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DOING BUSINESS IN RUSSIA

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1. CORPORATE LEGAL STRUCTURE

1.1. CURRENT LEGAL FORMS

A foreign company may choose to establish a presence in Russia through a Russian subsidiary.

The most common business structures in Russia are Limited Liability Companies **(the "LLC")** and Joint Stock Companies **(the "JSC").**

The current Russian legislation that provides the legal forms for corporate entities comprises the respective provisions of the Civil Code of the RF (**the "Civil Code"**), No. 14-FZ "On Limited Liability Companies" dated 8 February 1998 (**the "LLC Law"**) and the Federal Law No. 208-FZ "On Joint Stock Companies" dated 26 December 1995 (**the "JSC Law"**).

In the LLC (the Russian abbreviation – **"OOO"**) the participatory shares attributable to Shareholders **(the "Participants")** are not considered as securities under Russian securities legislation.

Shares in the JSC are considered to be securities and are subject to registration with the Federal Service for Financial Markets of the Russian Federation (**the "FSFM").** The JSC may have the type of either (i) the Open Joint Stock Company (**the "OJSC"**), which shares are publicly held (the Russian abbreviation – **"OAO"**), or (ii) the Closed Joint Stock Company (**the "CJSC"**), meaning privately held (the Russian abbreviation – **"ZAO"**).

Foreign companies often use LLCs to conduct their wholly-owned businesses in Russia. The LLC law provides for many similar provisions to those in the JSC Law. However, there are some distinctions. Generally, one Participant (individual or legal entity), may establish an LLC or JSC. However, the legal entity, which is wholly owned by one Participant/Shareholder, cannot establish another 100%-owned LLC or JSC.

1.1.1. Limited Liability Company

A Limited Liability Company is currently deemed to be the most common and simple form of the Russian legal entity (prior to the introduction of the Economic Partnership, as specified in Section 1.2.2 below).

The Limited Liability Company is often used by foreign investors who want to set up a wholly owned subsidiary. The establishment of a Limited Liability Company is mainly governed by the Civil Code and by the LLC Law, as well as by the Federal Law on State Registration of the Legal Entities and Individual Entrepreneurs ("**the Registration Law"**), No. 129-FZ dated 8 August 2001 (as amended).

Charter capital and contributions

The **charter capital** of a Limited Liability Company is divided into participatory shares ("*doli*").
Unlike the shares issued by a Joint-Stock Company, these participatory shares are not deemed to be the securities and therefore shall not be subject to the registration with the **FSFM**. Each holder of the participatory share is referred to as a " Participant".

The minimum charter capital of a Limited Liability Company is currently RUB 10,000 (approximately, EUR 250). **Contributions** to the charter capital of a Limited Liability

Company may be made in cash or in kind (i.e. securities, property or other tangible or intangible rights or assets having a monetary value). The proposed amendment to the Civil Code, which would require the minimum charter capital to be paid in cash only, is currently under review.

The LLC Participant may not be released from the respective obligation to pay the agreed contribution to the charter capital. Provided that all the Participants agree, contributions to the charter capital can be made by setoff against any existing monetary debt that the company owes to the Participant.

VAT may be available for certain types of equipment contributed to the charter capital of a company by a foreign Participant. Generally, any assets contributed to the charter capital must be subject to independent appraisal.

Net asset requirements

A Limited Liability Company must ensure that the value of its net assets does not fall below the amount of its charter capital. Failure to comply with this requirement may result in the company being required to decrease its charter capital accordingly. This shortfall may also be used as grounds for the company's compulsory liquidation if the value of its assets is less than the minimum charter capital amount.

Starting from 1 January 2012, a Limited Liability Company is obliged to provide all interested persons with the information about its net assets' value, but this does not mean that the company is obliged to disclose its balance sheet.

Participation Threshold

If the number of the LLC Participants exceeds 50, the company shall either to reduce the number of Participants or to reregister as an Open Joint-Stock Company or production cooperative within a year.

All limited liability companies must maintain a register of Participants. This register sets out the names of the Participants and the number of participatory interests they have in the company.

As a general principle, the responsibility of Participants for the company's liabilities is limited to payment (in full) of the amount of their participatory shares. In a limited number of cases, however, the corporate veil can be given binding instructions to the company that lead to the insolvency of the company.

Management structure

The managing bodies of a Limited Liability Company are:

- the general Participants' meeting;
- the general director;
- the board of directors (optional); and
- the management board – "*Pravlenie*" (optional).

The decisions on the most significant matters (such as amending the company's corporate documents, changing the charter capital, distributing profits and approving the annual reports and balance sheets of the company) must be adopted by the **Participants' meeting**.

The annual Participants' meeting must be held no earlier than two months before and no later than four months after the end of the company's financial year. Extraordinary Participants' meetings may be held at any time. Participants' meetings must be convened according to the procedure set out in the company's charter and the LLC Law.

Subject to contrary provisions in the company's charter, a Participant's voting power at a Participants' meeting will normally correspond to the proportion of the company's charter capital it holds.

Generally, the corporate decisions are adopted by a simple majority of the votes of all Participants in the company. Different voting majority may be specified in a company's charter, although certain majorities are fixed by law. All decisions (except approval of the company's annual reports and balance sheets) may be adopted without holding a meeting.

The **general director** manages the day-to-day operations of the company and transactions with respect to all other matters not falling within the authority of the general Participants' meeting and the board of directors (if there is one). The general director acts on behalf of the company, represents its interests, enters into transactions on its behalf, issues powers of attorney and hires and dismisses employees.

The general director is the only person who can represent the company without a power of attorney. The general director's powers may be limited by the company charter and his employment contract as per a decision taken by the Participants' meeting, the general director's authority may be transferred to a management company (in whole only). A foreign national may be appointed as general director of a Limited Liability Company, subject to compliance with work permit regulations.

A **board of directors** is an optional supervisory management body of a Limited Liability Company. The charter defines its authority, which typically might include appointing dismissing the general director or approving major transactions and interested-party transactions. A Limited Liability Company can also have a **management board**. By law, the general director chairs the management board. Unlike the general director, however, members of the management board must obtain a power of attorney issued by the general director in order to conduct transactions on the company's behalf.

Audit

The charter may provide for an **internal auditor** (an individual or a commission). In some cases, e.g. in companies with more than 15 Participants, the general Participants' meeting will not be able to consider the company's annual reports and balance sheets without preliminary internal auditor's approval.

An **external auditor** may also be appointed by the Participants' meeting to audit the company's financial and business activity. If certain turnover or asset value thresholds are exceeded, or if the company conducts certain regulated activities, an external auditor must be appointed.

Transfer of participatory shares

Participatory shares are freely transferable between the Participants. However, the charter or a Participants' agreement may specify that a participatory share transfer requires the consent of the other Participants and/or the company. A Participant may transfer its participatory interest to third parties, subject to a statutory pre-emption right in favor of other Participants.

The charter may also provide for the company's pre-emption right. Further, the charter may prohibit the transfer of participatory shares to a third party or make such a transfer subject to the consent of the other Participants or of the company. If such consent is not given, the company itself is obliged, by law, to purchase the relevant participatory interests. The procedure for selling participatory shares and for determining their offer price is set out in the LLC Law, although the company's charter and/or Participants' agreement may vary this statutory procedure. A participatory shares transfer agreement must be notarized and the participatory interest is transferred immediately upon notarization of the transfer agreement. This creates difficulties in the context of Russian agreements for the sale and purchase of participatory shares under which exchange and completion are to occur on different dates and especially where the sale agreement is conditional. By way of exception, notarization is not required:

- for the transfer of company-owned participatory shares to its current Participants or third parties;
- for the transfer of participatory share to the company; or
- for the sale of participatory shares from one Participant to another as a result of the exercise of pre-emption rights.

