ANDREAS NEOCLEOUS & CO LLC

Advocates and Legal Consultants

DOING BUSINESS IN THE RUSSIAN FEDERATION

NEOCLEOUS

ISSN: 1986-4086

© ANDREAS NEOCLEOUS & CO LLC Revised August 2011

The information in this brochure is subject to change without notice. Application of the information to specific circumstances requires the advice of lawyers who must rely upon their own sources of information before providing advice. The information is intended only as a general guide and is not to be relied upon as the basis for any decision without verification from reliable professional sources familiar with the particular circumstances and the applicable laws in force at the relevant time.

Andreas Neocleous & Co LLC
Local and international offices

Limassol, Cyprus	Neocleous House, 195 Archbishop Makarios III Avenue, P.O. Box 50613, CY-3608, Limassol, Cyprus Telephone: +357 25 110000 Fax: +357 25 110001 E-mail: info@neocleous.com
Nicosia, Cyprus	Xenios Business Center, Archbishop Makarios III Avenue, P.O.Box 26821, CY-1648, Nicosia, Cyprus Telephone:+357 22 110000 Fax: +357 22 110001 E-mail: nicosia@neocleous.com
Paphos, Cyprus	SP Center, Offices 410-411, 17, N Nikolaidi Street, P.O.Box 61297, CY- 8132, Paphos, Cyprus Telephone: +357 26 110000 Fax: +357 26 110001 E-mail: paphos@neocleous.com
Moscow, Russia	Perevedenovskiy per., 13, Building 21, 105082 Moscow, Russia Telephone: +7 495 933 8703 Fax: +7 495 411 8504 E-Mail: russia@neocleous.com
Brussels, Belgium	Avenue Louise 475/15, B 1050 Brussels, Belgium Telephone: +32 2 669 77 60 Fax: +32 2 626 37 12 E-mail: brussels@neocleous.com
Budapest, Hungary	Balassi B.u. 25, H-1055 Budapest, Hungary Telephone: +36 1 311 3135 Fax: +36 1 354 0677 E-mail: budapest@neocleous.com
Kiev, Ukraine	24/7 Institutska Street, Office 12, Kiev 01021, Ukraine Telephone and fax: +380 44 253 4495 E-mail: kyiv@neocleous.com
Prague, Czech Republic	Betlémská 1, 110 00 Praha 1, Czech Republic Telephone: +420 222231025 Fax: +420 222231024 E-mail: prague@neocleous.com
Sevastopol, Ukraine	45 Sovetskaya Str., Ap.4, Sevastopol 99011, Crimea, Ukraine Telephone: + 380 69 255 0182 Fax: + 380 69 253 5039 E-mail: sevastopol@neocleous.com

www.neocleous.com

Contents

Introduction

The Russian Federation ("Russia") became a recognised independent state on 24 August 1991. Its creation followed the break-up of the Soviet Union ("USSR") in 1991. Russia is regarded as the successor state to the USSR and as such inherited its permanent seat on the UN Security Council, most of its military assets, and the bulk of both its foreign assets and its foreign debt. Geographically, it is now the largest country in the world occupying territory covering some 17,075,200 square kilometres. Its land mass stretches across Eurasia from Eastern Europe to the Pacific coast and it also has coastlines on both the Arctic and the Atlantic oceans. Unsurprisingly both the topography and the climate which one may encounter within Russia are extremely diverse. The majority of the country does, however, have a northern continental climate.

Russia is now a democratic federative state based on the rule of law and a republican form of government. This is enshrined in its written Constitution which was adopted in 1993. The concept of separation of powers is a fundamental principle and state power is divided between the executive, legislative and judicial branches.

The office of President is legally distinct from all branches of power but is most closely allied to the executive branch. The President, currently Dmitry Medvedev, is elected for a six year term and is limited to two successive terms in office. He has extensive powers and is primarily responsible for domestic and foreign policy and represents Russia in international relations. He has powers of decree, legislative veto and may appoint and dissolve the government. The President also appoints Russia's regional leaders from candidates submitted by the majority party in each regional district.

Executive power rests with the government, which comprises a Prime Minister, deputy prime ministers and ministers. The current Prime Minister is Vladimir Putin.

Legislative power is vested in the bicameral Federal Assembly. This consists of the Federation Council (the upper house) and the State Duma (the lower house). The State Duma consists of 450 members elected nationwide by proportional representation via party lists. It drafts legislation, can amend the Constitution and has the power to file an impeachment motion against the President. The Federation Council consists of two representatives from each federal constituent entity. One is from the executive branch and is appointed by the regional governor. The second is from the legislature and nominated by the regional assembly. The Federation Council approves or rejects laws passed by the State Dumas and appoints high court judges.

Russia comprises 83 federal subjects. These are grouped into eight districts. Each district is administrated by an envoy of the President.

Judicial power is vested in the three highest courts which are the Supreme Court, the Constitutional Court and the Supreme State Arbitrazh Court. The Supreme Court considers criminal, civil and administrative cases and acts as the highest judicial body for all lower courts in these matters. The Supreme State Arbitrazh Court is the highest court in commercial disputes. It supervises lower arbitrazh courts and issues clarifications on

interpretations of the law. The Constitutional Court is the only court in Russia with the power of Constitutional review. It functions autonomously from all other courts and whenever an issue of constitutionality of an act is raised in another court it is automatically referred to the Constitutional Court.

The legal system itself is based on statutory law.

The population of Russia is approximately 142 million people of which 62.9% are of working age. The population is slowly declining but the government is actively seeking to halt this by altering its immigration policies and through introducing incentives and programmes directed at increasing birth rates and reducing mortality levels. There are 160 ethnic groupings within the population with the dominant group being Russian (79.8%) followed by Tatars (3.8%) and Ukrainians (2%). The official language is Russian whilst English and German are widely studied as foreign languages. The study of English is compulsory in many schools. Education is a high priority for both the government and the Russian people. Consequently, primary and secondary education is compulsory, of a high standard and free to all. The success of this policy is reflected in a near 100% literacy rate and one of the highest rates of people with doctorates in the world. This well educated, highly skilled and relatively low cost workforce is a significant asset for the country.

Importantly, Russia is extremely rich in natural resources such as petroleum, natural gas, timber, furs and precious and non ferrous metals. Russia possesses more than a third of the known gas reserves in the world and its proven oil reserves account for 5% of the world total (and recent exploration results suggest that this figure will increase). The terrain of the country and the distance of many deposits from the major Russian sea ports render full exploitation of the country's resource wealth difficult. Despite this, in 2010 Russia was the world's largest exporter of natural gas, the second largest exporter of oil and the third largest exporter of steel and primary aluminium. The richness of natural resources is reflected in the dominance of commodity producers within the Russian economy and their importance to the balance of trade.

In the years following its formation Russia suffered a sustained period of economic decline as the country wrestled with the difficulty of implementing structural, political, social and economic reform of a planned economy amidst a period of political uncertainty. This included the transfer of almost 75% of the economy from the public to the private sector. From 1999 to 2007, however, the economy demonstrated a remarkable turnaround recording an average annual GDP growth level of some 7%. Key to this recovery were large price rises for Russia's main commodity exports, a devaluation of the rouble in 1998, the introduction of tax reform, a tightening of fiscal policy and significantly, greater social and political stability. The latter has been closely associated with the presidency of Vladimir Putin who first came to power on 31 December 1999. The increasing purchasing power of the Russian people during this period also resulted in a dramatic growth in Russia's retail and consumer sections of the economy.

The heavy reliance of the country on commodity exports did, however, mean that the economy was particularly vulnerable to a downturn in the world economy and the impact of the global financial crisis began to be felt in the latter part of 2008. In 2009 the economy

contracted by 7.9%. However, despite the initial severity of the crisis the country had already resumed moderate growth by the second half of the year. Preliminary figures suggest that in 2010 GDP is likely to have grown by around 3.8% and the economy has stabilised. Much credit has been given to the Russian government for taking decisive actions to safeguard the economy. The Central Bank, as part of this, implemented a well ordered devaluation of the rouble thereby averting a run on the bank and encouraging import substitution. The government also introduced rescue initiatives for the largest companies and government controlled organisations acquired some banks and financial services companies. Additionally a package of tax incentives and other programmes encouraging economic activity was adopted. One of the top priorities of the stimulus package is to encourage innovation and modernisation within the industrial sector and by doing so reduce the susceptibility of the Russian economy to volatile commodity prices.

The World Bank forecasts that Russia's GDP will grow by 4.4% in 2011 and 4.0% in 2012. The European Bank for Reconstruction and Development forecast for Russia's GDP growth in 2011 is 4.6%. The country's estimated external debt at 31 March 2011 is USD 505 billion and the government plans to reduce this deficit to zero in 2015. This is regarded as a conservative forecast by Zeljko Bogetic, the World Bank's lead economist in Russia. The Russian currency is the rouble. This is subdivided into 100 kopecks. The average exchange rates in 2010 were: EUR 1=39.09 roubles; USD 1=29.09 roubles.

Moving forward Russia is committed to a long term market-centred economic policy. Its accession to the World Trade Organisation is imminent and strongly supported by bodies such as the US Chamber of Commerce. It is now a country with much to offer prospective investors in terms of a stable political, social and financial climate, a wealth of human and other natural resources, a consumer and retail sector with significant growth potential and a desire to improve and innovate within its industrial sector.

Forms of business entity

Foreign investors seeking to operate in Russia may elect to use any of the following forms of business entity:

- A representative office of a foreign legal entity;
- A branch of a foreign legal entity;
- A partnership (with unlimited or limited liability);
- A limited liability company; or
- A joint stock company.

Formation and accreditation of most types of business organisations is governed by chapter 1 of the Russian Civil Code and the 1999 Federal Law on Foreign Investments. Joint stock companies and limited liability companies are, however, governed by separate federal laws. These are Federal Law 14-FZ of 8 February 1998 and Federal Law 208-FZ of 26 December 1995. Each form of business entity is considered below.

Representative office

A representative office of a foreign legal entity is not considered to be a Russian legal entity but rather an officially recognised subdivision of the foreign entity. Consequently, it offers the following benefits:

- Reduced administrative, taxation and state counting obligations;
- It is treated as non-resident for exchange control purposes; and
- It may be able to benefit from a relevant double tax treaty.

Importantly, however, a representative office is not permitted to engage in commercial activities in Russia. Its function is restricted to carrying out liaison and associated activities which promote and protect the interests of the parent organisation. It could therefore be viewed as a low cost method of exploring the potential market available to the parent entity.

A representative office must be officially accredited in order to operate in Russia. Accreditation is normally granted for a period of up to three years. Several bodies are authorised to grant such accreditation but the majority of applications are considered by either the State Registration Chamber at the Russian Ministry of Justice ("the SRC") or the Russian Chamber of Commerce and Industry ("the CCI"). Other bodies such as the Central Bank of Russia tend to deal with applications specific to their industry. All representative offices applying for accreditation are required to pay a processing fee of between USD 1,000 and USD 2,500 depending upon the length of accreditation required.

In order to register a representative office the CCI stipulates that the following documents are required:

1. A written application signed by the head of the parent company and sealed with the company seal. The application should include the company name, the date of its establishment, its location, the nature of its business, details of the management representing the company, the purpose for which a representative office is required, information about ties with, and proposed cooperation with, Russian partners and the actual or proposed contact details for the representative office.
2. Articles of association or incorporation papers of the parent company.

3. Registration papers or an extract from the Trade Register issued within six months prior to the application or any other evidence of the fact that the company was registered according to the adopted procedure.
4. Evidence of the company's decision to open a representative office in the Russian Federation (eg a copy of company resolution to that effect).
5. Representative office regulations that define the internal rules, rights and obligations of a representative office in respect to the foreign company. The regulations must be agreed with the accrediting body.
6. A recommendation letter of a bank serving the parent company in its own country confirming the solvency of the parent. This must have been issued within the six month period prior to the application.
7. Two recommendation letters from Russian business partners or regional chambers of commerce and industry.
8. Power of attorney for the head of a representative office drawn according to all required procedures.
9. Information about the foreign company in the form of a standard questionnaire available from the accrediting body.

A representative of a foreign company acting as its spokesman at negotiations on the opening of a representative office, should submit a power of attorney for opening a representative office, authenticated by a notary, to the accrediting body. In order to obtain permission to open a representative office outside Moscow, the parent company should have a preliminary agreement with the local executive authorities regarding its location.

If a foreign company already has an accredited representative office, it may obtain a permit for opening other representative offices by producing only the documents specified in paragraphs 1, 4, 5, and 7. The official documents listed in paragraphs 2, 3, 4, 6, 8, with corresponding seals of notary institutions of the country a foreign company was registered in, should be legalised in accordance with the Hague convention of 1961 or through the procedure of consular legalisation at a Russian consular institution, unless it is otherwise stated by the international agreements of the Russian Federation. Documents written in foreign languages must have a corresponding translation into Russian attached to them. The translation should be authenticated by either a notary public or a Russian Consulate.

In the event of the opening of a representative office, a foreign company needs to have, according to the laws of the country of its registration, a special permit from state institutions, then the copy of such permit, authenticated and legalised by a notary, should be attached to the application. A foreign company may be requested to provide additional information about its activities requested by the accrediting body. Accreditation typically takes four to six weeks although a fast track procedure which takes two weeks is available. Once it is accredited, the representative office is included in the state register held by the SRC. The certificate of inclusion in the state register confirms the official status of the representative office.

After accreditation it is necessary to do the following before the representative office can become fully operational:

- Register with the Russian tax authority;

- Register with the State statistics committee;
- Register a company seal;
- Open bank accounts in Russia. These may be foreign currency or rouble accounts; and
- Register with the Russian social benefit funds.

These tasks can usually be completed within a three week period.

Branch of a foreign entity

Similar to a representative office a branch is considered to be a subdivision of a foreign entity rather than a Russian legal entity. Consequently it offers similar advantages to those previously listed for a representative office. However, a registered branch offers the additional benefit that it is permitted to fulfil all of the functions of the foreign parent including normal commercial activities.

For this reason the creation and liquidation of branches and the monitoring of their activities is supervised by the SRC. Branches may only be accredited by the SRC. Accreditation periods may range between one and five years and can normally be extended upon the expiry of the original term.

The list of documents required for the accreditation of a branch is identical to that required for the accreditation of a representative office. The immediate post registration requirements are also identical. The statutory fee payable for branch registration is 120,000 roubles (approximately USD 4,286) with a further fee of between USD 500 and USD 2,000 payable dependent upon the number of years for which registration is sought.

Many investors new to Russia choose to make use of the branch structure because a branch is relatively easy to establish and subject to less onerous reporting requirements than are placed on Russian companies. Additionally:

- Provision of funds and assets to a branch is not subject to profits tax. Contributions to a subsidiary are only tax free if they represent contributions to capital or the provision of funds or assets to a majority-owned subsidiary; and
- The repatriation of cash from a branch to the head office is made without restrictions after corporate profits tax has been paid at the permanent establishment level. In contrast, the repatriation of cash by a subsidiary is subject to Russian withholding tax (15% on dividends, 20% on interest etc) unless exempt or taxed at a reduced rate under a double tax treaty.

