russian paperwork is infamously time-consuming and western companies have to hire more back-office staff. As one of our Group members once famously said,

“Russian paperwork is like the Russian winter. It is there and you have to live with it and through it.”

President Putin has set ambitious targets to improve the business environment according to criteria outlined by the World Bank. Such top-level support ought to see at least limited improvements but institutionalised

corruption is a central problem which will require a change in mind-set and social as well as commercial behaviour. There is a long way to go; but you have to start somewhere.

In the World Bank's Ease of Doing Business survey, Russia is the second-best BRIC. China scores 91 in the most recent survey, with Russia on 120 (a high score is bad), but Brazil fares worse at 126 and India at 132 (for comparative purposes Czech Republic and Poland are at 62 and 64).

Ease of Doing Business Survey (World Bank rankings: a high number is negative)

	2011	2012
Russia	118	112
India	132	132
China	91	91
Brazil	128	130
Turkey	68	71