Where notarization is not required the transfer of title to the participatory shares is effective when the transfer is recorded in the Unified State Register of Legal Entities.

1.1.2. Joint-Stock Company

The JSC is a legal entity that issues shares to generate capital for its activities. A Shareholder of the JSC is not generally liable for the JSC's obligations, and the Shareholder's losses are limited to the value of its respective shares. Different classes of shares are permitted; dividends and voting rights are equal for each share in a class.

Both types of joint stock companies (OAO (OJSC) and ZAO (CJSC)) may issue common or privileged shares and bonds. Both forms are subject to statutory reporting requirements and regulatory restrictions, but the requirements for public disclosure are less rigorous for the CJSCs.

The recent changes to the Russian corporate law had provided for the Shareholders' agreements under which the respective Shareholders may, *inter alia*, determine voting obligations at general Shareholder meetings, coordinate voting options with other Shareholders, determine the price at which shares can be sold and coordinate other actions related to the JSC's management, activities, reorganization and liquidation.

The governing bodies of JSCs are the general Shareholders' meeting, board of directors and the executive body (sole or collegial). The executive body manages the JSC's day-to-day affairs and reports to the general Shareholders meeting. The Shareholders' meeting, upon proposal from the board of directors or at its own discretion, may delegate the power of the executive body to an external commercial company or to an individual manager.

Open and Closed Joint-Stock Companies

The legislation governing Russian joint-stock companies comprises Civil Code and the JSC Law.

As it was specified above, a Joint-Stock Company can either be “ open” (the applicable abbreviation is the “OAO”) or “closed” (the abbreviation is “3AO”), which comes either before or after the company's name. An Open Joint-Stock Company is capable of offering its shares to the public.

Charter capital and contributions

The **charter capital** of a Joint-Stock Company is divided into shares (which may be split into ordinary shares and privileged shares). These shares are securities for the purposes of Russian securities legislation and must be registered with the FSFM.

For an Open Joint-Stock Company the minimum charter capital is currently RUB 100,000 (EUR 2,500) and for a closed Joint-Stock Company it is RUB 10,000 (EUR 250), although this is expected to be increased to RUB 100,000 (EUR 2,500), notwithstanding of the type of Joint-Stock Company. Similar to the limited liability companies, the **contributions** to the charter capital may be paid either in cash or in kind.

However, the proposed amendment to the Civil Code which would require the minimum charter capital to be paid in cash only is under review. Other types of securities, such as corporate bonds, must be paid in cash only. It is possible to pay for new shares issued in a closed subscription by way of a debt-for-equity swap.

The charter capital may be increased by issuing shares or increasing the nominal value of the shares already in issue. Each capital increase must be filed and registered with the FSFM, which is a lengthy process.

As a general principle, the responsibility of Shareholders for the company's liabilities is limited to the payment (in full) of their shares. In a limited number of cases however, the corporate veil can be pierced, resulting in the Shareholders having unlimited liability for the obligations of the company. This can happen if, for example, a Shareholder gives binding instructions to the company that lead to the insolvency of the company.

Net asset requirements and creditor protection

A Joint-Stock Company must ensure that the value of its net assets does not fall below the amount of its charter capital. Failure to comply with this requirement may result in the company being required to decrease its charter capital accordingly. This shortfall may also be used as grounds for the company's compulsory liquidation if the value of its assets is less than the minimum charter capital amount.

Joint-stock companies are obliged (in certain cases) to file quarterly information on the value of their net assets with the Unified State Register of Legal Entities in addition to other filing obligations.

At least 5% of the founding capital of any Joint-Stock Company must be allocated to a reserve fund. This fund is created specifically to cover losses and to redeem bonds and shares of the company. Starting from 1 January 2012, Joint-Stock Companies have also been under an obligation to disclose information about their net asset value upon inquiry of the interested party, what is similar to the obligation on Limited Liability Companies.

Management structure

The managing bodies of a Joint-Stock Company are:

- the general director; the general Shareholders' meeting;
- the board of directors (optional for joint stock companies with fewer than 50 Shareholders holding voting shares); and
- the management board (optional).

The annual **Shareholders' meeting** must be held no earlier than two months before and no later than six months after the end of a company's financial year. Extraordinary Shareholders' meetings may be called by the board of directors, the external auditor, the internal auditor of the company or by Shareholders owning at least 10% of the voting shares in the company.

At Shareholders' meetings most decisions may be adopted by a simple majority of the Shareholders attending the meeting (e.g. with respect to the CEO appointment). However a limited number of more significant decisions require not less than 75% of the votes of the Shareholders attending the meeting (e.g. with respect to liquidation or reorganization of the company, amendments to the charter or approval of a new version of the charter). One share gives one vote. Subject to certain exceptions Shareholders may adopt decisions without holding a meeting.

The **general director** is the only person who can act on behalf of the company without a power of attorney. In companies where a management board is also established the general director is the chairman of the management board. The general director is responsible for the day-to-day operations of the company.

He or She is appointed and dismissed by the Shareholders, unless the company's charter stipulates that this decision falls within the authority of the board of directors. If the latter is the case, there is a legal procedure in order to avoid deadlocks relating to the appointment or dismissal of the general director when, for any reason, the board of directors fails to agree on this matter.

The authority of the general director may be transferred to a management company if the Shareholders so decide. A foreign national may be appointed as general director of a Joint-Stock Company subject to compliance with work permit regulations.

The **board of directors** is responsible for the general management of the company and has the authority to take decisions on almost any issue except those for which exclusive authority is reserved for the Shareholders' meeting. Members of the board of directors are elected by an annual/extraordinary Shareholders' meeting and serve as directors until the next annual Shareholders' meeting. There is no limit on the number of times that a member of the board of directors may be re-elected.

A Joint-Stock Company can also have a **management board.** Unlike the general director however, the members of the management board must obtain a power of attorney from the general director in order to conduct transactions on the company's behalf.

Audit

Joint-Stock Companies are required to appoint an **internal auditor (revision committee)** to audit the company's financial and business activity. Before the annual general Shareholders' meeting, the internal auditor (**revision committee**) prepares a report on the company's annual report and balance sheet. The internal auditor's report is then communicated to the Shareholders who are entitled to attend the meeting.

Additionally, the internal auditor (**revision committee**) may audit the company at any time:

- at its own initiative;
- upon a decision of the Shareholders' meeting;

or

- upon demand of a Shareholder or a group of Shareholders holding at least 10% of the voting rights in the company.

Open Joint-Stock Companies are subject to a statutory annual audit by an **external auditor**. This requirement also applies to Closed Joint-Stock Companies that they meet certain legal criteria.

Issue and transfer of shares

The shares of a Joint-Stock Company, whether open or Closed, are considered as securities and as such are subject to the registration requirements provided by the Federal Law No. 39-FZ “On the Securities Market” dated 22 April 1996 (as amended). When issuing new shares, all joint-stock companies must carry out the requisite filings with the FSFM (or with the Central Bank of Russia in the case of banks).

The documents that must be filed comprise the decision to issue shares, the report on the results of the share issue and other documents as well as in certain cases, the prospectus for the share issue. A share transfer takes effect when it is recorded in the register of Shareholders that all joint-stock companies are required to maintain. The register may be kept by the company itself or by an independent company duly licensed by the FSFM. In joint-stock companies with more than 50 Shareholders the register must be kept by an independent registrar.