Despite this it may sometimes be necessary to establish a Russian legal entity because of issues surrounding licensing, customs and privatisation of state property. The main advantage of doing business through a subsidiary with several subdivisions is the option of consolidating their profits and losses for tax purposes. Such consolidation is not allowed for branches of a foreign company unless the activities of branches form a unified technological process and special approval of the Ministry of Finance has been received.

Russian partnership

Partnerships in Russia may be unlimited or limited in nature. Both are regarded as legal entities under Russian law and as such they have an identity which is distinct from that of the individuals forming the partnership. A partnership may therefore own property, enter

into contracts and both sue and be sued in its own name. It will also be subject to regulation and taxation by the Russian state. However, a Russian partnership is not transparent for income tax purposes.

A full partnership is one in which each partner has joint and several liability for the obligations of the partnership. The liability is unlimited in scope and consequently a full partner may only be a full partner in one partnership. A limited partnership is one which is comprised of a mix of partners with "full" liability for the partnership obligations and partners who have a limited liability only. The liability of limited partners is restricted to their agreed financial contribution to the partnership and they do not participate in the management of the partnership's business activities. There must be at least one full partner in a limited partnership.

Upon liquidation of a limited partnership, including in case of bankruptcy, limited partners have a priority right ahead of the full partners to receipt of their investments from the property of the partnership remaining after satisfaction of the claims of its creditors. The property of the partnership remaining after this is distributed among the full partners and the limited partners in proportion to their shares in the capital of the partnership unless another procedure is established by the founding contract or by agreement of the general and limited partners.

Partnership is not a business form commonly used by foreign investors.

Limited liability company ("LLC")

The LLC form of business entity is popular with foreign investors seeking to establish a wholly owned subsidiary in Russia. An LLC may have between one and fifty participants. Where the number of participants exceeds fifty there is a legal obligation to reorganise within a year into either an open joint stock company (see below) or a production cooperative. It is not permitted to have a single participant LLC with a participant which is a single person business entity. LLCs are governed by Federal Law No 14-FZ as amended ("the LLC law").

Participants in an LLC have rights and obligations which are specified in the LLC law and in the LLC's own charter which is similar to a memorandum and articles of association. These include rights to participate in the management of the LLC, to access specified business information, participate in profit distribution, to sell or assign their participation interest to other participants in the LLC and to share in the distribution of assets after settlement with creditors following a winding up of the LLC. Obligations include the requirement to make contributions to the "charter" capital of the LLC. The charter capital of an LLC is the capital contribution made by its participants. The initial capital must be at least 10,000 rouble (USD 357) which is an amount linked to the national minimum wage. At the time of registration at least 50% of the capital must be fully paid up and the balance must be settled within one year.

LLC participation interests are not regarded as securities in Russian law and therefore there is no requirement to register them.

The highest governing body of an LLC is the general participants' meeting which is similar

to a shareholder meeting in a limited company elsewhere. Daily management of the business is the responsibility of the executive body which may consist of a single general director or a general director and a management council.

LLCs must register with their local tax inspectorate. The following documents are required:

1. A standard application form.
2. The protocol of the founders' meeting.
3. The charter of the LLC.
4. A copy of the passport of the proposed general director.
5. Powers of attorney issued by the founder or founders for the establishment of the LLC and for the filing of the application for registration.
6. Evidence supporting the good legal status of the founders.
7. The charter or its equivalent of any foreign legal entity which will be a participant in the LLC.
8. Confirmation that the registration fee has been paid.
9. A certificate of foreign tax registration where founders are foreign entities.
10. A bank letter confirming the good credit rating of any foreign entity included as a founder.
11. Confirmation that any foreign entity involved has contributed to the LLC charter capital.

All documents from a foreign entity must be notarised and apostilled in the country of origin and any document supplied in a foreign language must be accompanied by a translation into Russian which has a notarised certificate.

LLCs are a popular vehicle for foreign entities wishing to set up subsidiaries in Russia. This is because relative to joint stock companies they are easier to establish and finance as there is no requirement to register participant "shares". However, it does have the disadvantage that under LLC law there are a large number of issues that require a unanimous vote of all the LLC participants. This has the potential to hinder the efficiency of the business activities of the LLC.

Joint stock companies ("JSC")

JSCs are governed by Federal Law No 208-FZ of 26 December 1995 as amended ("the JSC law"). A JSC is a legal entity which raises capital to finance its activities by issuing shares. Generally the liability of a shareholder in a JSC is limited to the amount it pays for the shares it owns. A JSC may be classed as "open" or "closed". An open JSC may have an unlimited number of shareholders whilst the maximum permitted for a closed JSC is 50. All JSCs are required to maintain a register of shareholders and where the number of shareholders exceeds 500 this task must be delegated to a licensed registrar. Shareholders may be individuals or legal entities.

Each JSC must have a charter which is effectively the company foundation document. The charter must include the following:

- The name, address, and type of the JSC (ie open or closed);
- The amount of the JSC's charter capital;

- The quantity, nominal value, and categories (common or preferred) of shares, as well as the classes of preferred shares issued and distributed by the JSC;
- The rights of the holders of shares of each category;
- The structure and competence of the governing bodies of the JSC, and their decision-making procedures;
- The procedure for preparing for and holding general shareholders meetings, including a list of issues requiring either unanimous consent or a resolution adopted by a qualified majority of votes;
- Information on branches and representative offices;
- Information on the existence of any special right of participation in the management of the company (a "golden share") vested in the Russian Federation, a constituent entity of the Russian Federation, or a municipality of the Russian Federation; and
- Other provisions required by law.

The minimum charter capital of both open and closed JSCs is linked to the minimum monthly wage in Russia. Currently the minimum for an open JSC is 100,000 roubles and for a closed it is 10,000 roubles. The founders of a JSC are required to pay 50% of the charter capital within three months of registration with the remainder payable within the first year after registration. A JSC is permitted to issue shares, bonds and issuer's options. Shares may be common or "preferred" in nature. Preferred share capital may not exceed 25% of the total charter capital. In contrast to LLCs all securities issued by a JSC must be registered with the Federal Service on Financial Markets of the Russian Federation ("FSFM RF").

A JSC is required to have two governing bodies. These are the general shareholders' meeting and the executive body. An open JSC must also appoint a board of directors if it has more than 50 shareholders. Additionally all JSCs must set up an internal audit body or elect an internal auditor to oversee financial and economic activities of the JSC.

The general shareholders' meeting is the highest governing body and its status is safeguarded in the JSC law. It is required to meet at least annually. The daily management of the JSC is delegated to the executive body. The general shareholders' meeting can opt to delegate the powers of the executive body to an external commercial organisation or individual but only if such a step has been proposed by the board of directors.

The procedure for registering a JSC is the same as that for registering an LLC. The principal difference is the requirement to register issued securities with the FSFM RF. It is also possible to pledge such securities. Where a security is pledged it must be registered as such. Since 31 May 2011 the pledge instruction may specify:

- The date on which the pledgee has the right to terminate the pledge and obtain out-of-court enforcement of the pledged securities;
- The time limit for disposal of the pledged securities; and
- The documents which the pledgee is required to provide to the registrar when seeking the termination of a pledge and out-of-court enforcement of the pledged securities.

Foreign investment

Russia is keen to promote itself as a country with an attractive and stable investment climate. Political stability, rich human and natural resources and a growing domestic consumer market have all contributed to a large increase in direct foreign investment into the country. Constraints on foreign businesses are being steadily removed. However, the government has restricted access to 42 sectors of the economy which it deems to be of strategic importance and constraints exist on participation in the banking sector.

Legislative framework

The Russian Constitution, the Russian Civil Code and the laws on joint stock and limited liability companies and insolvency provide the general legal framework for trade and investment in Russia. Of additional importance to the foreign investor are:

- The Federal Law on Foreign Investments in the Russian Federation, dated 9 July 1999 ("the Investment Law") as amended; and
- The Federal Law on the Procedures for Foreign Investments in Companies of Strategic Significance for National Defence and Security, dated 29 April 2008 ("the Strategic Investment Law").

The Investment Law

The Investment Law is intended to attract foreign materials, financial resources, and technology and management skills to improve the Russian economy, by creating a stable environment for foreign investors. It states that while foreign investments should generally be treated no differently from domestic investments, certain additional limitations may be imposed in order to protect the country; the Russian constitutional system; public morality; public health; the rights and legal interests of other entities; and the security of the Russian state. The law does not apply to the investment of foreign capital in banks, credit organisations, insurance companies or non-commercial organisations. Such investment is governed by different legislation.

The Investment Law allows foreign investment in most sectors of the Russian economy. It allows for:

- Participation in the capital of enterprises established by Russian legal entities and Russian citizens;
- Establishment of enterprises fully owned by foreign investors and establishment of branches of foreign legal entities;
- Acquisition of enterprises, property, buildings, shares in enterprises, stocks, bonds and other securities and property which may be owned by foreign investors under Russian legislation;
- Acquisition of land tenure rights and rights to use other natural resources;
- Acquisition of other property rights;
- Any other investment activity which is not specifically prohibited by Russian law, including provision of loans, credits, property, and property rights.

Importantly, the Investment Law includes a number of broad protections and guarantees for foreign investors in order to assure them that their investment will be legally protected in

Russia. These include the following:

- The right of access to the Russian courts to defend their interests.
- The right to purchase stocks; participate in the privatisation process; transfer their property rights to third parties; and acquire real property.
- The right to transfer profits abroad. The Investment Law also states that foreign investors have the right to export property, electronic records and other company documents that were originally imported into Russia as investments.
- The protection that their property can be nationalised only in accordance with existing Russian law. In cases of nationalisation, the foreign investor must be compensated for the lost property and any other losses.

Additionally, Article 9 of the Investment Law introduces a tax stabilisation clause ("the Grandfather Clause") for foreign investors. The Grandfather Clause applies to the following:

- Foreign investors that are implementing "priority investment projects";
- Russian companies with more than 25% foreign equity ownership; and
- Russian companies with some foreign participation that are implementing "priority investment projects".

The Investment Law defines a "priority investment project" as a project with foreign investment of at least one billion roubles, or, where a foreign investor has purchased an equity interest of at least 100 million roubles. The investment project must also be included in a list of projects approved by the Russian government.

The Grandfather Clause states that any change in customs duties, federal taxes or contributions to non-budgetary funds that has a negative impact on a foreign investor will not be enforced until initial investments have been recouped. This guarantee applies for a maximum period of seven years unless the Russian government chooses to extend it. Key exceptions to the Grandfather Clause exist for protective customs tariffs on commodities, excise tax, VAT on domestic goods, and Pension Fund payments. The Grandfather Clause will also not be enforced if a Russian law or normative act is enacted to defend the Russian constitutional system; public health; the rights and legal interests of other entities; or the security of the Russian state. In addition, the government has yet to establish the criteria by which it will determine that a change in legislation has had a negative impact on a foreign company.

The Strategic Investment Law

The Strategic Investment Law was introduced with the intent of regulating the acquisition of "control" over Russian strategic companies by foreign investors or "groups of persons" that include a foreign investor. Acquisitions by such entities of control of strategic companies require the prior consent of the Russian government or, a post-transaction notification or, in some circumstances, both preliminary consent and post-transaction notification. For the purposes of the law "control" denotes not only a certain minimum shareholding or level of participation, but also rights to appoint management bodies and otherwise determine the company's business activity.

The Strategic Investment Law provides a list of more than 40 business activities that constitute strategic activities in Russia. These include subsoil development, nuclear energy,

space development, military and specialised equipment and natural monopolies.

Prior consent of the Russian government is required for the following where they will result in the acquisition of control of a strategic business:

1. Transactions in shares or participatory interests if as a result of such transactions a foreign investor or group of persons acquires:
   - The right to direct or indirect disposal of 10% or more of the total number of votes at shareholder level - for companies using federal subsoil plots;
   - The right to direct or indirect disposal of more than 50% of the total number of votes at shareholder level - for companies engaged in strategic activities other than the use of federal subsoil plots;
   - The right to appoint the chief executive officer, or more than 50% of the members of a collective executive body of such a company (or both);
2. The unconditional ability to elect more than 50% of the members of the board of directors or another collective governing body of such company;
3. For companies using federal subsoil plots – transactions aimed at the acquisition by a foreign investor or group of persons of shares (participatory interests) if the foreign investor or group of persons already has:
   - The right to direct or indirect disposal of 10% or more of the total number of votes at shareholder level (that is, any increase in a shareholding in a strategic company);
   - The right to appoint the chief executive officer, or 10% or more of the members of a collective executive body of such a company (or both); and
   - The unconditional ability to elect 10% or more of the members of the board of directors (supervisory council) or other collective governing body of such company;
3. Agreements resulting in the acquisition by a foreign investor or by a group of persons of rights to perform the functions of a management company;
4. Other transactions aimed at the acquisition by a foreign investor or group of persons of the right to determine the decisions of the governing bodies of such a company, including the rights to determine its business activities; and
5. Transactions aimed at the acquisition by a foreign state, international organisation or organisation controlled by them, of the right to dispose directly or indirectly of more than:
   - Five percent of the total number of votes at shareholder level - for companies using federal subsoil plots; or
   - More than 25% of the total number of votes at shareholder level - for companies engaged in strategic activities other than the use of federal subsoil plots.

A post transaction notification must be given to the government whenever 5% or more of the shares of any class in any strategic company are acquired.

Foreign states, international organisations or organisations controlled by either are explicitly prohibited from acquiring control over strategic companies. The Strategic Investment Law also imposes further special clearance requirements on investment into any business by foreign states, international organisations and organisations which are under the control of

either of the aforementioned bodies. A transaction which would give any of these parties the right to control either directly or indirectly more than 25% of the total number of votes attached to voting shares in any Russian company, or to otherwise block decisions of the governing bodies of a Russian company requires prior clearance from the Russian government or the Federal Antimonopoly Service or, in some circumstances, from both.

Any transaction which is executed in breach of the Strategic Investment Law will be deemed to be void. The parties to such a transaction may be ordered to reverse all elements of the transaction and, if this is impossible to achieve, a court may rule to deprive the foreign investor of voting rights at general shareholders meetings of a strategic company with the intention of nullifying its ability to control the business.