An **Open Joint-Stock Company** is a “public company”. It may make both Closed and public offerings of its shares. There are no statutory pre-emption rights or restrictions on the transferability of shares in the company whether to other Shareholders or third parties.

Contractual restrictions can, however, be introduced through Shareholders’ agreements. When the charter capital is increased by issuing additional shares, however, existing Shareholders do have the benefit of statutory pre-emption rights.

Shares of a **Closed Joint-Stock Company** may not be issued to more than 50 Shareholders. Shares are freely transferable between Shareholders, although it is possible to introduce contractual restrictions by means of a Shareholders’ agreement. Share sales to third parties are subject to the statutory pre-emption rights of other Shareholders in the company (and the company itself if so provided in the charter). The statutory procedure and terms for exercising the pre-emption rights may not be varied in the company’s charter.

Redemption of shares

In certain cases where a Shareholder disagrees with decisions taken at a Shareholders’ meeting it may be allowed to require the company to purchase its shares.

This applies for the following situations:

- a decision has been taken to reorganize the company;
- a decision has been taken to adopt charter amendments or to adopt a revised charter limiting the rights of the Shareholder in question; and
- a major transaction has been approved.

The shares will be redeemed at a price fixed by the board of directors or by the general meeting of Shareholders if there is no board of directors. This price may not be less than the market value of the shares as determined by an independent appraiser in accordance with the methods prescribed in the JSC Law.

Expelling a Shareholder

The general rule is that a Shareholder may not be expelled from a Joint-Stock Company. However, in the case of an Open Joint Stock Company a Shareholder that has acquired more than 95% of the voting shares may “squeeze out” the minority Shareholders.

1.1.3. Representative office or branch

A foreign company may choose to establish a presence in Russia through a representative office (the “**RO**”) or branch. The RO or a branch is not a Russian legal entity but is a legal part of the foreign parent company, and, therefore, the head office bears full responsibility for the obligations and actions of the RO or branch. The RO is authorized to conduct certain “preparatory and auxiliary” activities for the head office.

The branch, on the other hand, is able to conduct all activities that the head office itself could perform, including the execution of sales contracts. However, the Russian customs authorities often try to identify the ultimate Russian buyers of the imported goods and question the right of the branches of foreign legal entities to declare goods for customs clearance; therefore, it may be difficult for a Russian branch to clear goods through customs.

An appropriate state authority must perform accreditation of the ROs and branches established by the foreign parent company. Typically the State Registration Chamber is the authorized state registration body. However, the appropriate authority will depend on the foreign company’s activities – the Central Bank of the Russian Federation accredits foreign banks’ representative offices, and the Federal Aviation Service accredits foreign aviation companies’ representative offices. The maximum period of accreditation for the RO is three years and for the branch - five years. The accreditation period may be extended. Once accreditation is obtained, the RO or branch should register with other state bodies – the Federal State Statistics Services, the tax authorities and state non-budgetary funds.

Setting up the RO or branch takes approximately 3-6 weeks after all necessary documents have been submitted to the registration authorities. The accreditation process requires the preparation, approval, and, in many cases, notarization and apostillation (legalization) of a large amount of documentation. The total time required may exceed the registration period stipulated by law.

The RO is authorized to conduct certain “preparatory and auxiliary” activities for its head office. A branch, on the other hand, is able to conduct all activities that the head office itself could perform, including the execution of sales contracts. Depending on the exact scope and nature of activities, both ROs and branches may create a taxable presence in Russia for their headquarter company.

1.2. New Legal Forms

1.2.1. Economic Partnerships

From 1 July 2012, it will be possible to incorporate a business as an **“Economic Partnership”** (*“khozyaistvennoe partnerstvo”*). This new form of legal entity is designed for the new technology sector and is meant to provide more flexibility to its Participants than the existing Limited Liability Company and Joint-Stock Company forms.

This legal form is designed for companies involved in innovative activities (including venture capital financing). The constitutive document of an Economic Partnership is the Articles of association.

A partnership can be created by two or more persons (both individuals and legal entities can participate in a partnership). An Economic Partnership is governed in accordance with a special partnership management agreement concluded by the partners. This agreement is certified and kept by the notary.

The maximum number of partners in an Economic Partnership is 50 persons. If the number of partners in an Economic Partnership exceeds 50, it must be re-organized as a JSC within a year. Share capital of the Economic Partnership shall be divided into shares.

Contributions to the share capital can be made in money, securities, property rights or other rights with a monetary value. The partners have the right to participate in managing the partnership and in allocation of profits and expenses. The allocation of profits and expenses can be disproportionate to number of shares owned.

All Shareholders by unanimous decision elect the governing bodies of the Economic Partnership. The partnership must maintain a register of Participants, indicating the size of their stakes in the partnership capital and the stakes that belong to the partnership.

If the Economic Partnership is technically insolvent and the intellectual property owned by it may be seized and sold, some or all of the partnership's Participants can fulfill its obligations. Taking into consideration that the new law is effective started on 1 July 2012, there is currently no practice related to establishing (including registering) Economic Partnerships in Russia. Therefore, certain practical aspects of commercial activities and managing Economic Partnerships are unclear.

Thus, it could be recommended to establish the Russian subsidiary in one of the more common legal forms — LLC or JSC.

1.2.2. Investment partnerships

Starting from 1 January 2012, Russian law has provided for an **"Investment Partnership"** (*"investitsionnoe tovarischestvo"*), which is not a legal entity but a variation of a simple partnership.

This is similar to the concept of limited liability partnerships that exist, for example, under German law ("*Kommanditgesellschaft*") and English law. An investment partnership is designed to be the appropriate organizational form for collectively accumulating funds for investment under Russian law. It is intended only for the joint acquisition and sale of shares for investment in unquoted companies and Economic Partnerships, corporate bonds and futures instruments.

An investment partnership is based on an investment partnership agreement which must be notarized but does not require State registration.

Registration of a Russian legal entity

The Registration Law provides for a single procedure for the registration of legal entities, regardless of their organizational/legal form and the type of business activities they conduct.

Scope of registration

A company is deemed to be duly registered under Russian law once it has undergone:

- State registration (in the Unified State Register of Legal Entities);
- Tax registration; and
- Registration with the Federal Service for State Statistics and the three social funds (pension, social security and compulsory medical insurance).

Registration Procedure

The tax authorities are responsible for the state and tax registration of companies, as well as for forwarding documents to the Federal Service for State Statistics and the three social funds.

However state registration may, be handled by other authorities in the near future due to the current reform of the Civil Code. The time taken for registration is five days from the date of submitting the documents to the registration authorities. In practice the whole process of company incorporation, including collection of documents required, the opening of the bank account, registration with funds, takes approximately one or two months to complete (i.e. for the company to be fully operational).

The application to register the company can be filed by the applicant in person, can be sent by mail (the latter adding significant time to the registration process and being unreliable) or can be presented in electronic form. The applicant must be the chief executive of the founding parent company or the new company's founder himself/herself (if an individual). It is not possible to appoint an attorney to sign the application which means the process of establishment will take longer where the chief executive/founder is unable to file/collect documents in person. The procedure for submitting documents in electronic form is new and was implemented in April 2012.

Filing is made via the Federal Tax Service website (nalog.ru) or the unified portal of the government and municipal services (gosuslugi.ru). Specifically, the procedure stipulates that documents should contain an applicant's electronic signature or that an applicant be allowed to have a notary verify his signature by electronic signature. Documents may still be submitted in traditional paper form.

Before documents are submitted for state registration the new company must have identified its future premises (as the address is set out in the documents to be filed for state registration). It should have a lease agreement or a letter from the owner or landlord guaranteeing that, upon registration, the premises will be leased to the company. The registration application must be notarized and, if signed abroad, legalized. Foreign documents must also be accompanied by a certified Russian translation. The most practical approach is to execute the company charter and the supporting documents in Russia on the basis of a power of attorney (except for the application which must be signed in person by the chief executive of the founder as stated above).

Payment of charter capital

At least 50% of the charter capital must be paid prior to state registration for a Limited Liability Company, or within three months of state registration for a Joint-Stock Company. In all cases, the balance must be paid within one year of state registration. If a founder fails to pay the total amount of its shares/participatory interests within these time limits, then the non-paid shares/participatory interests become the property of the company.

Registration of the initial share issue

As shares in joint-stock companies are treated as securities, there are certain additional registration requirements imposed by the FSFM. The share issue registration process comprises the following stages:

- passing a decision to issue shares;
- approving the decision to issue shares;
- state registration of the share issue;
- subscription for shares; and
- state registration

2. FOREIGN INVESTMENTS

2.1. Foreign investment law

Foreign investors are guaranteed certain property rights to their investments in the Russian Federation and to profits derived from Russia. Foreign investments are regulated both on a federal and regional level. According to the federal law on foreign investments, the rights of foreign investors to conduct business activities in Russia and their rights to dispose of profits gained in Russia cannot be less favorable than those of national investors'. Certain limitations can be placed on foreign investors but only if these limitations are required to protect constitutional guarantees; the health, rights and lawful interests of nationals; or state defense and security measures.

Foreign investors are generally subject to the same treatment as Russian investors. Restrictions on business activities – licensing, notifications and permission requirements – apply to both Russian and foreign legal entities.

Foreign investors are guaranteed the full and unconditional protection of their rights and interests. A foreign investor is entitled to recover losses caused by an unlawful action or omission by the federal or regional state authorities in accordance with Russian civil legislation.

The property of a foreign investor or company with foreign participation cannot be seized by way of nationalization or requisition except for cases stipulated by Russian federal laws or international laws. In case of requisition, the worth of the seized property must be reimbursed to the foreign investor or company with foreign participation. In case of nationalization, the worth of the nationalized property and incurred losses must be reimbursed.

The law also offers foreign investors protection from unfavorable changes in Russian legislation if the foreign investor holds more than 25 percent of a Russian company's share capital. The law also offers foreign investors engaged in a priority investment project protection regardless of the foreign investor's stake in the project's share capital. Foreign investors are protected against:

- newly adopted laws altering customs duties, federal tax rates and contributions to state non-budgetary funds (subject to certain restrictions);
- amendments to current laws resulting in an increase of the investor's tax burden;
- any introduced bans and limitations on foreign investments in Russia.

Foreign investors have this protection during the first seven years of an investment project's pay-back period, starting from the date that the foreign investor began funding the project.

Russian legislation limits the activities of non-Russian investors participating in companies that are of strategic importance to Russia ('strategic companies') that carry out certain activities, including:

- exploration of subsoil and extraction of mineral resources on land plots of federal importance;
- aerospace activities;
- certain services provided by a natural monopoly or a company with a dominant position on the Russian market;
- harvest of live aquatic resources;
- activities controlling hydro-meteorological and geothermal processes and events;
- certain activities related to the use of nuclear and radiation-emitting materials;
- certain activities related to the use of encrypting facilities and bugging equipment;
- military related technical activities.

Thus, non-Russian state companies are prohibited from performing transactions that would allow them to control strategic companies (e.g., from purchasing more than 50 percent of the voting shares (participation units) of a strategic company, participating in the regulatory body of a strategic company, etc.).

Non-Russian state companies may perform some transactions after obtaining approval from state authorities (i.e. purchase of more than 5 % of voting shares (participation units) of a strategic company (different thresholds are set for different types of strategic companies)).

Other non-Russian investors (non- Russian private companies; non-Russian individuals; or Russian companies controlled by non-Russian companies or individual(s)) are permitted to carry out transactions that would result in their acquisition of control over a strategic company. However, such transactions, among others, must be approved by the state authorities.

Russian legislation limits the ability of non-Russian investors to participate in companies that are of strategic importance to Russia.

2.2. Currency Control

2.2.1. General approach

Most currency restrictions in Russia were removed in January 2007, following amendments to Federal Law No. 173-FZ "On Currency Regulation and Currency Control" dated 10 December 2003 (the "**Currency Law**"), which regulates currency transactions.

Consequently, most currency transactions can be conducted without limitation. However, the Currency Law, and related regulations, still provide for a number of restrictions which should be considered (i) when dealing with transactions between residents and non-residents (in particular when importing and exporting goods and capital); and (ii) when importing and exporting foreign currency in cash.

2.2.2. Foreign currency transactions

Foreign currency transactions between residents

The following persons are considered to be "residents":

- nationals of the Russian Federation, except those who are (or are considered to be) living abroad on a permanent basis;
- foreign nationals and stateless individuals who live permanently in Russia on the basis of a residence permit;
- legal entities duly registered under Russian law;
  diplomatic representatives, consular offices and other official representatives of the Russian Federation; and
- the Government of the Russian Federation, regions and municipal units of the Russian Federation.

Generally, foreign currency operations between residents are prohibited, although there are some exceptions. For example residents may borrow from, and then repay to the Russian banks in foreign currency. Contracts in Russia may be concluded in foreign currencies. However, the actual payment must be made in rubles. This can lead to exchange rate differentials, which may arise between the date the transaction is entered into and the payment date.

Foreign currency transactions between non-residents

The following persons are considered to be “non-residents”:

- individuals who are not defined as residents;
- started from 5 June 2012, Russian individuals living legally outside the Russian Federation for a period of at least one year (as per amendments to the Currency Law as of December 2011);
- legal entities and all other organizations that are registered under the legislation of a foreign country, and that are located outside the Russian Federation;
- representative offices and branches of legal entities or other organizations located in the Russian Federation and registered under the legislation of a foreign country; and
- diplomatic representatives, consular offices and other official representatives of foreign countries, as well as international and intergovernmental organizations that is located in the Russian Federation.

Payments in any currency are permitted without restriction between non-residents, provided that any such payments in Russian rubles in the territory of the Russian Federation are made to and from the non-residents’ accounts opened with Russian authorized banks[1]. Settlement of the purchase and sale of securities transactions between non-residents are also permitted, although they can be subject to Russian securities market and anti-monopoly regulations.

Foreign currency transactions between residents and non-residents

Generally, foreign currency transactions between residents and non-residents are also permitted without any restrictions. However, “transaction passports”, which record foreign currency flows through Russian authorized banks, are required to be filed and maintained with an authorized bank (where the resident’s account is opened) for all transactions involving the import or export of goods, loans, the provision of services and intellectual property between residents and non-residents.

Under the transaction passport (and as part of its regular reporting), the bank reports the receipt and repayment of the currency to the Central Bank of Russia (the “**CBR**”).

[1] Credit organizations holding a CBR license for conducting operations in a foreign currency.

In 2011, the Currency Law was amended to ease transaction passport requirements. In particular, the requirement of having such a passport for cross-border transactions up to USD 50,000 (or its equivalent in another currency) was dropped. For cross-border loan transactions, however, the threshold remained at the same level of USD 5,000 (or its equivalent in another currency). Furthermore, residents must repatriate, with certain exceptions, rubles and foreign currency received from international trade and commercial activities into their Russian licensed bank accounts. Among the exceptions there are payments due to a non-resident lender. These payments may be directly transferred into the lender's foreign bank account.