Proposed changes to the Strategic Investment Law

The Strategic Investment Law has been criticised on the grounds that it includes too many areas which are not actually strategic in nature and also because of the high level of bureaucracy attached to it. A law intended to simplify the process whereby foreign investors can access strategic business areas was expected to be introduced in 2010 but in fact appeared to stall at the draft stage. However, the process has now been given fresh impetus by Prime Minister Putin who has in recent months firmly put his support behind the need for reform. This was notable at the 25 March 2011 meeting of the Government Commission on Monitoring Foreign Investment when he stated,

> "We need to get rid of inefficient or obviously excessive procedures and create the most favourable environment for companies that want to invest and put their expertise and resources in our economy….It is especially important that foreign partners come to us with their long-term projects and invest money in Russian businesses and new facilities ….I can add that we will also keep improving investment legislation, and so I ask the Federal Anti-Monopoly Service to expedite the submission to the government of the second package of amendments for simpler procedures with foreign investors in the strategic sectors. Our objective now is to encourage investment activity as much as we can, making it a key factor in re-establishing the national economy. Foreign direct investments will play a big role here, of course. Russia should be an attractive long-term strategic investment destination."

Other measures intended to promote investment

Production sharing agreements

One of the most recent attempts to promote foreign investment was the passage of several amendments to the Federal Law "On Production Sharing Agreements" ("the PSA Law").

The PSA Law was originally intended to attract both Russian and foreign investment into the development of Russia's natural resources such as oil, gas and gold. It was not successful primarily because PSAs could only be initiated by a limited number of state bodies in Russia.

In January 1999 and July 2001, several amendments to the PSA Law were enacted that significantly increased the number of government authorities empowered to submit laws on production sharing projects to the Russian legislative branch. These changes meant that there were an increased number of opportunities for investors to conclude

production sharing agreements. The most recent amendments provide for two alternative production sharing mechanisms and also simplify procedures for developing subsoil plots, gas deposits, oil deposits and other natural resources.

Free economic zones

USSR law allowed the creation of special free economic zones ("FEZ") within Russia and granted important privileges to companies investing in an FEZ. The registration process was simplified, and investors were afforded a special customs regime as well as lower taxes for import and export of their goods. The legal status of an FEZ following the dissolution of the USSR was, however, uncertain until July 2005 when the Russian government adopted a specific law on "Special Economic Zones". This law created four types of zone: industrial, technical-innovation, tourist-recreation and port. It should be noted that these special territories generally have not proven to be a strong vehicle for attracting foreign investment.

Regional legislation

Some regions have made special efforts to introduce favourable conditions for foreign investment. When considering investing in Russia, in addition to reviewing the applicable federal legislation, potential investors should also examine regional laws.

One of the most progressive regional foreign investment laws was approved in the St. Petersburg Region in June 1998. This law was designed specifically to increase foreign investment in the region and contained loan guarantees and several tax incentives. Other pro-investment regions include Samara, Khabarovsk, Novgorod, Saratov and Nizhnii Novgorod. These regions of the Federation have all attracted significant amounts of foreign capital and highlight the need for foreign investors to review the relevant local legislation before making a final choice of location.

International trade agreements and associations

Russia inherited 14 bilateral investment treaties from the USSR: with Austria, Belgium, Luxembourg, Great Britain, Germany, Italy, Spain, Canada, the People's Republic of China, Korea, the Netherlands, Finland, France and Switzerland. They were ratified in 1989-1990 and came into force in 1991. Russia has since negotiated another 34 agreements, of which 20 have so far been ratified: with Greece, Cuba, Romania, Denmark, Slovakia, the Czech Republic, Vietnam, Kuwait, India, Hungary, Albania, Norway, former Yugoslavia, Italy, Lebanon, Macedonia, the Philippines, Egypt, South Africa and Japan.

Restrictions applied for import and export

While every product may be imported or exported, the import and export of certain items is restricted to those possessing appropriate licences. A licence from the Federal Customs Bureau at the Ministry of Economic Development and Trade of Russia is required for the importation of alcohol, weapons and explosives, radioactive materials and waste, cryptographic equipment, precious or semi-precious stones and certain other goods.

Similarly, pharmaceuticals may only be imported with the permission of the Ministry of Health and Social Development of Russia.

A "passport of transaction" – a document of currency control issued by the importer's or exporter's bank should be presented to customs. This contains financial details of the products being imported or exported.

Goods must be certified as meeting appropriate standards and safety requirements. The Federal Customs Bureau requires a safety certificate to accompany imported consumer goods and to be presented at the time of customs clearance.

The banking system

Overview

Russia's banking sector suffered much less from the world's financial and economic crisis than many emerging and most developed markets. By October 2010 Moody's had upgraded its outlook to "stable". An important factor in enabling the sector to withstand the global shock was a significantly lower leverage level and low international wholesale funding exposure level. At the beginning of 2008, the ratio of assets to equity for Russian banks stood at just eight. This compared to 38 for European banks and 31 for American banks. Foreign borrowings accounted for just 20% of total assets. During the crisis, only 18 banks failed and none of them was of a sufficient size to affect the stability of the banking system as a whole or of any particular market segment.

The penetration of banking services is, however, very low in comparison to the levels seen in both developed and emerging markets. Mortgage loans are a mere 3% of GDP, compared to more than 50% in developed economies. Approximately 80% of the market is controlled by the 30 largest Russian banks. Only one of these banks, VTB, provides a full range of financial services, from commercial to investment banking. During the crisis, VTB received significant support from the government, using government funding to finance development, including its investment banking business. As a result, VTB now has an investment banking business which is world class.

Legislative framework

The Russian banking system is regulated by several legislative acts of which the following are the most important:

- The Civil Code of the Russian Federation;
- Federal Law 395-1 On Banks and Banking Activities ("the Banking Law");
- Federal Law 86-FZ On the Central Bank of the Russian Federation ("the Central Bank Law");
- Federal Law 40-FZ On the Insolvency (Bankruptcy) of Credit Organisations;
- Federal Law 177-FZ On the Insurance of Deposits of Individuals in the Banks of the Russian Federation; and
- Federal Law 115-FZ On Combating Money Laundering and the Financing of Terrorism ("the Money Laundering Law").

The system consists of the Central Bank of the Russian Federation ("the Central Bank"), which is the head of the system, credit institutions, their branches and representative offices of foreign banks. As of 1 January 2011, there were 955 banks in Russia. The Central Bank sets and pursues a single state monetary policy and exchange rate policy; manages currency circulation; acts as the lender of last resort for credit institutions and manages the bank refinancing system; sets the rules for conducting banking operations; manages most categories of state budget accounts; issues licences to, regulates and supervises all credit institutions in Russia; and promotes and monitors the proper functioning of payment systems.

The Banking Law distinguishes between bank and non-banking credit organisations and the

name of any credit organisation must make clear its legal form and include the words "bank" or "non-bank credit organisation" as appropriate.

Banking activities

A bank is a credit organisation that has the right to carry out general banking activities including:

- Taking of demand or fixed term deposits from individuals and legal entities;
- Investing funds deposited by depositors;
- Opening and maintaining bank accounts for individuals and legal entities;
- Checking payments ordered by individuals and legal entities, including those of correspondent banks, within their bank accounts;
- Collection of cash, bills, payment documents and cash services for individuals and legal entities;
- Buying and selling foreign currencies;
- Taking precious metals in the form of deposits and investing them;
- Providing bank guarantees; and
- Providing money remittances on the instruction of individuals without opening a bank account (excluding postal remittance).

In addition banks may also:

- Provide financial guarantees to third parties;
- Acquire the right to demand payment from third parties;
- Manage the property and finances of legal entities and individuals as a trustee;
- Participate in transactions involving precious metals;
- Rent a dedicated space, or a safe (safety deposit box) within such a space, for storing documents and other valuables;
- Conduct leasing operations; and
- Provide consulting and other information services.

A non-banking credit organisation may only perform a limited number of specified banking operations as specified in its licence.

Licensing

The Central Bank is responsible for supervision of the commercial banking sector and all credit institutions in Russia must be licensed by the Central Bank in order to carry out banking activities. The type of licence depends on the requirements of the applicant and on the operations it is planning to perform. The licence granted by the Central Bank makes it clear what activities may be carried out. Carrying out banking activities without a licence is a criminal offence.

The licence is not limited in time. It may be withdrawn if the banking operations stipulated by the licence are not begun more than a year after issue. The Central Bank may also refuse to issue a banking licence in the event of any of the following:

- Non-compliance of the application documents with Russian legal requirements;
- The unsatisfactory financial standing of the founders of the credit organisation, or their failure to perform their respective obligations in relation to the federal budget, the budgets of constituent entities of the Russian Federation or local budgets;

- The failure of a nominee for the position of chief executive officer or chief accountant of the credit organisation (or their deputies) to meet the qualification requirements, or an unsatisfactory business reputation of a nominee for the position of a member of the board of directors of the credit organisation.

Foreign involvement in the banking system

The Banking Law permits a foreign bank to open a representative office or a local subsidiary office in Russia.

Representative office

Representative offices of foreign banks are accredited by the Central Bank. The initial accreditation is normally for a three year period. Renewal of the accreditation can then be sought an unlimited number of times. Permission to open a representative office will generally be granted to a foreign bank which satisfies all three of the following criteria:

- A history of at least five years' operations in its home country; and
- A good reputation in the banking system of its country; and
- A stable financial position.

Confirmation of the foreign bank's compliance with these criteria must be supplied by the relevant supervisory body in the home country. The Central Bank has supervisory powers over representative offices and these include the discretion to close a representative office at any time.

Representative offices have limited legal capacity. They are allowed to study the economic situation and standing of the banking sector of Russia, to maintain and develop contacts with Russian banks, and to develop cooperation on an international basis. The representative office may not solicit new clients for the foreign bank but it may provide consultancy services to existing clients.

Foreign owned local subsidiary

A foreign bank may establish a subsidiary in Russia in the form of a Russian legal entity (a JSC or an LLC) (see Section 2). The basic requirements are as outlined for representative offices above.

The direct participation of foreign banks in the Russian market is subject to certain restrictions. The prior approval of the Central Bank is required before a non-resident can acquire 20% or more of the shares in a Russian bank or non-banking credit organisation. No prior approval is required for an acquisition which maintains the holding of a non-resident below the 20% threshold but the Central Bank must be notified of the purchase. A similar regulation applies to Russian residents. The minimal charter capital requirements and mandatory financial ratio requirements are identical for all banks including foreign owned subsidiaries. However, the Central Bank may at its discretion impose additional requirements on reporting procedures, approval of management bodies and permitted operations of both the representative offices and subsidiaries of foreign banks. The current requirements set by the Central Bank in relation to foreign owned subsidiaries are stringent and consequently as yet no such subsidiaries have been established.

Anti money laundering

The Money Laundering Law came into force on 1 February 2002. It is based on the recommendations made by the Financial Action Task Force on Money Laundering ("the FATF"). The objective of the Money Laundering Law is the creation of a legal framework which will prevent the legalisation of illegal revenues and financing of terrorism.

The Money Laundering Law imposes certain requirements on bank and credit organisations, professional participants in securities markets, insurance and leasing companies, postal and other entities that deal with the transmission of money or other valuables. Foremost amongst these requirements such entities must:

- Establish and implement procedures to ensure that the identity of both clients and beneficiaries of payments are known;
- Require certain information on payers in payment orders;
- Report to the Federal Financial Monitoring Service ("FFMS") on cash or deposit transactions of 600,000 roubles or more (or the equivalent in foreign currency);
- Report to the FFMS transactions with real property of 3 million roubles or more (or the equivalent in foreign currency) and all complex or unusual transaction schemes that have no apparent economic or lawful purpose irrespective of their amount;
- Identify foreign public officials and the sources of their money and other property, pay increased attention to transfers of monetary funds and other property between foreign public officials and their close relatives.

The creation and maintenance of anonymously held accounts is forbidden. The fact that information has been passed by the bank or other financial entity to the FFMS must not be disclosed to the customer concerned. The FFMS works in cooperation with its equivalent bodies in other countries.

The penalties for non compliance with the Money Laundering Law are severe. The Central Bank will automatically revoke the licence of any bank which is found to have breached the Money Laundering Law on more than one occasion in a one year period. Any individual or legal entity found guilty of breaching the law risks a fine of up to 1 million roubles and a maximum five year prison term.

Currency control

The Civil Code states that the national currency of Russia is the Russian rouble. Agreements may refer to the rouble value equivalent in foreign currency, but all transactions conducted in Russia should be made in roubles unless the law specifically permits the use of other currencies. The Russian rouble is fully convertible within Russia and the Commonwealth of Independent States. Russia has accepted the International Monetary Fund rules for the full convertibility of the rouble for international transactions, but some restrictions remain in place for the time being.

Under Russian law, both resident and non-resident companies and individuals can freely perform currency transactions, including credit (loan) transactions, securities trading, contributions to the charter capitals of foreign entities and advance payments on certain export import transactions. However, when making payments under foreign trade contracts and credit (loan) agreements between non-residents and residents, Russian residents should

comply with the requirements of currency legislation.

The main federal legislation regulating currency transactions is the Law "On Currency Regulation and Currency Control" of 2003 ("the Currency Law"), last amended in July 2008. The Currency Law sets legal bases and principles of currency regulation and currency control, the powers of regulatory authorities and agencies, and the rights of individuals and legal entities to possess, use, and dispose of "currency value" and internal securities. It also identifies liability for violations of currency legislation. According to the Currency Law, currency values include foreign currency and external securities.

The Currency Law declares the following basic principles:

- Any currency transaction which is not specifically prohibited or regulated is permitted without restriction;
- In cases of doubt, the Currency Law is to be interpreted in favour of market participants, whether residents or non-residents.

All transactions involving the buying and selling of foreign currency in Russia must be completed through authorised banks. They are deemed to be agents of the Central Bank for currency control purposes and are responsible for verifying that the transactions they process on behalf of their clients comply with the law. Such banks must have a licence from the Central Bank to conduct foreign currency operations.

Import and export transactions

The following rules apply to Russian residents only:

- In general residents must settle payments through bank accounts in authorised banks or through accounts opened in banks outside Russia;
- Russian companies must hold all foreign currency export proceeds in their Russian bank account(s);
- "Transaction passports" are required for certain transactions (external trade, loans) at Russian banks;
- Most Russian residents are prohibited from performing foreign currency transactions (the Currency Law provides some exceptions);
- The purchase and sale of foreign currency may only be performed at authorised Russian banks;
- Cash exports are subject to restrictions;
- When a Russian company or individual opens an overseas bank account in an OECD or FATF member countries they must notify the tax authorities and present regular reports on the cash flow in such accounts; and
- The operation of an overseas bank account by a Russian resident is subject to certain restrictions.

Regulation of loans

Russian residents receiving or making foreign currency loans from or to non-residents may be required by the Central Bank to use a special account or to reserve an amount of up to 20% of the loan for up to one year.

In relation to rouble loans extended by non-residents to residents, the Central Bank may

require the foreign lender to use a special account or to reserve an amount of up to 20% of the loan for up to one year. If the rouble loans are being granted by residents to non-residents, the Russian lender may be required by the Central Bank to reserve an amount of up to 100% of the loan for up to 60 days, and the foreign borrower may have to use a special account. The Currency Law allows Russian borrowers to secure long-term loans received from residents of member states of OECD and FATF by assigning export receipts collected in foreign bank accounts.