2.2.3. Import and export of foreign currency in cash

Residents and non-residents can import and export foreign currency in cash subject to the following rules:

- Import rules

Threshold Amount	Restriction requirements
Up to $10,000	No restriction
Exceeding $10,000	Subject to customs declaring in written form

- Export rules

Threshold Amount	Restriction requirements
Up to $3,000	No restriction
Up to $10,000	Subject to customs declaring in written form
Exceeding $10,000	Authorized in the amount up to equivalent import amount on the customs return

2.2.4. Liability

Breach of the currency control rules can result in administrative and criminal sanctions. The Code on Administrative Offences prescribes administrative fines for illegal currency transactions that can range from 75% to100% of the restricted transaction's amount.

This Code also provides for administrative fines as follows:

- between RUB 1,000 to RUB 1,500 (EUR 25[2] to EUR 37) for individuals;
- between RUB 5,000 and RUB 10,000 (EUR 125 to EUR 250) for company officials;
- between RUB 50,000 to RUB 100,000 (EUR 1,250 to EUR 2,500) for legal entities, where they breach the procedures for opening accounts in banks located outside Russia.

[2] For the purpose of this report the exchange rate of RUB 40 = EUR 1 is used throughout this text.

With respect to the breach of rules provided for opening “transaction passports”, fines may range (i) from RUB 4,000 to RUB 5,000 for company officials (EUR 100 to EUR 125) and (ii) between RUB 40,000 to RUB 50,000 (EUR 1,000 to EUR 1,250) for companies.

More serious criminal sanctions may be applied under the Russian Criminal Code. In particular, it stipulates that persons not repatriating foreign currency to accounts in Russia where it is required by law may face limitation of freedom, compulsory labor or imprisonment in each case for a term of up to three years. This type of punishment is only applicable to a company’s general director.

3. BUSINESS AND PERSONAL TAXATION

3.1. Taxation of foreign companies in Russia

A foreign company which carries out activity in Russia through a "separate division", a term which includes representative offices, branches, construction sites and other places of business, for a period exceeding 30 days in a calendar year, is required to register with the Russian tax authorities within 30 days from the moment of commencing its activity. This rule applies regardless of whether the activity is taxable or not. In case the foreign company operates in more than one location, it must register separately in each location where it is present. Each real estate project or construction site must also be separately registered.

Although the taxation of a separate division of a foreign company is very alike to that of the Russian subsidiary, there are certain differences that can make this an attractive form of doing business in Russia from the tax perspective.

3.1.1. Profit tax

Foreign companies are subject to profit tax which applies to their profits from business activity only if their business activity creates a permanent establishment **(the “PE”).** If no PE exists, foreign entities are exempt from Russian profit tax.

Any foreign company receiving Russian-sourced income that is not connected with the activity of the PE will be subject to withholding tax as described in the Section 3.2 of this Report.
So named “passive" income (such as dividends, interest and royalties) is the most common type of the Russian-sourced non-business related income.

The Tax Code defines the term "permanent establishment" as a branch ("filial"), representative office, division, bureau, office, agency or any other separate fixed place of activity, through which a foreign company regularly performs its business activity in Russia. The term is used exclusively for tax purposes and does not affect the legal status of an entity.

The following areas of activity are expressly listed as giving rise to the creation of the PE:

- exploration for, or extraction of, natural resources;
- construction, installation, assembly, adjustment, maintenance and operation of machinery and equipment, including gambling equipment;
- sales from warehouses owned or rented by a foreign legal entity in Russia;
- provision of services or performance of any other activity, apart from "preparatory and auxiliary" activities or activities explicitly defined as not creating the PE.

A foreign legal entity may also be considered as having the PE if it conducts the activities listed above through a dependent agent. A dependent agent represents a foreign company in Russia under a contract, acts on its behalf, and has and regularly exercises the right to sign contracts on behalf of the foreign company, or negotiates their significant terms.

Russian tax law specifically provides that the gathering and distribution of information, marketing, advertising, market research and the import and export of goods by a foreign company should not by themselves lead to the creation of the PE.

Russia's double tax treaties, which prevail over Russian domestic law, also include a definition of the PE. Thus, if a foreign company qualifies as a resident of a country with which Russia has a tax treaty in force, then the definition of the PE in that treaty will prevail.

3.1.2. Profit tax base calculation

The PEs and Russian legal entities apply similar rules for determining taxable profits and the calculation of taxes due. The rules on tax return submitting and the maintenance of tax registers are also similar. The only major difference between a foreign entity with the PE and a Russian legal entity is the monthly advance payment of profit tax. Permanent establishments are exempt from this requirement and are thus not obliged to remit profit tax on a monthly basis.

Generally, the PEs should calculate their profit tax using the direct method (i.e. gross income net of allowable deductions) to arrive at taxable income. However, when a foreign entity has a PE because it conducts preparatory and auxiliary activities in Russia in favor of third parties on a free-of-charge basis, the PE will be deemed to have taxable income equal to 20% of the expenses of the PE.

In addition, Russian tax law allows the foreign company to allocate income and expenses to its Russian PE. In particular, where all income from activity in Russia earned through the PE is received by the head office of the foreign company, the income of the Russian PE is determined by reference to the foreign company' accounting policy. Moreover, in cases provided by a double tax treaty, Russian tax law also allows a deduction by the PE of overhead expenses incurred by the head office but relating to the PE (e.g. management and administrative costs). The tax authorities may require documentary support and justification of any amounts allocated.

Nevertheless, the allocation of income and expenses between the foreign company and its Russian PE should take into account the functions that are to be performed in Russia, the assets to be used and the commercial risks to be borne. It should be noted that the Russian tax law does not impose a "branch profit" tax on profit repatriated by the PE to its head office.

3.1.3. Property tax

The Tax Code sets forth certain conditions regarding the application of property tax to the foreign company that are summarized below:

- a foreign company which carries out activity in Russia through the PE is subject to the corporate property tax that will apply to both movable and immovable property of the PE in accordance with the corporate property tax rules applicable to Russian legal entities (as referred to Section 3.6 "Corporate Property tax")

- a foreign company whose activities do not constitute the PE shall be subject to the property tax only on its immovable property located in Russia.[3]

There are also some differences in the taxation of immovable property depending on whether it is owned by a foreign legal entity or a Russian legal entity.

For example, the immovable property tax base of a foreign company without having the PE in Russia, or which does not relate to the PE of the foreign company in Russia, is calculated on the basis of the inventory value of the property (as determined by the relevant state body) rather than the average annual value. Thus, the tax base for the year will be the inventory value as of 1 January, with the quarterly advance tax payments based on one quarter of the inventory value multiplied by the applicable tax rate.

3.2. Russian-sourced income of foreign companies

Like in many other jurisdictions, the income of a foreign entity that was generated from the Russian source and that is not attributable to a permanent establishment may be subject to withholding tax at source. The responsibility for withholding the tax lies with the tax agent — the Russian entity or foreign company with a registered PE — making the payment to the foreign company that does not have the Russian PE. Failure to withhold tax may lead to fines of up to 20% of the tax amount, while delay in payment may lead to late payment interest.

Withholding tax is applied to the following types of Russian-sourced income:

- dividends;
- income relating to the distribution of profit or property, including distributions on liquidation;
- interest on debt instruments, including profit-sharing debt and convertible bonds;
- royalties;
- income from the sale of shares of a Russian corporation if more than 50% of its assets consist of immovable assets located in Russia, or from sales of financial instruments which are derived from such shares (excluding most sales on a foreign stock exchange);
- income from sales of immovable assets located in Russia;
- income from leases and sub-leases of property used in Russia (including sea and aircraft);
- income from international freight, including demurrage and other payments relating to freight;
- fines and penalties due by Russian parties for breaking contractual obligations
- other similar types of income.

Income generated from the sale of goods, the performance of works and the provision of services in Russia are not subject to Russian withholding tax, provided that the activity does not lead to the creation of a Russian PE. Withholding tax is applicable regardless of the form of payment and includes payments in kind or by means of a mutual offset of liabilities between the seller and the buyer. With respect to income from the sale of shares or immovable assets, related expenses may be deducted when determining the tax obligations of the foreign company, provided that the tax agent receives documents supporting the expenses before payment is made.

[3] Thus, a foreign company that owns only the movable assets located in Russia which is not attributable to the PE of such foreign company in Russia shall not be subject to the corporate property tax on that movable property.

The withholding tax rate varies according to the type of income, as shown in **Table 1** below.

% Rate	Type of income
10	Income from international freight and rental of property involved in international shipping and income from leasing and sub-leasing sea and aircraft
15	Dividends received by foreign companies from Russian legal entities, as well as interest on state and municipal bonds
20	Royalties, interest (other than that received from state and municipal bonds), income from leasing and sub-leasing of property used in Russia, distribution of profit or property to foreign companies, including liquidation proceeds and other similar income of a foreign company without a PE in Russia
20	Profit from the sale of shares (or share derivatives) in a Russian entity, where more than 50% of the company's assets consist of immovable property located in Russia, or from the sale of immovable property located in Russia, provided that the income recipient submits documents supporting the deductibility of the expenses to the tax agent prior to his payment of the proceeds. In the absence of documentation, etc., it is 20% of the sale proceeds.

The issuer of securities must act as the tax agent regarding the payment of interest and dividends to the foreign company, and if the issuer fails to withhold the relevant tax, responsibility lies with the broker, asset manager, nominal holder or other agent to the transaction.

The broker, asset manager, etc., is also the responsible tax agent with respect to withholding tax on a capital gain derived by the foreign company from the disposal of securities.
The tax agent is not obliged to withhold tax in the following circumstances:

- the tax agent has received notification from the taxpayer that the income relates to a PE of the taxpayer in Russia, and the taxpayer has provided a notarized copy of its tax registration certificate, issued no earlier than the previous tax period;
- the income is exempt from tax under a production sharing agreement;
- the relevant double tax treaty provides for an exemption from withholding income tax.

To claim the benefit of a double tax treaty at the time of paying Russian-sourced income, the foreign legal entity must provide written confirmation to the payer that it is a tax resident of that foreign country. The written confirmation must be provided prior to the payment date. It must also be certified by the competent foreign body and apostilled.

The Russian tax authorities may also request for a notarized Russian translation of the confirmation. If confirmation is not provided prior to payment, and the foreign company suffers a withholding rate, which is higher than that provided by the treaty, it is possible to claim a refund within the three year period following the end of the tax period in which the payment was made.

In general, after receiving the proper documentation, the Russian tax authorities should refund any excess tax within one month of the date of the application. However, in practice this process is usually significantly delayed.

Special provisions allow banks to bypass the residence confirmation requirement for inter-bank transactions, provided that the residence of the foreign bank in a treaty jurisdiction can be confirmed by reference to a public information source.

3.3. Profit tax

3.3.1. Taxpayers

Profit tax applies to Russian legal entities and foreign legal entities carrying out activities in Russia through a permanent establishment or receiving income from Russian sources. A Russian legal entity must be registered with the local tax inspectorate according to the company's registered address, as well as at the offices corresponding to any branch or subdivision of the entity. The company is subject to the profit tax in respect of each of these locations.[4]

From 2012, the Tax Code introduced consolidation for profit tax purposes for taxpayer groups if all the qualifying Participants taken together meet the following minimum requirements in relation to the preceding calendar year:

- total taxes paid of 10 billion rubles (approximately USD 330 million);
- total revenue of 100 billion rubles (approximately USD 3.3 billion);
- total value of assets (at year end) of 300 billion rubles (approximately USD 10 billion).

3.3.2. Tax rate

The maximum profit tax rate is 20%, comprising:

- 2%, payable to the Federal budget
- 18%, payable to the Regional budget

Regional governments have the right to reduce their portion of profit tax by up to 4.5%. Please refer to Section 3.7 of this Report for further details.

3.3.3. Tax base

The tax base is defined as total income received by a taxpayer less related expenses and allowable deductions. Income includes sales income, i.e. total proceeds from the sale of goods, works, services and property rights and non-sales income. Income received in a foreign currency must be converted into rubles using the official exchange rate set by the Central Bank of Russia (CBR) as at the date of income recognition.

Non-sales income includes goods, works, services and property rights received free-of-charge, based on market value, except in the case of property received by a Russian company from its parent or subsidiary where the parent owns more than 50% of the subsidiary. This exemption is applied if the property (other than cash) is transferred to a third party within one year. Non-taxable income, of which the legislation provides an exhaustive list, also includes property and property rights received as a contribution to a company's charter capital, leasehold improvements made by a lessee to the lessor's property, and interest received on overpaid tax.

[4] Please refer to the Section 3.1 and Section 3.2 of this Report for details about the taxation of the foreign companies and to the Section 3.7. For information on profit tax reductions and exemptions.

Deductible expenses are subdivided into sales expenses related to the core business activity of a taxpayer and non-sales expenses.

Income from the sale of unquoted shares and participations in Russian companies, and of quoted shares in high-technology Russian companies, acquired after 1 January 2011 and held for at least 5 years, are exempt from profit tax. Assets and liabilities denominated in foreign currency must be converted into rubles. The revaluation profit or loss is included in non-sales income/expense on the earliest of: the last day of the reporting (tax) period or the date of disposal/settlement.

3.3.4. Recognition of income and expenses

There are two alternative methods for recognizing income and expenses depending on the level of income. The accruals basis must be used by taxpayers with an average income exceeding RUB 1 million (approximately USD 33,000) per quarter for the previous four quarters, while taxpayers falling short of this threshold may choose between the accruals or cash basis.

3.3.5. General criteria for deducting expenses

Expenses are considered deductible for profit tax purposes if they meet three general criteria: the expenses must be incurred in the course of a taxpayer's income generating activity, be economically justifiable and supported by relevant documentation. They must not be listed as one of the specifically non-deductible expenses provided in the law. Additional deductibility criteria applying to certain types of expenses are noted below.

In practice, the tax authorities apply the general criteria very strictly, and may challenge any expense which is not directly related to the generation of income. Expenditure which indirectly benefits or promotes the growth of the business may not be considered "economically justified".

Documentary requirements are also exacting, and include both documents specified by legislation (agreement, act, invoice and VAT invoice) and other supporting materials.

For overseas expenses, the documentation must be prepared in accordance with the common business practices of the country where the expenses were incurred, although this does not guarantee deductibility.

3.3.6. Depreciation

Depreciable property is property, both tangible and intangible, which has the following characteristics:

- a useful life of at least 12 months
- a value of no less than RUB 40,000 (approximately USD 1,300).

3.4. Withholding income tax

A foreign company receiving Russian - sourced income which is not attributable to its Russian PE (e.g., rent, royalties, interest and dividends, freight income, etc.) is subject to withholding income tax at the source.

Income derived from the business activities of the foreign company in Russia (e.g., nonrecurring consultancy services), which do not give rise to the PE, are exempt from withholding income tax.