Penalties

Penalties for violations of currency regulations are provided in article 15.25 of the Code of Administrative Offences, adopted in 2002. These penalties are mainly fines. Authorised banks may also be fined for failure to submit proper documents to the authorities and deprived of their licence to conduct foreign currency transactions.

The tax system

Overview

The system of taxation in Russia has developed rapidly since the dissolution of the USSR. The Russian Ministry of Finance has overall responsibility for collecting state budget revenues and for setting tax policy. The task of actual tax collection is delegated to the Federal Tax Service which is subordinate to the Ministry of Finance. The principle legislation consists of parts I and II of the Tax Code of the Russian Federation ("the Tax Code"). Taxes within the territory of the Russian Federation can be imposed or cancelled only by the Tax Code. Taxes levied include both direct and indirect taxes. Indirect taxes account for approximately 43% of all taxes collected. The accounting period in Russia is the calendar year. Every legal entity must register with the tax authorities in each location where it has assets or conducts business. Foreign legal entities must register with the tax authorities in every location where it conducts business for a cumulative period of 30 days or more in a calendar year. It is not necessary to register separately for each tax.

Part I of the Tax Code came into effect in 1999. It sets out the general principles of taxation and mainly deals with administrative and procedural rules including those for appealing against a tax authority. Part II of the Tax Code came into effect in 2001. It deals with the procedure of calculation and payment of certain taxes such as excise taxes, VAT, individual income tax, social security contributions as well as special tax regimes. Importantly, international taxation agreements entered into by Russia have supremacy over the Tax Code and where the provisions of an agreement are in conflict with the Tax Code the provisions of the agreement will be applied.

The Tax Code is amended regularly. Taxes, duties and fees may only be altered by the introduction of new legislation. Draft laws are developed by the Duma, approved by the Council and then signed into law by the President.

In 2002 the profits tax and mineral extraction tax provisions of the Tax Code were introduced. In 2003, further amendments introduced a simplified system of taxation, a single tax on imputed income, a new chapter on transportation tax, and established a special tax regime for production sharing agreements. The corporate property tax chapter came into effect as of 1 January 2004. This was followed by chapters on water tax, land tax, and state duty in 2005. The remaining chapter of the Tax Code still under review covers the property tax on individuals, which is currently governed by the old 1991 legislation. The most significant recent changes to the Tax Code relate to the replacement of the unified social tax by social security contributions to the Russian social funds. Since 1 January 2010 employers have been required to make a deduction of 26% of an employee's salary and to remit this to the social security funds. The maximum annual taxable income is currently set at 415,000 roubles. Employee earnings in excess of this are not subject to the social funds tax. From 1 January 2011 the requirement to pay social security contributions was extended to include individual entrepreneurs and advocates or notaries engaged in private practice.

Categories of taxation

Under the Tax Code revenues are collected at three budgetary levels: federal, regional and local. The current division is as shown in the following table.

Federal taxes	Value added tax (VAT), Excise taxes, Corporate profits tax, Personal income tax and obligatory social security contributions, Water tax, Mineral resources extraction tax, Payments for the use of natural resources tax
Regional taxes	Transport tax, Corporate property tax, Gambling tax
Local taxes	Individual property tax, Land tax

All taxes are legislated at the federal level and federal taxes are applied at a uniform rate throughout Russia. In the case of regional taxes, each region has the authority to set its own rate and the proceeds received are divided between the regional budget and the federal budget. Similarly, local authorities have the ability to set the rate applied for local taxes.

In certain circumstances some categories of tax payer may opt to be taxed via one of four special tax regimes. These special tax regimes have the status of a federal tax and may provide exemptions from certain federal, regional, and local taxes. The special regimes are:

- Farmer taxation;
- Simplified system of taxation;
- Unified tax on the imputed profit for certain types of activity; and
- Taxation of production sharing agreements.

Principal taxes

The key elements of the most important taxes are summarised below.

Value added tax ("VAT")

VAT accounts for approximately 40% of all taxation income. In general in Russia VAT is imposed on:

- The supply of goods and services in Russia;
- The importation of most goods into Russia;
- Construction and assembly for in-house consumption; and
- The transfer of goods for in-house consumption within Russia provided that the costs of the goods are not deductible for the purpose of the corporate profit tax.

Since 1 January 2004 the standard rate of VAT has been maintained at 18%. A reduced rate of 10% applies for some foodstuffs and children's goods, as well as medicines, printed matter (except those of erotic content), educational and scientific goods and books. Exports are zero-rated (except oil and gas exported to CIS countries and exports of any goods to Belarus). Import VAT is recoverable if the usual VAT recovery requirements are met. However, foreign companies that are not tax registered in Russia are not entitled to recover import VAT.

VAT exemptions apply to a broad range of goods and services, including:

- The lease of premises to foreign lessees or to organisations accredited in Russia but only when the corresponding foreign state offers a similar relief to Russian entities, or when stipulated by an international treaty;
- Specified banking transactions;

- The sale of securities;
- Transactions involving medical equipment and medical services;
- The transfer of exclusive and non-exclusive rights to software, know-how, databases, inventions, and a range of other rights under a licence agreement;
- Specific research and development services;
- The sale of scrap and waste ferrous metals;
- The assignment of loan agreements; and
- The import of technological equipment that does not have a Russian equivalent.

All taxpayers are required to file VAT returns quarterly. The deadline for filing a VAT return is 20 days from the end of the tax period. Where output tax exceeds input tax the taxpayer has the option of paying VAT in three instalments in the three months following the relevant quarter. If in a particular tax period there is an excess of input VAT over output VAT, the difference can be refunded or offset against current or future tax liabilities. However, in such circumstances the taxpayer will be subject to a mandatory desk tax audit and in general any refund due will only be paid at its completion. Exceptions to this were introduced effective from 1 January 2010. A simplified procedure for VAT offset or refund prior to the tax authorities' finalisation of the tax audit is possible where:

- The taxpayer has existed for not less than three years, and the total amount of VAT (except import VAT), excise taxes, corporate profits tax and mineral extraction tax paid over the three preceding calendar years is not less than 10 billion roubles (approximately USD 333 million); or
- The taxpayer has provided a bank guarantee of an authorised Russian bank covering the full amount of the reclaimed VAT.

A Russian customer of a foreign company that is not registered with the tax authorities and is active in making sales or in providing services in Russia must withhold either 9.09% or 15.25% reverse charge VAT (depending on the applicable underlying VAT rate) from the amounts transferred to the foreign company and must itself remit such VAT directly to the state budget.

Excise tax

Excise tax is charged on imported products such as tobacco or alcohol products, petrol and cars. Excise tax is not chargeable if the goods are re-exported. There are special rules for calculation, accrual, payment, and offset for oil products.

Since 1 January 2010 excise rates for alcohol products with an ethyl alcohol content of up to 9% by volume have been increased by 20% on average. Rates for tobacco and tobacco goods increased by 40%. The rates for petrol and cars were also increased. However, the most significant increase in rates, almost threefold, affected beer with an alcohol content between 0.5% and 8.6%.

Since 1 January 2011 excise tax on the sale and import of oil products has been levied based on five quality grades. The rate on higher grade products is less than that levied on lower grade products as follows:

- Products compliant with Euro-5 and Euro-4 standards 3,773 roubles per tonne;

- Products compliant with Euro-3 standards 4,302 roubles per tonne;
- Products not compliant with any of the above standards 4,624 roubles per tonne.

Mineral extraction tax

The mineral extraction tax was introduced via chapter 26 of the Tax Code on 1 January 2002. It replaced the previous tax on restoration of the mineral resource base and the subsoil use tax payable on the value of minerals extracted. Subsoil users licensed by the state are required to make subsoil payments if they perform one or more of the following activities:

- Prospecting and appraisal;
- Exploration of subsoil deposits; or
- Construction works on an extraction site (not connected with mineral extraction).

There are minimum and maximum rates for each type of activity, depending on the territory used within the subsoil activity, rather than as was previously the case the value of minerals extracted.

The mineral extraction tax is generally calculated as the value of the mineral resources extracted from the subsoil based on the prices at which the extracted minerals were sold, subject to the transfer pricing provisions of the Tax Code, and effectively not lower than the market price. Taxpayers are required to calculate the tax base separately for each type of mineral resource extracted and pay it on a monthly basis. The rate varies widely, for example it is 17.5% for gas condensate and 4.0% for coal. From 1 January 2011 the tax rate for gas is set at 237 roubles per 1,000 cubic metres of gas and this rate is scheduled to increase in both 2012 and 2013.

Subsoil users that simultaneously meet the following requirements are granted the concession of paying 70% of the full tax rate:

- They have prospected and explored an oilfield at their own expense; and
- They were exempt from the tax on the restoration of the mineral resource base confirmed in the relevant licence issued before 1 June 2001.

Any mineral extraction tax paid is treated as a deductible expense for the purposes of calculating corporate profits tax. Oil companies may enjoy tax holidays with respect to crude oil that is difficult to develop.

Corporate profits tax

The corporate profits tax regime was significantly overhauled in 2008 with most changes being implemented with effect from 1 January 2009. The maximum tax rate for all legal entities is now 20% of taxable profits. One-tenth (2%) of the corporate profit tax is allocated to the federal budget and nine-tenths (18%) is allocated to the regional budget. A region may, for example if it wishes to attract inward investment, choose to reduce its regional portion of the rate to a figure not lower than 13.5%. Thus the possible corporate profit tax rate range is 15.5% to 20%. The taxable base is on an accruals basis.

Resident legal entities are required to pay tax on their worldwide income. Foreign legal entities are required to pay tax at the 20% rate on income derived from a permanent establishment in Russia. A reduced rate of 10% is applied for profits received from operation, management or rent (freight) of vessels, aircraft and other transport facilities or

containers (including trailers and ancillary equipment required for transportation) and related to international shipping operations. Additionally foreign legal entities are subject to withholding tax on income received from Russian sources which is not related to a permanent establishment.

Separate rates apply to taxation of dividends. Dividends received by Russian residents from Russian companies are liable to 9% tax, deducted at source. Dividends received by Russian legal entities from foreign companies. Dividends paid by Russian companies to foreign organisations are generally taxed at the rate of 15%. This may be reduced based on a relevant double taxation treaty. Importantly, the tax rate for Russian holding companies receiving dividends from foreign and Russian subsidiaries is reduced to 9%. This reduces to zero if certain participation requirements are met.

Taxable income may differ from the income shown in the statutory accounts because of differences in accounting policies. Some income is exempt from corporate profits tax. Expenses are generally deductible for tax purposes provided that:

- They were incurred in the course of carrying out business and are economically justifiable;
- They are properly documented; and
- The Tax Code does not list them as "non deductible".

Some important changes to the Tax Code were introduced on 31 December 2010. These provide a new exemption from taxation of income and stipulate conditions under which unclaimed dividends may be written back to the entity's accounts as undistributed profit. Property, and property or non-property rights introduced to an economic entity or partnership with a view to increasing its net assets are now classed as exempt income. This creates opportunities for providing tax-free financing to Russian organisations by all shareholders, regardless of the size of their shareholding. Previously exemption was only available to majority shareholders and did not extend to rights in property or non-property. It was also subject to a one-year time limit, which has been abolished.

The new tax benefit also applies when:

- Net assets are increased concurrently with a reduction or termination of an obligation of the company to its shareholders or participants, if the net assets are increased in accordance with the provisions of Russian legislation or the constitutional documents of the organisation, or at the discretion of a shareholder (participant) of a company or partnership; and
- Dividends unclaimed by shareholders are recorded as retained profit of the company.

Therefore, the Tax Code now sets out exemption from taxation not only when a company records unclaimed dividends as retained profit, but also when dividends due to shareholders are allocated in full or in part to increase the company's net assets when a shareholder declines to receive them or when unclaimed dividends in respect of which the limitation period under the Law has elapsed are used for this purpose.

Personal income tax

Personal income tax is levied on the worldwide income of individuals who are Russian tax

residents (ie if they are present in Russia not less than 183 days in any calendar year) and on the income of non-residents received from sources in Russia. The general tax rate is 13%. The rate of 35% is applied to:

- Income received as winnings or prizes from gambling, contests and other events organised for advertising goods, works or services in excess of 4,000 roubles per year.
- Interest on bank deposits exceeding the discount rate set by the Central Bank of Russia on deposits in roubles or 5%, whichever is higher, for the period in which the interest is accrued or in excess of 9% on deposits in foreign currency.
- Dividends paid to residents are taxed at source at 9%. Non-residents are liable to 30% tax on profit received from a Russian source. Dividends paid to non-residents are subject to tax of 15% deducted at source.

Certain categories of income are not subject to personal income tax. These include various statutory allowances, compensation payments, alimony and certain types of gifts and material aid. Additionally as of 1 January 2009 the following were also exempted from personal income tax with immediate effect:

- Income in kind of up to 4,300 roubles per month received by employees as remuneration from small agricultural producers;
- Income in kind provided to seasonal agricultural workers by way of subsistence; and
- Compensation in cash or in kind to persons under the age of 18 as reimbursement of the cost of travel to and from a licensed place of learning in Russia is not subject to personal income tax.

With effect from 1 January 2010 significant new tax concessions were also introduced in order to encourage voluntary pension savings.

Water tax

The water tax is paid by organisations and individuals engaged in water use, for example the exploitation of subterranean water reserves and the use of areas of water for the purpose of hydro energy and timber flotation. The tax rate varies according to the water source (ground and surface water) and its location (river, lake or sea). The tax period is three months. The tax will rise steeply in the period 2011 to 2013 as follows:

- From 1 January 2011 the water tax rate will be 125% of that applied in 2010;
- From 1 January 2012 the water tax rate will be 126% of that applied in 2011;
- From 1 January 2013 the water tax rate will be 127% of that applied in 2012.

Corporate property tax

Corporate property tax is a regional tax. It is established by the Tax Code and the relevant regional legislature may set a maximum rate of 2.2%. It may also waive the tax completely. The tax is levied on the assets of Russian legal entities; the assets of foreign entities having permanent establishments in Russia or owning real property in the territory of Russia, on its continental shelf or in its exclusive economic zone. The tax base for Russian legal entities and for foreign entities operating through a permanent establishment includes fixed assets apart from land plots and certain other natural resources such as bodies of water.

Organisations which do not possess relevant assets are not obliged to submit nil returns for corporate property tax. Assets over which federal executive bodies exercise the right of

economic management became subject to corporate property tax from 1 January 2010. Assets over which they have only operational management rights are not subject to corporate property tax.

Gambling industry tax

Gambling industry tax is levied on every gambling device at the following annual rates:

- For one gambling table: from 25,000 to 125,000 roubles;
- For one gambling machine: from 1,500 to 7,500 roubles;
- For one totalizator or bookmaker window: from 25,000 to 125,000 roubles.

The gambling industry tax is levied in every region at the minimum rate or such higher rate (within the above parameters) as the regional legislature may decide.

Since 1 July 2009 only licensed premises which have permission to organise and conduct gambling in the gaming zone may offer gambling services.