There is no withholding tax on the repatriation of profits from the local Russian RO or branch of a foreign company to the head office. However liquidation proceeds are subject to taxation at source.

3.4.1. Tax rates

Withholding income tax rates vary depending on the type of taxable income. Tax rates for dividend income are:

% Rate	Type of income
0	dividends payable to the Russian company if this Russian company owns at least 50 percent of shares in the dividend payer for 365 consecutive days provided that the dividend payer is not a resident of an off-shore country (e.g., BVI, Guernsey, Jersey, Cyprus, or any other state indicated in the list established by the RF Ministry of Finance).
9	for dividends received by the Russian company from the Russian company or foreign company.
15	for dividends payable to the foreign company by Russian company.

Generally, the foreign companies having no PE in Russia are subject to a 20 percent withholding income tax on most Russian source income such as interest, royalties, income from leasing and rental operations, etc.

Freight income is taxed at 10% rate. Withholding income tax rates may be reduced down to 0 % rate in accordance with double tax treaties concluded between the Russian Federation and the country of the factual beneficiary's residence.

A foreign company should confirm its residency in a country party to a double tax treaty with the Russian Federation to enjoy the reduced withholding income tax rates. This confirmation is documented by a certificate issued by the relevant foreign authorities. In the absence of the proper certificate, tax should be withheld and remitted to the budget. If tax is withheld even though treaty relief is available, a refund claim can be filed by the foreign recipient.

3.4.2. Filing and payment

Withholding income tax should be withheld from income payable to the foreign company and remitted to the budget on the date when the payment is made to the foreign company. The Russian company (or the foreign company with PE in Russia) should also file a withholding income tax calculation.

3.5. Value added tax

Value Added Tax (VAT) is an indirect tax, the burden of which is borne by the end-customer but should be accounted for by the supplier.

3.5.1. Taxable supplies

Generally VAT should be charged by the taxpayers (companies, individual entrepreneurs, importers of records) on the following transactions:

- sale of goods (works, services) provided that such supplies are performed on the territory of the Russian Federation and Russian continental shelf (including those supplied free-of-charge);
- transfer of property rights;
- transfer of goods, works and services for the taxpayer's own consumption and the incurred expenses are non-deductible for profits tax purposes;
- construction and installation works carried out for internal consumption;
- import of goods into Russia and other territories under Russian jurisdiction.

3.5.2. Place of supply rules

The Tax Code stipulates specific 'place of supply' rules that are applied to determine whether goods, works or services are supplied in Russia and thus are subject to Russian VAT.

It is important to understand where the goods are located at the moment of sale; whether or not the goods have been transported; and where the goods originated from.

Sale of goods, works, services (including those supplied free-of charge) or transferred for the company's own consumption), transfer of property rights, construction conducted by and for the company itself and import of goods into Russia are subject to Russian VAT.

Works (services) are generally deemed to be supplied in Russia if the supplier of such works (services) has a place of business in Russia. However there are specific 'place of supply' rules in the Tax Code for a number of works (services) (for instance, for services related to movable or immovable property, for intangible services like consulting, marketing, engineering, for transportation and freight forwarding services, for works (services) rendered on the Russian continental shelf, etc.).

3.5.3. Taxable base

VAT should be accounted for in prepayments when they are made and/or on the total transaction price at the moment of the goods' shipment, when works are performed, services rendered or property rights transferred.

If more than one of these actions is undertaken, VAT should be accounted for when the first occurs. VAT accounted for on prepayments may subsequently be offset against the full amount of VAT due after disposal.

Effective 1 October 2011, when the value of goods (works, services) has been changed (change in the price of the goods (works, services) or their quantity), an adjusted VAT invoice should be issued and respective amendments to VAT obligations should be performed.

3.5.4. Input VAT

Generally, the Russian taxpayers are entitled to claim for recovery input VAT related to purchased goods (works, services) and property rights provided that:

- goods, works, services and property rights are acquired for the purpose of carrying out VAT-able transactions;
- goods, works, services and property rights are booked in accounts;
- VAT invoices duly prepared in accordance with the invoice requirements provided by the Tax Code (customs declarations for customs VAT) are received by the taxpayer.

In respect of VAT paid at customs upon import and VAT withheld by tax agents, VAT should be paid to the customs authorities/to the Russian budget upon the import of goods / when the payment to an unregistered foreign supplier is made.

Under certain conditions it is also possible for the taxpayers who made advance payments to the suppliers to recover the amount of VAT included in advance payments. In case of performance of the supplies that are both subject to VAT and not subject to VAT, or if different VAT rates are applicable to the supplies, taxpayers in most cases should account for supplies and respective input VAT separately. Recovery of VAT in these cases may be subject to specific rules (proportional recovery, collecting supporting documents, etc.).

3.5.5. VAT invoice

VAT invoice is a specific document serving VAT recovery and is distinct from a commercial invoice. A VAT invoice can be issued either in hardcopy or in electronic format.

3.5.6. Tax rates

Generally, the sales of goods (works, services) are taxable at the standard VAT rate of **18%.**

A reduced VAT rate of **10%** shall apply to certain types of medical goods, books and periodicals, foods and children's goods (according to the list established by the RF Government).

The Tax Code also provides for a list of goods (works, services) that are supplied at **0%** VAT rate. This list includes, inter alia: export sales; international transportation services and related freight forwarding services; transport and certain related services for oil, oil products, natural gas and electrical power transmission; services provided at river and sea ports; and services provided by Russian railway carriers.

To apply the 0% VAT rate, the supplier should collect specific supporting documents within the established term and submit a VAT return with these supporting documents to the tax authorities.

Generally, the sales of goods (works, services) are taxable at a standard VAT rate of 18 percent.

3.5.7. VAT Exemptions

The Tax Code lists certain types of activities that are exempt from VAT, in particular:

- leasing premises located in Russia to foreign individuals and foreign representative offices accredited in Russia;
- selling residential real estate, certain medical goods, medical services, foods produced by students or school cafeterias, public conveyance services, ritual

services, educational services rendered by licensed nonprofit educational institutions, cultural services, art services, etc.;
- banking and insurance services; sales of financial instruments in conditional transactions;
- licensing or assigning certain intellectual property rights.

Import of the specific types of goods into Russia may also be VAT exempt.

The Tax Code provides for certain types of VAT exemptions, primarily related to financial and social welfare services.

3.6. Corporate Property Tax

Property tax is a regional tax, thus its application is governed by regional regulations, as well as the Tax Code.

3.6.1. Taxpayers

The following entities are subject to property tax:

- Russian companies
- Foreign companies which perform their activity via permanent establishments in Russia or own immovable property in Russia
- separate subdivisions of the Russian companies having separate balance sheets.

3.6.2. Tax base

Property tax is levied on both movable and immovable property. Property that is subject to taxation includes so named (i) "Fixed Assets" and "Profitable Investments in Property" as classified under Russian Accounting Standards, and (ii) property provided for temporary use, in trust, contributed under a simple partnership (joint activity) agreement, or received under the concession agreement.

Land, water and other natural resources are not subject to property tax.

The tax base is determined as the average annual residual value of taxable property (i.e. cost less depreciation), calculated in accordance with Russian accounting principles. The average annual value is calculated by taking the sum of the residual values of the relevant property on the first day of each month of the tax period and the last day of the tax period divided by the number of months in the tax period plus one.

For details on how property tax applies to the foreign companies, please refer to the Section 3.1 of this Report.

The property of religious organizations and various types of public organization is under tax exemption.