Transportation tax

Transportation tax is a regional tax payable annually on registered means of transportation by registered owners of vehicles. The tax base is determined from the engine horse power, or in registered tonnes or as a taxable unit. The minimum tax rate is five roubles for every horse power of a vehicle. The regional authority has power to increase or reduce the tax rate. From 1 January 2010 the rate stipulated by the Tax Code may be increased by up to 10 times (previously it could be increased or reduced up to five times). Rates may vary according to the year of manufacture and environmental class of vehicle. Individual entrepreneurs engaged in passenger or freight services as their main activity are exempt from transportation tax on ships, boats and aircraft.

Land tax

Local authorities levy annual land tax or land rent according to the type of land and its location. There are average basic rates, which are adjusted up or down depending on the location of the land plot, its condition, status of city, infrastructure, etc. The rates are higher in Moscow, St. Petersburg, other regional centres, and oil extraction regions. Land tax rates are set by the relevant regional legislature at up to 0.3% for agricultural land and 1.5% for other types of land.

From 1 January 2010 land tax became payable by organisations and individuals having land plots which are recognised as taxable objects, on the right of ownership, permanent use or the right of inheritable life possession. Land on which individuals are constructing housing for personal use is exempt from the tax.

Tax penalties

The following tax penalties may be imposed in the event of violation of the Tax Code:

1. Non-registration or late registration with the tax authorities:
   - 10,000 roubles for missing registration deadlines;
   - 10% of income received as a result of activity conducted without registration, with a minimum penalty of 40,000 roubles.
2. Late submission of tax returns:
   - 5% of the amount due for each full or part month late;

- 30% of the tax underpaid, plus 10% of the amount due for each full or part month late beginning from the 181st day.

3. Gross violation of the rules of accounting for income, expenses and taxable objects (for example, missing source documents or ledgers, or repeated errors in accounting or financial statements):
   - 10,000 to 30,000 roubles;
   - 20% of the amount of tax underpaid (if any), but not less than 40,000 roubles in case of tax base underestimation.
4. Non-payment or underpayment of taxes:
   - 20% of the tax underpaid as a result of understatement of the taxable base or illegal actions;
   - 40% of the tax underpaid if the tax underpayment was deliberate.
5. Non-withholding or non-remittance of taxes by a tax agent:
   - 20% of the withholding tax not remitted.

In the cases above, in the event that taxpayers correct errors themselves and pay the required additional taxes, the penalties for incorrect accounting and incomplete tax payments are not assessed. Late payment interest is charged at one three-hundredth of the Central Bank refinance rate (8.25% per annum as of 1 July 2011) for each day of delayed payment of tax. There is also criminal punishment for tax evasion.

Double tax treaties

Russia has double taxation treaties in place with 77 countries and several more are currently in negotiation. Full details may be found in Appendix A. The majority of treaties are based on the OECD Model Treaty. It should be noted that as yet local Russian tax authorities lack experience in interpreting and applying the treaties and so obtaining the full benefit of them may occasionally be a time consuming process.

Competition law

Overview

The principal law aimed at maintaining fair commercial competition in Russia is the Federal Law on Protection of Competition ("the Competition Law"). The Competition Law was adopted on 26 July 2006 and has been amended on several occasions since then. The most recent amendment was in April 2010 and further amendments are expected during 2011. It is therefore particularly important for the reader to confirm the up to date position with us in respect of regulations which are of significance.

The monitoring and enforcement body for the Competition Law is the Federal Antimonopoly Service ("the FAS"). The Competition Law has extra-territorial effect. This means that its provisions extend to relations that arise among persons, inside or outside of Russia, that affect or have the potential to affect competition in Russia. The law regulates competition in both the commodities market and the financial services market. It covers seven areas which are of particular interest to foreign investors, namely:

- Abuse of a dominant position;
- Agreements and concerted actions limiting competition;
- State preferences;
- Establishment of companies;
- Mergers and acquisitions;
- Unfair competition; and
- Requirements for tenders and selection of a financial services provider by natural monopolists and various state and municipal bodies under government tenders.

Abuse of a dominant position

A business entity is presumed to hold a dominant position in a market if it has a market share of 50% or above. A business entity holding a market share of between 35% and 50% may be deemed by the FAS to be in a dominant position. However, the FAS will only take this view if the results of its own investigation into the market indicate that this does represent the true status enjoyed by the business entity. A business entity with a market share which is less than 35% will ordinarily be presumed to be in a non dominant position unless it has a decisive influence on the conditions of product circulation in the market or it has a "collective dominant position" (see below). Different criteria, as agreed with the Russian government and the Central Bank, are applied when assessing the market dominance of financial organisations.

When determining the market share held by a business entity, the FAS is likely to include that held by any group of companies to which it belongs. The group will include all persons and legal entities related by a common controlling share ownership, contractual or other de facto management control.

The Competition Law also has a concept of "collective dominant position", that is collusive oligopoly behaviour in the market by between three and five independent companies. A participant in a collective domination position may hold only 8% of the market but will be viewed as a violator if it, together with one or two other participants, has more than 50% of

the commodity's market share, or, together with up to four other participants, holds more than 70% of the commodity's market share, and such entities meet certain criteria specified in the Competition Law.

For those in either a dominant or a collective dominant position, the Competition Law prohibits any of the following activities:

1. The setting of, or the support of, monopoly high or low prices;
2. The withdrawal of goods from circulation if as a result there is a rise in the price of those goods (ie the creation of deliberate shortages);
3. The creation of discriminatory conditions that place one or more business entities in an unequal position as compared to other entities in their ability to access the market for particular goods;
4. The imposition of contractual terms that are either unduly onerous on the other contracting party or which do not relate to the subject matter of the contract;
5. The discontinuance or reduction of production of goods for which there is a consumer demand if it is possible to produce those goods on a profitable basis;
6. The unjustified refusal to enter into a contract with particular customers if it is possible to produce or deliver the relevant goods to such customers;
7. The practising of price discrimination for the same goods where it is not economically or technologically necessary to do so;
8. The creation of other discriminatory conditions;
9. The creation of barriers to market entry or market exit for other business entities; and
10. The violation of pricing rules.

The FAS has the discretion to allow activities 5, 8 and 9 if the dominant entity can prove that the positive effects of the activity outweigh its negative consequences.

The FAS has the right to order any entity holding a dominant position to divest itself of certain activities or businesses or to break up the business into separate legal entities if regular monopolistic behaviour is found to exist. Monopolistic behaviour will be deemed to be regular if the FAS finds more than two examples carried out for three or more years.

Agreements and concerted actions limiting competition

The Competition Law prohibits the "coordination of economic activities" by economic entities if such coordination may lead to the restriction of competition within a market. "Coordination of economic activities" is understood as coordination of the actions of economic entities by a third person who does not belong to the "group of persons" of such economic entities.

Additionally, under the law the FAS can outlaw agreements, transactions or other business activities (such as distribution arrangements, agency and supply contracts, technology licences, pricing strategies and marketing practices) of legal entities operating in similar markets that lead or may lead to the following:

- Fixing or controlling of prices, discounts, bonus payments and surcharges;
- Increase or reduction of prices, or manipulation of prices at auctions and tenders;
- Division of the market along geographical lines, or according to the volume of sales or purchases, the range of marketable goods, or the range of suppliers or customers;

- Restriction of access to the market or removal of other entities that sell or purchase particular products from the market;
- Refusal to deal with specific customers or suppliers;
- Imposition of contractual terms that are disadvantageous to the other party or do not relate to the subject matter of the contract;
- Setting different prices on the same goods without economic or technological justification;
- Discontinuance or reduction of production of goods for which there is a consumer demand if it is possible to produce them on a profitable basis;
- Restriction of access to the market or the removal from the market of other entities that sell or purchase particular products.

The Competition Law further prohibits other agreements between legal entities operating in the same market, including agreements between non-competing entities, which will or may result in exclusion, limitation, elimination of competition or derogation of interests of other entities. In certain cases the above-mentioned activities may be allowed if the legal entity is able to demonstrate that the benefits, including socio-economic effects, outweigh the harm, or that such agreements or business activities are permitted by federal laws.

Importantly the Competition Law allows the following "vertical" agreements between economic entities not competing with each other, one of which acquires goods or is the potential acquirer, while the other supplies goods or is the potential seller:

- Agreements that are concluded between economic entities each having a market share of less than 20% in any market; and
- Agreements concluded in written form that are commercial concession agreements.

Such agreements are however, prohibited if they either lead to resale price fixing, or impose an obligation on the buyer not to permit the sale of a competitor's products.

Agreements that are intended to limit competition are regarded as the worst form of violation of the Competition Law. Any entity which is found by the FAS to be a party to an anti-competitive agreement may be fined at a rate of between 1% and 15% of its turnover in the market to which the agreement relates. This is subject to a maximum cap of 4% of the entity's total worldwide turnover. Company officers may also be subject to individual fines and criminal sanctions.

State and municipal preferences

A state or municipal preference is the practice of granting an economic entity certain privileges over other market participants, ensuring more favourable conditions for its activity in the relevant market by:

- Transferring of state or municipal property, other objects of civil rights; or
- Granting of property exemptions.

The Competition Law permits and regulates the procedure of providing state or municipal preferences for the following purposes:

- Ensuring vital activity for the population in Arctic regions and equivalent areas;
- Carrying out fundamental scientific research;

- Environmental protection;
- Cultural development and conservation of the cultural heritage;
- Agricultural production;
- Support of small businesses engaged in high priority activities;
- Rendering social services to the population; and
- Rendering social support to unemployed citizens and facilitating employment of the population, and other purposes.

Subject to a few exceptions specified in the Competition Law such preferences are permitted provided that the prior written approval of the FAS has been obtained.

Establishment of companies

The prior approval of the FAS may be required for the establishment of a new company whose charter capital is paid by contribution of shares, participation interests or property assets of a financial organisation. Approval is necessary if the balance sheet value of the total aggregate shares, participation interests and property assets of such financial organisation exceeds an amount that is established by the Russian government from time to time.

Outside of these circumstances the founders of a new company must obtain prior approval of the FAS for the establishment of a new company if the charter capital of the new company is paid by contribution of shares, participation interests or property assets (excluding cash assets) of another non financial organisation legal entity ("Company A"), if the newly established company acquires:

- More than 25% of the shares of Company A if Company A is a JSC and the charter capital of the newly established company is paid by contribution of shares in Company A; or
- More than one-third of the participation interests of Company A if Company A is an LLC and the charter capital of the newly established company is paid by contribution of a participation interest in the Target); or
- More than 20% of the book value of the main production assets and intangible assets of any of its founders, and if:
    - The balance sheet value of the total aggregate assets of the founders and of Company A exceeds seven billion roubles; or
    - The aggregate revenue earned by the founders and Company A from the sale of goods in the past calendar year exceeds 10 billion roubles; or
    - Company A is included in the FAS register of dominant entities or legal entities with a Russian market share exceeding 35%.

Mergers

In general entities which satisfy any of the following conditions must obtain the prior approval of FAS before engaging in either a consolidation or a merger:

- The aggregate value of the combined entities exceeds three billion roubles;
- The aggregate turnover of the entities and any group of persons associated with them during the preceding calendar year exceeds six billion roubles; or
- Any of the entities is included in the FAS register of entities with a 35% or higher market share of the relevant market.

Financial organisations are subject to different notification and approval thresholds which are set by the government and linked to their total balance sheet assets.

Exceptions to the requirement for FAS approval exist where any of the following apply:

- A parent and subsidiary relationship already exists between the entities; or
- The entities are already owned by the same group of persons who have fulfilled specific disclosure requirements of the Competition Law; or
- Performance of such transactions is stipulated by the legal acts of the President or rulings of government; or
- Transactions are made with regard to shares (participation interests) of the financial organisation.

Acquisitions

The prior approval of the FAS may be required before completing an acquisition of interests, assets or rights in a Russian company.

In the case of an acquisition of a participation in an LLC there may be an approval requirement if an entity acquires a portion of the total participatory interest which is:

- More than one-third (on a first acquisition); or
- More than a half (on a first or any further acquisition); or
- More than two-thirds (on a first or any further acquisition).

In the case of an acquisition of share interests in a JSC there may be a prior approval requirement if an entity acquires a portion of the total share interest which is:

- More than 25% (on a first acquisition); or
- More than 50% (on a first or any further acquisition); or
- More than 75% (on a first or any further acquisition).

In the case of an acquisition of the right of ownership or the right to use the main production assets or intangible assets of an entity there may be a prior approval requirement if the acquired assets account for more than 20% of the book value of the main production assets and intangible assets of another legal entity.

There may also be a prior approval requirement in the case of an acquisition of rights conferring the ability to determine the commercial behaviour of the target company (including as a result of change of indirect control over a Russian target company) or of the right to perform the functions of its executive bodies.

In all these cases different conditions as set by the government apply to financial organisations. Additionally, prior notification and approval of the FAS is only mandatory if one or more of the following conditions also apply:

- The aggregate book value of the assets of the acquirer and its "group of persons" plus the target and its "group of persons" exceeds seven billion roubles and the balance sheet value of the total assets of the target and its group exceeds 250 million roubles; or;
- The aggregate revenue earned by the acquirer and its "group of persons" plus the target and its "group of persons" from sale of goods over the past calendar year exceeds 10 billion roubles and the balance sheet value of the total assets of the target

and its group exceeds 250 million roubles; or

- Either the acquirer, or any of its "group of persons", or the target, or any of its "group of persons", is included in the FAS register of entities with a market share exceeding 35% in the relevant market.

To determine the minimum value for the assets, the FAS takes into consideration not only the acquirer and the target company, but also all persons (individuals or legal entities) in the acquirer's "group of persons." The broad term "group of persons" includes all individuals or legal entities related to the acquirer as a result of controlling share ownership, or through certain management contracts, familial relations and other de facto control mechanisms.

Unfair competition

The Competition Law prohibits any actions on the part of commercial entities which, by contradicting any of the following, may cause actual or potential harm to another commercial entity:

- The provisions of the Competition Law;
- Standard business practice, or
- The principles of good faith, reasonableness and fairness.

This includes activities such as the distribution of false information about another entity and the sale of goods made possible by intellectual property theft.

Requirements for tenders and selection of a financial services provider by natural monopolists and state and municipal bodies under government tenders

The Competition Law provides a list of actions in conducting tenders which are prohibited if they lead to a restriction of competition.

Protection of intellectual property

Overview

The principal pieces of legislation governing intellectual property rights in Russia are:

- Part IV of the Civil Code of Russia (Federal Laws 230-FZ and 231-FZ dated 18 December 2006); and
- The Federal Law on Commercial Secrecy (Federal Law 98-FZ dated 29 July 2004).

Part IV of the Civil Code has, with effect from 1 January 2008, replaced or amended all previous intellectual property laws. Additionally, Russia is a party to many significant international treaties covering intellectual property rights. These include but are not restricted to:

- The Berne Convention for the protection of literary and artistic works;
- The Universal Copyright Convention;
- The Paris Convention for the protection of industrial property; and
- The patent cooperation treaty.

The existing intellectual property rights of both foreign individuals and of foreign owned business entities are therefore protected in Russia and, subject to fulfilling standard bureaucratic requirements, such parties can file for protection in Russia.

The government agency which has responsibility for the registration of intellectual property rights, the granting of patents and the issuing of the associated certificates is the Federal Service for Intellectual Properties, Patents and Trademarks ("Rospatent"). A change of ownership of intellectual property rights, or, the encumbrance of intellectual property rights must be registered with Rospatent in order to be effective.

Copyright

Part IV of the Civil Code:

- Protects works of science, literature and the arts via copyright; and
- Protects the rights of performers, phonogram producers, broadcasting and cable casting entities, compilers and publishers via "neighbouring rights".

Copyright arises by virtue of the creation of the work and there is no need to register the copyright in order to obtain protection under Russian law. Copyright extends to computer software programs and to databases both of which may be registered with Rospatent if the author so wishes.

The law divides the rights of the author of a work into the following two categories:

- Personal rights. These cover rights of authorship, public disclosure, name, reputation and of recall of the work. These rights are vested in the author and may not be assigned or transferred. These rights are protected in perpetuity.
- Exclusive rights. These cover rights of the author to make use of the work in any manner including translation rights, distribution rights, performance rights, rights to amend and rights to make copies. Such rights may be assigned or licensed via a copyright agreement which should be registered with Rospatent to ensure enforceability.

Copyright protection for all works lasts during the life of the author and for 70 years following his death. Neighbouring rights are protected during the life of the author and for 50 years from the date of publication. Infringement of a copyright or of neighbouring rights may attract civil, administrative or criminal liability. Infringers may be required to pay damages to the injured party and to recognise its rights and also to compensate for lost benefits. The courts may order the infringer to make compensation payments of up to 5 million roubles or to pay double the normal price for the right to use the work.

Patents

Part IV of the Civil Code affords patent protection to inventions, utility models and designs. Patents may be granted to individuals or to legal entities. Patent applications must be submitted to Rospatent for examination and approval. Approved patents are registered in either the State Register of Utility models or the State Register of Industrial Designs at the time the patent is issued. The granting of the patent is also publicised. Patent applicants must pay filing, registration and annual maintenance fees.

Inventions

Patent protection may be obtained for an invention if it is new, innovative and has industrial application. An invention may be described as a technical solution related to a product or a production process. Importantly topologies of integrated circuits are excluded from patent protection but are subject to protection measures under part IV of the Civil Code. In general the maximum duration of patent protection for an invention is 20 years from the date of filing for protection. Protection may be extended by a further five years where the invention relates to a medicine, a pesticide or an agrochemical and special permission is required for its use.

Utility models

A utility model is a term used to describe a technical solution relating to a tool or machine designed to perform a specific task or function. A utility model may be patented if it is novel and has industrial application. The initial term of protection granted is 10 years from the date of filing for protection. This may be extended by a maximum of three years.

Industrial designs

The term industrial design relates to the combination of artistic design and physical construction which together determine the external appearance of a product. An industrial design is eligible for patent protection if it is both new and original. Initial protection is granted for a period of 15 years from the date of filing for protection. Extension by a period specified in the original application is possible subject to that period not exceeding 10 years. The patent owner has the exclusive right to use the invention, utility model or industrial design. However, it is possible by agreement to assign or license this right to a third party. In order to be legally valid any such agreement must be registered with Rospatent. Infringement of patent rights can result in civil, administrative or criminal liability.

Trademarks

Part IV of the Civil Code provides protection for trademarks which have been registered by Rospatent. Rospatent will only register a trademark which is novel and cannot be confused with an existing trademark registered with it or in accordance with international treaties to

which Russia is a party. Rospatent will recognise marks represented by words, designs, three dimensional objects, light, sound and any combination of the foregoing. It will not allow registration of certain types of symbols such as state symbols and flags. Trademarks may be registered by individuals or by legal entities subject to the payment of filing and registration fees.

Initial trademark protection is for a period of 10 years from the date of the filing of the application. Protection may be extended for a further 10 year period provided that the application to do so is submitted to Rospatent during the last year of the existing registration. The extension process may be repeated an unlimited number of times. Trademark protection lapses if no renewal application is made.

It is possible to transfer an individual trademark to a third party via either a concession or a license. Any such agreement must be registered with Rospatent in order to be valid. Infringement of a trademark carries civil, administrative and criminal liability. Under the administrative law disputes may be resolved by the arbitrazh court, or alternatively by the Appellation Chamber of Rospatent with a right of appeal to the High Patent Chamber of Rospatent or to the court.

Appellation of origin

An appellation of origin is a geographical indication used to identify the geographic origin of certain goods. Appellations of origin are only legally protected after they have been registered with Rospatent. Registration is only possible where the specific features of a certain good for which the appellation of origin is sought are mainly or exclusively determined by natural conditions or human factors which are characteristic of the geographical area. If it is satisfied that this requirement has been fulfilled Rospatent will issue a certificate confirming the right to use the appellation of origin within one month of payment of the appropriate fee.

The right to use an appellation of origin may be granted to an individual or a legal entity. The right may be extended to any individual or legal entity residing in the same geographical location which produces goods complying with the appellation and which makes the appropriate statutory application. The initial period of protection is 10 years from the date of filing an application. This may be subsequently renewed for further periods of 10 years. There is no limit on the possible number of renewals. It is not possible to assign or license the right to use an appellation of origin. Infringement of the right may attract civil, administrative and criminal sanctions.

Topologies of integrated microcircuits

Part IV of the Civil Code grants an author legal protection for original topologies of integrated microcircuits which he or she has developed. The author has exclusive rights to use the topology as he or she wishes and to prevent use by a third party. The topology may be registered with Rospatent but the exclusive rights are legally recognised even if no registration is made.

The exclusive right to use the topology lasts for 10 years commencing on the date of its first use or the date of its registration with Rospatent, whichever is the earlier.

The exclusive rights to a topology may be assigned or licensed to a third party via a written agreement.

Trade secrets and "know-how"

The Federal Law on Commercial Secrecy ("the Commercial Secrecy Law") protects confidential information only if an entity has both established a trade secrets system and, ensured that all its employees and counterparties comply with that system.

Under the Commercial Secrecy Law and part IV of the Civil Code an item of information is a trade secret only if all the following criteria are satisfied:

- It has actual or potential commercial value because it is not known to third parties;
- Lawful access to it is restricted;
- The owner has taken reasonable steps to safeguard its confidentiality; and
- Maintaining confidentiality brings existing or potential commercial benefit to the owner.

The owner may initiate criminal or administrative prosecution for violation of the trade secrets system. Part IV of the Civil Code requires employees with access to a trade secret to maintain confidentiality until termination of the owner's exclusive right to the trade secret.

Real estate

Overview

The right to privately own real estate in Russia is contained in both the Russian Constitution and the Russian Civil Code. Specifically important in relation to property rights is the Land Code of October 2001 as amended ("the Land Code") and other federal legislation adopted further to the Land Code's provisions. Legislation in the area is still developing and consequently some discrepancies exist. In the event of any inconsistencies between laws the provisions of the Land Code prevail. Currently, for historical reasons, legislation treats land plots and buildings on them as separate items of real estate. However, in practice, the concept of land and buildings as a single item is recognised via provisions that prohibit the disposal of a land plot and a building located on such land plot separately from each other when such properties are owned by one and the same owner. Additionally, in general, where a building is located on a land plot that is state or municipally owned the owner of the building has the exclusive right to lease or buy the land plot. The obvious exception to this is where there is more than one building on the plot and they are separately owned.

Interests in real estate fall into one of the following two categories:

- Ownership – The owner has full title to the real estate including rights of possession and use, disposal rights and leasing rights. The state retains ownership of the subsoil.
- Leasehold – The lessee is granted possession and use of the real estate for a defined or in some circumstances an indefinite term.

Foreign ownership of real estate

In general foreign investors enjoy the same rights to own real estate as do Russian individuals and Russian legal entities. A small number of specific prohibitions on land plot ownership do exist for reasons of national security. Foreigner investors are specifically prohibited from owning land plots:

- In border areas (the current detailed list was approved on 9 January 2011 by Presidential Decree No 26. It includes municipal districts and cities adjacent to the border.);
- In other particular territories of Russia pursuant to other federal laws; and
- Within the boundaries of sea ports.

Additionally, the President has the right to establish a list of the types of buildings and other structures to which pre-emptive buy-out or lease rights to land plots for foreigners may not apply.

Foreign nationals, foreign legal entities and stateless persons are also, under the Federal Law of 24 July 2002 "On Circulation of Farm Land", prohibited from owning agricultural land although they are permitted to lease it. The same restriction applies to Russian legal entities in which the equity participation of foreign nationals, foreign legal entities, stateless persons or any combination of these categories exceeds 50%.

In general foreign investors may be granted leases of either land or buildings without restriction. The majority of leases are governed by the Civil Code and the Land Code. It is common for purchases of real estate by foreign investors to be structured as a share

purchase of a company holding real estate rather than as a direct asset purchase deal. This is because share deals often enjoy a more favourable tax treatment than asset deals. Currently many investments into Russia are routed via Cyprus because Cyprus has a low domestic rate of taxation and a favourable double taxation treaty with Russia.

Registration of rights over real estate

Rights to real estate including ownership, leaseholds in excess of one year duration, mortgages and any transfer or termination of such rights must be registered in the Unified State Register of Real Estate ("the Register") in accordance with the Federal Law 122-FZ of 21 July 1997 "On State Registration of Rights to Real Estate and Transactions Therewith", as amended. Long term leases and mortgages are deemed null and void unless they have been registered. The Register is a matter of public record and any person or legal entity may request access to an entry relating to a specific property. Registration is not mandatory for rights relating to real estate which existed before 1 January 1998 but registration must be completed if those rights are transferred or become encumbered. The registration process should be completed within one month and is carried out by the registration authorities at the location of the real estate. They will issue a certificate confirming the registration and the rights of the applicant in respect of the real estate.

Additionally, since the Federal Law No 221-FZ dated 24 July 2007 "On the State Cadastre of Immovable Property" ("the Cadastre Law") came into effect on 1 March 2008 all real estate property has been required to undergo state cadastral registration. Previously cadastral registration applied only to land plots. Registration is completed by the Federal Service on State Registration, Cadastre and Cartography. The State Cadastre is also publically accessible and interested parties may apply to the appropriate state authority to obtain cadastral plan copies for specific real estate.

Supreme Arbitrazh Court Resolution no 10 of 17 February 2011

Item 13 of the Resolution states that "a change of the amount or term of execution of a secured obligation, eg in view of changing the interest rate under the loan or the term of repayment of the loan, in comparison to the provision of the pledge agreement, cannot be by itself a ground to terminate the pledge". This provision is related to specific loan operations, when a pledge is granted not by a borrower, but by a third party of a deal – a guarantor (or pledgor). As a result a borrower and a bank can change the terms of a loan agreement without the pledgor's consent and thereby expose him to new risks and possibly to fraudulent schemes.

Item 13 has provoked considerable controversy because of its apparent inconsistency with basic provisions and principles of the civil legislation, namely articles 337, 339, 423 of the Civil Code and article 9 of the Federal Law "On mortgages (real estate pledge)", under which any changes to the principal conditions of a loan agreement shall be reflected in the pledge agreement, otherwise it cannot be considered contracted and cannot secure obligations under the loan agreement.

Until the situation is resolved in a manner which will protect the pledgor's rights the probability of a person providing property as a pledge is negligible and the institution of mortgaging of real estate is threatened.

Leasehold agreements

Leases may be for a fixed term or for an indefinite period which may be terminated by either party to the agreement giving three months' notice. There is no requirement to register indefinite leases or short term leases (less than one year) in order for them to be legally effective. The maximum lease term for land anywhere in Russia is 49 years, but a more typical period for a commercial lease of real estate is five or ten years. Russian law generally treats commercial leases as a matter of private concern although a limited number of regulations do apply. These are:

- Unless the initial agreement explicitly states otherwise a tenant has the right of first refusal to renew the lease upon its expiration. The renewal agreement may vary the terms of the original lease.
- Where a tenant continues to use a property after the expiration of a lease and the landlord expresses no objection the lease is deemed to have been renewed for an indefinite period on the old terms and conditions.
- Where leased real estate is sold the lease survives and the new owner assumes all the rights and obligations of the landlord.
- Where land is privately held the tenant has a statutory pre-emptive right to purchase the land if it is put up for sale and the tenant owns a building or facility on the land plot. A pre-emptive purchase right also exists on slightly different terms if the land plot is owned by the state or a municipality.
- Owners of buildings or immovable facilities on a plot of land which owned by a separate person have a statutory entitlement to right of use of the land under the building or facility.

In general assignment, sub letting or mortgage of land leased by a tenant does not require the consent of the landlord unless the lease agreement with the tenant states that consent is required. In the case of real estate other than land the position is reversed and consent for assignment, sub letting or mortgaging is required unless the lease agreement specifically waves this right.

Outside of these basic regulations there is great flexibility in the manner and terms on which commercial leasehold agreements may be drawn up.

Real estate transactions

A real estate sale is normally a two step event. The first step is the execution of a written sale and purchase agreement. The second is the registration of the change of ownership in the Register. The transfer takes effect following the completion of a standard document formally conveying the real estate from the seller to the buyer. Generally commercial real estate transactions are subject to VAT.

Employment regulation

Overview

Labour relations in Russia are subject to the "Labour Code of the Russian Federation", effective 1 February 2002 ("the Labour Code") as amended. Also significant are:

- 1996 Federal Law "On Trade Unions, Their Rights and Guarantees of Activity", as amended.
- Russian legislation on minimum wages, health and safety and other related laws and regulations.

Importantly the Labour Code establishes that Russian labour legislation is applicable to all employees working in Russia regardless of their nationality unless an international agreement stipulates to the contrary. Under the Labour Code an employer may be an individual or a legal identity and the term encompasses both foreign nationals and foreign legal entities.

Regulation of working terms and conditions

The following provides a summary of the key areas of regulation in addition to which there are also protective measures relating to matters such as sick leave and maternity leave.

Remuneration

Russian law establishes a minimum monthly wage for all workers which is adjusted on a regular basis. The minimum monthly rate at the time of writing is 4,330 roubles. Regional minimum wages are also set. These cannot be lower than the federal minimum wage. Remuneration must be paid in roubles and with a frequency of no less than twice per month.

Contract of employment

Within three business days of commencing work every employee must be supplied with a written contract setting out the terms of his employment. The contract is issued in duplicate and both copies must be signed by both parties to the contract. The Labour Code sets out minimum requirements in respect of the content of the contract including the following:

- Contracts are for an indefinite period unless specific conditions laid down in the Labour Code are satisfied which allow for a fixed term contract; and
- The duties of the employee must be clearly defined within the contract.

The employer is also required to document new hirings, job transfers, disciplinary actions, vacations, dismissals and other information relating to labour relations and safety.

Working hours

The standard working week is 40 hours. These may be worked over five or six days. Certain more vulnerable categories of employee have a lower number of standard working hours. Minimum payments for overtime work are defined in Russian employment law and the length of any working day preceding a public holiday must be reduced by one hour. Employers are legally required to keep comprehensive records of all time worked by each individual employee.

Holiday leave
There is a minimum paid holiday entitlement of 28 days for all employees. A new employee will normally only begin actually taking holiday after he has completed the first six months of his contract.

Workplace discrimination
It is forbidden to impose either directly or indirectly restrictions, privileges or salary rates on the basis of any characteristic not related to an employee's business qualities.

Termination of employment
The grounds on which an employer may legally terminate an employment contract are set out in the Labour Code and associated federal laws. Where grounds for termination do exist the employer must demonstrate strict compliance with the procedural and documentary requirements set out in the Labour Code. The Labour Code also gives additional protection to potentially vulnerable classes of employees such as pregnant women, the disabled and trade union members.

Employees wishing to terminate their employment contracts are required to give two weeks' written notice to their employer.

Social security
As mentioned in the taxation section of this brochure employers are required to make significant social contributions on behalf of their employees. There is currently no requirement for employees to contribute. There are two forms of obligatory social taxation as follows:

Social insurance contributions
The contribution to be made on behalf of each employee from 1 January 2011 is an amount equal to 34% of that employee's income. Any employee income in excess of 463,000 roubles is exempt from the payment. The contributions are allocated as follows:
- 26% to the State Pension Fund;
- 2.9% to the Social Security Fund;
- 3.1% to the Federal Medical Insurance Fund; and
- 2% to the Territorial Medical Insurance Funds.

Accident insurance contributions
A contribution of between 0.2% and 8.5% of an employee's salary is required according to the level of risk attributed to the employee's job.

These contributions apply to all payments to individuals with the following exceptions:
- Payments and allowances to foreign nationals who are classed as only temporary visitors to Russia;
- Payments and allowances made by Russian entities to foreign nationals working or conducting business outside of Russia.

Income paid to contractors is exempt from payments to the Social Security Fund and accident insurance contributions are only payable if the civil contract specifically states that accident insurance coverage is included.

Employment of foreign nationals

In general

In general there are no restrictions on how many foreign nationals an individual company can employ or how long they may employ them for. The government does, however, set an annual quota for the total number of foreign nationals which can be hired within Russia as a whole. The size of the quota is varied in accordance with the rate of unemployment in Russia.

Hiring foreign national employees requires advance planning since the employer is required to apply for a quota for work permits well in advance of any recruitment. Applications for a quota for work permits must be filed by 1 May in the year prior to the year for which the quota is required.

Having obtained a quota an employer must then obtain:

- Permission to hire foreign nationals;
- Individual work permits; and
- Work visas.

These must be obtained before the earlier of the commencement of the employment contract or the date on which the foreign national actually commences work in Russia.

Both work visas and work permits are normally issued for a one year period. Persons holding only a business visa are not permitted to work in Russia and are entitled to stay in the country for a maximum of 90 days in any 180 day period. Business visas are issued solely to facilitate activities such as contract negotiations and conference attendance.

Quota exempt professions

Each year the government produces a list of professions and occupations which are excluded from the quota total. Foreign nationals falling into these categories may be employed without reference to the quota requirement. The basis for inclusion on the exempt list is linked to perceived skill shortfalls in the Russian economy at any given time.

Foreign specialists

Highly qualified specialist employees are also excluded from the quota requirement and are also subject to a simplified procedure for obtaining work permits and work visas. A foreign national will usually be recognised as a specialist if he is paid at least two million roubles per annum. A work permit and a work visa invitation for a specialist will normally be issued within 14 business days of an application being submitted. Specialists may be issued with work permits and work visas which are valid for up to three years.

Immigration notification requirements

Notification must be given to the immigration authorities every time a foreign national enters or leaves Russia. Responsibility for making the notification may rest with that person's landlord or his employer. The notification requirement includes the travel of both employed foreign personnel and their family members. Failure to comply with visa requirements or notification requirements can result in significant fines being levied both per employee and per violation.

Voluntary liquidation and insolvency

Voluntary liquidation

A sole entrepreneur or a legal entity may only go out of business on a voluntary basis if it is able to pay all its debts and interest accrued thereon. In this case the liquidation proceedings begin with a resolution passed by a general meeting of the company. A liquidation committee or a liquidator is appointed to supervise the liquidation. The liquidation committee acts on behalf of the legal entity and represents it before the relevant bodies and in court. The liquidation committee must inform public authorities and potential creditors of the initiation of the liquidation process by post and by advertising. The committee terminates its activity after the voluntary liquidation is completed and all creditors are repaid.

The right to file an application for voluntary liquidation arises on the date of entering into force of relevant court rulings, arbitration court rulings or referee's court ruling on debt recovery.

Insolvency overview and legislative framework

Legislative framework

In general insolvency proceedings in Russia are governed by the following items of legislation:

- Part I of the Civil Code of the Russian Federation (articles 61- 65); and
- Federal Law 127-FZ dated 26 October 2002 "On Insolvency (Bankruptcy)" as amended ("the Insolvency Law").

Banks and other credit institutions are also regulated by the Federal Law "On Insolvency (Bankruptcy) of Lending Organisations", enacted in 1999 and last amended in 2009 ("the Banking Insolvency Law"). Additionally, due to their national importance, a special bankruptcy procedure was established to deal with the insolvency of natural monopoly companies and strategic enterprises. In these instances the proceedings are regulated by chapter IX of the Insolvency Law.

The recent financial crisis highlighted the fact that the existing insolvency process was not widely viewed as a reliable and transparent process for resolving debtor-creditor issues. Many creditors viewed it as an underhand process used by debtors to transfer assets and avoid creditors. This resulted in several substantial amendments being made to the Insolvency Law in 2009. The amendments were aimed at increasing the perceived transparency, fairness and robustness of the process. Key changes that were introduced included:

- Increasing the ability of a creditor to challenge a possible fraudulent transaction;
- New rules covering the duties, rights, liabilities, remuneration, expenses and qualification requirement for "insolvency managers"(see below);
- Additional rights for the creditors' meeting including the right to determine the remuneration of the insolvency manager;
- The establishment of a national union of self-regulating organisations of insolvency managers; and

- A requirement to record key information about ongoing insolvency procedures in the Unified Register of Insolvency Information.

Definition of insolvency
Bankruptcy or insolvency is the process of declaring a sole entrepreneur or a legal entity insolvent when they are unable to pay their debts. The Insolvency Law also establishes a procedure for declaring a private individual insolvent, but this is not yet in force.

Under the Insolvency Law:
- A sole entrepreneur is considered incapable of meeting the claims of creditors or of making obligatory payments if he fails to discharge such obligations or duties within three months after their due date and if the sum of the obligations exceeds 10,000 roubles; and
- A legal entity is considered incapable of meeting the claims of creditors or of making obligatory payments if it does not discharge the obligations or duties within three months after their due date and if the sum of the obligations exceeds 100,000 roubles.

The minimum debt limits are set in order to discourage frivolous attempts to start insolvency proceedings against a business which is in fact financially sound.

Initiation of insolvency proceedings
Insolvency proceedings commence with the filing of a written petition to an arbitration court. The right to submit such a petition is granted to a wide range of stakeholders. These may be: the debtor himself, a creditor or group of creditors, any authorised bodies, the tax authorities or the public prosecutor. A company or other business debtor must initiate proceedings within one month of realising that full satisfaction of one or more creditors' outstanding claims would be impossible. If it fails to do so, officers and directors of the debtor can be made personally liable for its debts. Once the arbitration court initiates the insolvency procedure, all of the debtor's obligations are deemed to have matured.

Order of creditor claims
Creditors' claims are ranked in three groups, as follows:
1. Personal tort claims including those for compensation for injury, pain and other suffering;
2. Claims for severance pay, outstanding wages and remuneration due under copyright agreements such as authors' royalties; and
3. All other creditors including taxes and other mandatory payments imposed by the state.

Claims of each group must be satisfied in full before any payment can be made to creditors in a lower ranking group. Where funds are insufficient to pay a category in full, funds are divided between all creditors in the group on a *pari passu* basis. Secured creditors fall outside the bankruptcy proceedings to the extent that their claims can be satisfied from the security they hold.

Insolvency procedures
There are four insolvency stages; each of which has strict time limits imposed by the Insolvency Law. The stages and associated time limits are:

Supervision	Maximum time limit of 7 months
Financial rehabilitation	Maximum time limit of 24 months
External controls	Maximum time limit of 18 months
Competitive	Maximum time limit of 12 months

Supervision is the first stage in the insolvency procedure. It is designed to preserve the debtor's property, to ascertain the financial state of affairs of the enterprise, to draw up a register of creditors' claims and to hold the first meeting of creditors.

The arbitration court appoints an insolvency (or 'temporary') manager who is mandated to supervise the business during the process of liquidation. The existing directors retain their functions subject to some restrictions designed to maintain the asset base of the business for the benefit of creditors. Upon the commencement of supervision any enforcement proceedings regarding collection of funds and assets from the debtor must be suspended. Several other protective measures are also enacted to ensure that shareholders or participants in the business are unable to extract monies from it. Any set off of counter claims of the debtor against a creditor is also prohibited if it breaches the priority ranking of creditors claims. Any transactions which may potentially have a significant impact on the asset base of the business may only take place with the approval of the insolvency manager.

The insolvency manager's main responsibilities are:

- To identify all creditors and examine the strength of their claims. He invites creditors to submit their claims by advertisement in the newspaper "Kommersant";
- To maintain the register of creditors' claims against the debtor;
- To examine the financial standing of the debtor; and
- To convene a first meeting of creditors.

The creditors at the first creditors' meeting will examine the findings of the insolvency manager, appoint a creditors' committee and take a decision on the further proceedings to be taken in relation to the insolvent business. Depending on the circumstances of the case the meeting of creditors decides whether to apply to the court for a financial rehabilitation, an external control procedure or to wind up the enterprise under a competitive procedure. Alternatively the court may approve an informal agreement ("amicable arrangement") between the enterprise and its creditors and terminate insolvency proceedings.

Financial rehabilitation

Financial rehabilitation is an insolvency procedure which is applied to a debtor with a view to restoring the debtor's solvency and having the debt repaid under a debt repayment schedule. The procedure is initiated by shareholders, proprietors of a unitary enterprise or by third parties by application to the arbitration court or to the first meeting of creditors during a supervision procedure. The application should contain a proposal on security for the debtor's commitment and a rehabilitation plan. Repayment cannot be secured by the debtor's property or property rights.

The debtor's promoters, owners of property of the debtor, its founders or third parties prepare a debt repayment schedule setting out the process of recovery and realisation of

assets and a timetable for debt repayment. Officers or third parties may provide guarantees of repayment. The rehabilitation plan must be submitted to a further meeting of creditors for approval.

Initiation of a financial rehabilitation must be approved by creditors and a court, (approval by a court alone is sufficient if a bank guarantee is available). In financial rehabilitation the debtor enjoys the same benefits as in the supervision procedure but with extended timeframes. An insolvency manager (who must be a properly authorised person – see below) is appointed to manage the debtor's activity.

External control

External control is an insolvency procedure applied to a debtor with a view to restoring the debtor's solvency outside the control of the management which was in place at the time the business was declared to be insolvent.

Once external control is initiated, there is a moratorium on the payment of all creditors' claims, the management of the company is dismissed, and no action can be taken against the debtor's property except with the permission of the court.

The power to oversee the debtor's business is vested in a court-appointed insolvency manager who is known as "the external arbitral administrator". It is his responsibility to draft an independent plan for the restoration of the debtor's solvency within a specified time period. This plan must be submitted to a further meeting of creditors for approval. Having reviewed the report the creditors' meeting will decide on what further action should be taken and make appropriate recommendations to the court. The court may decide to either terminate the insolvency proceedings or to place the debtor into liquidation. It is possible for a single extension of six months to be granted for the external control procedure.

Competitive procedure

A competitive procedure (or liquidation of a business) is the principal insolvency procedure. It is applied to a debtor deemed incapable of restoration to solvency. It involves realising the assets, distributing the proceeds to creditors on a pro rata basis and winding up the enterprise. It is undertaken when other procedures are not successful or not approved by creditors. The claims of creditors are satisfied in accordance with the ranking set out in the Insolvency Law.

The court appoints an insolvency manager known as the liquidation manager to carry out the procedure. His rights and duties include:

- Taking control of the debtor's property;
- Dismissing employees;
- Appointing an independent appraiser to value the debtor's property;
- Collecting amounts due to the debtor; and
- Exercising the other duties established by the law.

The initial duration of the procedure is six months but the court may extend this period by a maximum of a further six months.

Amicable arrangement

An amicable arrangement may be concluded at any stage during insolvency but not earlier than the first creditors' meeting called during the supervision phase. The agreement must be supported by a majority of the insolvency creditors, subject to the unanimous agreement of the secured creditors. Such agreement may be concluded only upon payments to satisfy claims of the first and second priority creditors and must be approved by the court. A unilateral refusal to perform a final voluntary arrangement is prohibited. If an amicable arrangement is approved the insolvency procedure has to be dismissed.

Insolvency managers

All types of insolvency managers are required to be Russian citizens and members of an appropriate self-regulating professional body approved by the court to perform insolvency proceedings and to exercise the associated powers.

Insolvency of banks and other credit institutions

Insolvency proceedings of banks and other credit institutions are carried out within the framework of the Insolvency Law but are additionally regulated by the Banking Insolvency Law.

Under the Banking Insolvency Law before any liquidation process can be initiated the Central Bank must first revoke the licence of a bank or other credit institution and put in place a temporary administration to recover and restructure the financial situation. The insolvency procedure is effectively limited to realising the assets and distributing funds to creditors. Accordingly, only the competitive procedure can be used. Amicable agreements are not available for banks and credit institutions.

If a bank is declared insolvent, the order of priority of creditors' claims is as referred to in the Insolvency Law, with one important exception: the claims of individual bank depositors must be satisfied as a matter of first priority, preceding the satisfaction of all other claims. There are other minor differences: claims based on credit agreements with a maturity date of not less than five years, which cannot be terminated before the maturity date, and which have an express provision stating that they are subordinated, may be satisfied only after all other creditors have been paid in full, and the right to submit a claim to the arbitration court matures earlier than in a non-bank procedure.

Insolvency of natural monopoly companies and strategic enterprises

Under the present law insolvency proceedings may be initiated against monopolist companies and strategic enterprises only if:

1. Creditors' monetary claims have been outstanding for at least six months after their due date, and
2. Aggregate claims exceed the value of the debtor's assets; and
3. The initiating creditor's claim exceeds 500,000 roubles.

Insolvency proceedings may never be initiated against a nuclear power plant due to the risk of endangering public safety.

The judicial system

Overview

The court system is established by the Russian Constitution. The principal laws regulating the court system include:

- Civil Procedures Code, adopted in 2002;
- Arbitration Procedures Code, adopted in 2002;
- The Federal Constitutional Law "On the Constitutional court of the Russian Federation", adopted in 1994;
- The Federal Constitutional Law "On arbitration courts of the Russian Federation", adopted in 1995;
- The Federal Constitutional Law "On the court system of the Russian Federation", adopted in 1996;
- The Law "On International commercial arbitration", adopted in 1993;
- The Law "On Justice of the Peace of the Russian Federation", adopted in 1998; and
- The Law "On arbitration tribunal of the Russian Federation", adopted in 2002.

The Russian court system is effectively a dual one consisting of the courts of common jurisdiction, headed by the Supreme Court, and the arbitrazh courts, headed by the Supreme Arbitrazh (Commercial) Court. Outside of these as noted previously there is also a Constitutional Court that solely resolves issues relating to the compliance of federal and regional laws and regulations with the Russian Constitution.

Courts of common jurisdiction

The system of common jurisdiction is mainly regulated by the Civil Procedures Code adopted in 2002. It consists of the Russian Supreme Court, the supreme courts of republics, regional courts, courts of the cities with federal status (Moscow and St. Petersburg), courts of autonomous regions, the military and specialised courts, and district courts.

The district courts are the first instance courts which examine most disputes arising from civil, tax, criminal and administrative matters. The decisions of the district courts may be appealed in the regional courts.

Smaller cases arising from marriage, employment, protests of bills and other issues where the value of the claim does not exceed 50,000 roubles may be dealt with in the court of the justice of the peace, with appeal to the district court.

The Russian Supreme Court is the court of last resort for civil, tax, administrative, criminal, and other cases under the jurisdiction of common courts. It carries out judicial supervision over their activities and provides explanations on issues of court proceedings.

Arbitrazh courts

Arbitration courts settle disputes arising from commercial issues and protect the rights and interests of individuals, legal entities, entrepreneurs and the state in the economic

sphere. The arbitration court system is regulated by the Arbitration Procedures Code adopted in 2002 and by the Law "On the Arbitration courts of the Russian Federation" adopted in 1995. In general such courts favour the use of documentary evidence rather than oral evidence and provide a speedy and efficient method of settling commercial disputes. There are clear guidelines for establishing the jurisdiction of Russian courts in cases involving either foreign defendants or disputes between foreign parties.

The system of arbitrazh courts is divided into four levels as outlined below.

Courts of first instance
These are courts that settle original complaints. They are organised on the basis of territorial jurisdiction. Proceedings commence with a statement of claim. The court must consider the case within three months of the filing of the statement of claim and judgment is announced immediately after the hearing. Any appeal against a judgment must be lodged within one month of the judgment being rendered. Grounds for appeal are factual mistake or mistake in the application of law.

Courts of appeal
These courts hear appeals arising from judgments made by the courts of first instance. Currently there are 20 courts of appeal separated on the basis of territorial jurisdiction. Generally an oral hearing takes place within one month of the filing of an appeal. All parties to the case are permitted to provide written responses to the appeal before the hearing. The ruling of the court of appeal is effective immediately it is pronounced. It is possible to circumvent the courts of appeal by opting to file an appeal with the federal arbitrazh court ("court of cassation appeal").

Court of cassation appeal
Both a judgment from a court of first instance and a ruling made by a court of appeal may be appealed in a court of cassation appeal. In such instances the appeal may only be made on a point of law. The appeal must be filed within two months of the original judgment or ruling and the appeal hearing must take place within one month of filing. The court of cassation appeal has the power to:

- Uphold, reverse or amend a judgment; or
- Order a rehearing in the court which gave the original judgment or ruling.

It also has the power, rarely exercised in practice, to order the suspension of the enforcement of a judgment or ruling during the period of the hearing.

Supreme arbitrazh court
The Supreme arbitrazh court is the court of last resort for settling economic disputes. It exercises judicial supervision and has the power to establish precedents to unify and direct the practices of the inferior courts (Resolution of the Constitutional Court of Russia No 1-P, 21 January 2010). A party may challenge a judgment of any of the three types of court outlined above by filing a supervision appeal with the Supreme arbitrazh court. Filing must take place within three months of the last judgment given on the case. In each instance a panel of three judges of the court will first review the party's appeal and decide whether grounds exist to perform a supervisory review of the

judgment already given. Usually the appeal will be terminated at this point. In the rare event that the appeal is deemed to have some merit the case will be passed to the president of the court for supervisory review.

Proposed changes to arbitrazh court procedures

On 24 March 2011 the Plenum of the Supreme arbitrazh court adopted a resolution ("the Resolution") to propose to the State Duma of the Federal Assembly of the Russian Federation a draft law "On amending the Russian Arbitration Procedure Code and the second part of the Russian Tax Code in connection with the development of summary proceedings". The principal proposed amendments are as follows:

- Statements of claim and all other documents in the case, including the parties' evidence, will be placed on the website of the arbitrazh court with access restricted to the parties and the court. This will allow a significant reduction in the time spent reviewing the documents. At the court's discretion cases may be reviewed by electronic means without the parties being present.
- Cases using summary proceedings are to be heard by a sole judge within two months of the filing of a statement of claim with the court.
- The summary procedure will apply to monetary claims of up to 300,000 roubles for legal entities and up to 100,000 roubles for individual entrepreneurs, compared with the current limits of 20,000 roubles for legal entities and 2,000 roubles for individual entrepreneurs;
- The availability of the summary procedure will be extended to the following categories of cases if the value of the claim is no more than 100,000 roubles:
    - Cases challenging individual regulatory acts and the decisions of authorities discharging public functions to the extent that such challenges entail claims for the payment or recovery of money or recovery of other property of the claimant;
    - Cases holding a person liable under administrative legislation if the only punishment provided by the law is an administrative fine;
    - Claims for recovery of compulsory payments and penalties.
- The following will also be dealt with under the summary procedure regardless of the amount:
    - Claims based on documents filed by the plaintiff which establish monetary obligations admitted by the defendant but which remain unsatisfied; and
    - Claims based on documents confirming contractual debt and claims based on a notarised protest of a bill of exchange which is in arrears, has not been accepted or has no date for its acceptance.

The draft law includes a means of transferring cases from the summary procedure to the standard procedure in the event of circumstances arising which complicate the case examination, such as a third party entering the case, or a counter-claim which cannot be examined under the summary procedure. The summary procedure will not extend to corporate disputes and cases on protection of rights and legal interests of a group of persons.

Enforcement of judgments

Judgments of the Russian courts of common jurisdiction and of the arbitration courts are enforced through the enforcement (or "bailiff") service. The enforcement of judgments is regulated by the laws "On enforcement officers" adopted in 1997 and "On enforcement procedure" adopted in 2007. A judgment of a foreign court may only be executed in Russia if it has been recognised by a Russian court. Such recognition is available only if supported by a relevant international treaty and a federal law.

An enforcement order given by a Russian court on behalf of an international court's decision may be executed in Russia within three years from the date of issue.

Russia is a party to the Kiev Agreement on "the Procedure for resolving disputes relating to business activity". According to the Agreement, decisions rendered by the state courts of certain CIS nations are enforceable in Russia.

Decisions rendered by the courts of many countries may not be recognised or enforceable in Russia. In such a case a foreign litigant may start new court proceedings before a Russian court even in the case where the decision has been awarded outside of Russia. The Russian court is free to re-examine the case on its merits.

Arbitration

The use of arbitration as a means of resolving disputes has become increasingly popular as an alternative to the state arbitrazh court system. This is particularly true where a dispute involves a foreign party and there is no bilateral treaty with the country of the foreign party which would allow a foreign judgment to be enforced in Russia. Foreign claimants may take disputes to the International Commercial Arbitration Court of the Chamber of Commerce and Industry ("ICAC") or to a private arbitration tribunal located in Russia or elsewhere.

Domestic arbitration is subject to the 2002 federal law on arbitral tribunals. International commercial arbitration is governed by the law "On International Commercial Arbitration Court" enacted in July 1993. This is modelled on the provisions of the standard UNCITRAL arbitration rules. In addition, the international commercial arbitration provisions of various international treaties which Russia is party to apply in Russia. These include the European Convention on International Commercial Arbitration of 1961 and the New York (United Nations) Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 ("the New York Convention").

ICAC settles disputes arising from contractual and other civil law relationships relating to foreign trade transactions and other forms of international commercial relations, provided that the place of business of at least one of the parties is located abroad. It also adjudicates on disputes arising between enterprises with foreign investment, international associations and organisations established in Russia.

Foreign investors may use the ICAC only if they jointly draft an arbitration agreement on the disputes which have arisen or which may arise between them in respect of a defined legal relationship. An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement.

The duration of the proceedings is limited to 180 days from the date of the formation of the arbitral tribunal.

If the parties settle their dispute during the proceedings, the proceedings may be terminated. At the parties' request the arbitral tribunal may record the settlement in the form of an arbitration award on agreed terms. The awards of ICAC are enforced in the state arbitrazh courts. The awards of ICAC are not subject to appeal in any court. The state arbitrazh court may review the legitimacy of the case of the ICAC and the grounds on which it may refuse to recognise and enforce a foreign arbitral award are substantially the same as those set out in the New York Convention.

Appendix

Double taxation agreements

Country	Dividends (%)	Interest (%)	Royalties (%)	Effective date
Albania	10	10	10	1 January 1998
Algeria	5 or 15	0 or 15[(2)]	15	1 January 1999
Armenia	5 or 10	0	0	1 January 1999
Australia	5 or 15	10	10	1 January 2004
Austria	5 or 15	0	0	1 January 2003
Azerbaijan	10	0 or 10[(2)]	0	1 January 1999
Belarus	15	0 or 10[(2)]	10	1 January 1998
Belgium	10	0 or 10[(2)]	0	1 January 2001
Botswana	5 or 10	0 or 10[(2)]	10	1 January 2010
Brazil	10 or 15	0 or 15[(2)]	15	1 January 2009
Bulgaria	15	0 or 15[(2)]	15	1 January 1996
Canada	10 or 15	0 or 10[(2)]	0 or 10[(4)]	1 January 1998
Chile	5 or 10	15	5 or 10[(4)]	Ratification pending
China	10	0 or 10[(2)]	10	1 January 1998
Croatia	5 or 10	10	10	1 January 1998
Cyprus	5 or 10	0	0	1 January 2000
Czech Republic	10	0	0	1 January 1998
Denmark	10	0	0	1 January 1998
Egypt	10	0 or 15[(2)]	15	1 January 2001
Finland	5 or 12	0	0	1 January 2003
FYROM	10	10	10	1 January 2001
France	5 or 10 or 15	0	0	1 January 2000
Germany	5 or 15	0	0	1 January 1997
Greece	5 or 10	7	7	1 January 2008
Hungary	10	0	0	1 January 1998
Iceland	5 or 15	0	0	1 January 2004
India	10	0 or 10[(2)]	10	1 January 1999
Indonesia	15	0 or 15[(2)]	15	1 January 2003
Iran	5 or 10	0 or 7½[(2)]	5	1 January 2003

Country	Dividends (%)	Interest (%)	Royalties (%)	Effective date
Ireland	10	0	0	1 January 1996
Israel	10	0 or 10(2)	10	1 January 2001
Italy	5 or 10	10	0	1 January 1999
Japan(1)	15	0 or 10(2)	0 or 10(4)	1 January 1987
Kazakhstan	10	0 or 10(2)	10	1 January 1998
Korea, DPR	10	0	0	1 January 2001
Korea, Republic	5 or 10	0	5	1 January 1996
Kuwait	0 or 5(5)	0	10	1 January 2004
Kyrgyzstan	10	0 or 10(2)	10	1 January 2001
Lebanon	10	0 or 5(2)	5	1 January 2001
Lithuania	5 or 10	0 or 10(2)	5 or 10	1 January 2006
Luxembourg	10 or 15	0	0	1 January 1998
Malaysia(1)	0 or 15	0 or 15(2)	10 or 15(4)	1 January 1989
Mali	10 or 15	0 or 15(2)	0	1 January 2000
Mexico	10	10	10	1 January 2009
Moldova	10	0	10	1 January 1998
Mongolia	10	0 or 10(2)	See note 6	1 January 1998
Montenegro	5 or 15	10	10	1 January 1998
Morocco	5 or 10	0 or 10(2)	10	1 January 2000
Namibia	5 or 10	0 or 10(2)	5	1 January 2001
Netherlands	5 or 15	0	0	1 January 1999
New Zealand	15	10	10	1 January 2004
Norway	10	0 or 10(2)	0	1 January 2003
Philippines	15	0 or 15(2)	15	1 January 1998
Poland	10	0 or 10(2)	10	1 January 1994
Portugal	10 or 15	0 or 10(2)	10	1 January 2003
Qatar	5	0 or 5(2)	0	1 January 2001
Romania	15	0 or 15(2)	10	1 January 1996
Saudi Arabia	0 or 5	0 or 5(2)	10	1 January 2011
Serbia	5 or 15	10	10	1 January 1998
Singapore	5 or 10	0 or 7½(2)	7½	1 January 2010

Country	Dividends (%)	Interest (%)	Royalties (%)	Effective date
Slovakia	10	0	10	1 January 1998
Slovenia	10	10	10	1 January 1998
South Africa	10 or 15	0 or 10(2)	0	1 January 2001
Spain	5 or 10 or 15	0 or 5(2)	5	1 January 2001
Sri Lanka	10 or 15	0 or 10(2)	10	1 January 2003
Sweden	5 or 15	0	0	1 January 1996
Switzerland	5 or 15	0 or 5 or 10(2)	0	1 January 1998
Syria	15	0 or 10(2)	4½ or 13½ or 18(4)	1 January 2004
Tajikistan	5 or 10	0 or 10(2)	0	1 January 2004
Thailand	15	0 or 10(2)	15	1 January 2010
Turkey	10	0 or 10(2)	10	1 January 2000
Turkmenistan	10	5	5	1 January 2000
UK	10	0	0	1 January 1998
Ukraine	5 or 15	0 or 10(2)	10	1 January 2000
USA	5 or 10	0	0	1 January 1994
Uzbekistan	10	0 or 10(2)	0	1 January 1996
Venezuela	10 or 15	0 or 5 or 10(2)	10 or 15	1 January 2010
Vietnam	10 or 15	10	15	1 January 1997

Notes

1 Treaties made with USSR. All other treaties are with the Russian Federation.

2 In general a zero rate applies to interest payments to the governments of contracting states, and to payments guaranteed by the governments of contracting states.

3 The zero rate applies if the interest is paid in connection with the sale on credit of any industrial, commercial or scientific equipment, or in connection with the sale on credit of any merchandise by one enterprise to another enterprise.

4 Depending on the nature of the rights.

5 The zero rate applies to dividends paid to governmental agencies or financial institutions.

6 Rates are determined in accordance with local legislation.