3.6.3. Tax rates

The maximum rate of the corporate property tax as set forth by the Tax Code is 2.2%, and this is the rate, which is currently applied in the majority of Russia's regions, including Moscow and St. Petersburg. However, a reduction or exemption is offered by some regional authorities, often conditional on investment in the region.

3.6.4. Tax payments

The usual fiscal period is a calendar year. Nevertheless, advance tax payments must be calculated and paid based on the results of each calendar quarter. Advance payments are computed by multiplying the average net book value of taxable property for the reporting period by one quarter of the applicable tax rate. The total amount of tax due for a tax period is determined by multiplying the tax base for the tax period by the tax rate for the entire period less the advance payments remitted for each quarter to date.

Corporate Taxpayers must file quarterly tax returns no later than 30 days after the reporting period. Annual tax returns should be filed no later than 30 March following the reporting period.

Regional authorities have the power to amend the tax payment deadlines. Some authorities exempt certain categories of taxpayers from their obligations to make quarterly advance payments. Interest applies to late payment of tax.

3.6.5. Property located in other regions

When an entity owns immovable assets located in a region other than that where it is registered, it is required to pay tax to the budget of the each region where the assets are located. The tax rates and the filing and payment procedures are governed in accordance with the law of that particular region.

3.7. Tax Incentives

The examples of current tax incentives that are considered mostly attractive for the companies that are intending to start doing business in Russia will be the special economic zones and Skolkovo innovation center.

3.7.1. Special economic zones

The corporate taxpayers may enjoy certain benefits from tax incentives granted under the special economic zones regime (“**SEZ**”), which were created in Russia by Federal Law No. 116-FZ “On Special Economic Zones in the Russian Federation” dated 22 July 2005 in order to promote economic growth in specific areas and regions of Russia.

The major purpose for formation of the SEZ is to attract foreign investment as SEZ are exempt from customs duties. They are deemed to be an effective means of promoting import/export business. The tax advantages provided for the residents of these zones are as follows:

- reduced corporate profits tax;
- exemption from property tax and land tax; and
- Exemption from customs duty and VAT (in several cases).

Types of SEZ

There are four types of SEZ:

- technical research and implementation zones (Saint Petersburg, Dubna, Tomsk, Zelenograd);
- industrial production zones (Lipetsk, Tatarstan);

- recreation and tourism zones (Altai, Buryat Republic, Kaliningrad); and
- port zones.

A company registered in Russia is entitled to obtain the status of a SEZ resident after entering into a special agreement with the local agency in charge of the relevant zone.

3.7.2. Skolkovo innovation centre

In 2010, a territorially isolated complex in the Moscow Region named the “Skolkovo innovation centre” was created for the purpose of research, development, and commercial development of research and development activity. A special legislative regime regulating how it will operate has been established.

The Participants in the Skolkovo initiative benefit in particular from the following tax, customs and accounting incentives:

- 0% corporate profits tax rate applicable to income generated as a result of research, development and commercial development for the first ten years from the moment of the respective Skolkovo project participant’s registration;
- exemption from property tax and land tax;
- reduced payroll-related taxes;
- VAT exemption;
- reimbursement of customs duties and VAT payable upon the importation of goods;
- exemption from the obligation to keep financial accounting, unless the Participant’s annual income exceeds RUB 1 billion (EUR 25 million); and
- exemption from the payment of state duties for the issuance of work permits, invitations and visas for foreign employees.

In order to operate in the Skolkovo innovation centre and benefit from the above incentives, investors have to set up Russian companies to conduct research there and to follow a special procedure to obtain the relative status for these new companies.

3.8. Other taxes

3.8.1. Excise tax

Taxpayers

Excise tax is payable by companies and individual entrepreneurs on the production of the excised goods in Russia, or when imported into Russia.

Excisable goods

The primary categories of excisable goods are cigarettes and tobacco products, motor vehicles, ethyl alcohol and certain spirit-based and oil products. There is no excise tax on natural gas and crude oil.

Import and export of excised goods

Since Russia generally applies the "destination principle" in assessing consumption taxes, exports of excised Russian goods outside of Russia are free from excise tax. To obtain the above exemption, a taxpayer must comply with certain customs export procedures and present documentation evidencing the export of the goods.

A separate procedure for payment of excise taxes is established for goods imported into Russia from the Customs Union member states.

Tax rates

Excise tax rates may vary depending on the category of excised goods. The rates are periodically adjusted by the tax authorities. The tax base is determined by either the quantity of excisable goods or the value of such goods depending on whether the tax rates are specific (i.e. a fixed amount per unit) or *ad valorem* (a percentage of the sales price).

Excise tax should be charged at the date of sale, which is generally deemed to be the date when the goods are actually delivered. A producer of excised goods may deduct excise tax paid on the purchase or import of excisable goods used in the production of those goods. Otherwise, excise tax is non-deductible.

Excise Payments and filings

The tax period is the calendar month. Deadlines for tax payments and submission of tax returns may also vary, depending primarily on the category of excised goods. Excise tax reporting and payments must be made at the location of the taxpayer and at any separate sub-divisions which carry out transactions subject to the excise tax.

Certain alcohol and tobacco products, both domestic and imported, require an advance payment by means of an excise stamp, which must be attached to each excisable item at the place of production prior to its sale.

3.8.2. Land tax

Land tax is a local tax, thus its application is governed by local regulations, as well as the Tax Code.

Taxpayers

Land tax applies to legal entities and individuals who own land or have a permanent right to its use. Legal entities and individuals who apply special tax regimes, use land free of charge, or under lease agreements, are not subject to land tax.

Tax base

The tax base is the cadastral value of the land as determined on 1 January of the reporting year

The cadastral value for a specific plot is determined in accordance with the Russian Land Code. In the case of joint ownership, the tax base is determined for each taxpayer's share of the land. The tax base of land formed during a tax period is the cadastral value on the date of its cadastral registration.

Tax allowances

Religious, historical or cultural sites, as well as land used by the state enjoy exemptions from land tax.

Tax rates

Local authorities set the land tax rate. According to the Tax Code, these rates may not exceed the following limits:

- 0.3% of the cadastral value of land which is either (i) used for agricultural purposes, or (ii) occupied by residential properties or utilities;
- 1.5% of the cadastral value of other land
- in Moscow, the following tax rates are applicable: (i) 0.3% for agricultural land, 0.1% for land used for residential purposes, and (ii) 1.5% for land used for any other purposes.

Tax calculation, payments and filing

Although the tax period for land tax is a calendar year, most taxpayers must make advance tax payments on a calendar quarterly basis. Also, regional authorities can exempt certain other categories of taxpayers from remitting quarterly advance payments.

The amount of advance tax payable is calculated by multiplying one quarter of the applicable tax rate by the cadastral value of the land subject to taxation, as determined on 1 January of the current tax period.

Legal entities and individual entrepreneurs must file an annual tax return (and pay the balance of tax) no later than 1 February of the following year.

Regional authorities have the right to amend the deadlines for tax payments, including advance payments, but individuals need not pay the tax any earlier than 1 November of the following year.

In Moscow, legal entities and entrepreneurs must pay the land tax no later than 1 February, and individuals no later than 1 December, of the following year.

3.8.3. Transport tax

Transport tax is a regional tax, thus its application is governed by regional regulations, as well as the Tax Code. The respective local authority may only impose this tax if its legislation contains transport tax provisions in compliance with the Tax Code.

Taxpayers

The companies who are registered owners of "transport vehicles" are subject to transport tax.
Transport vehicles are not limited to cars, motorcycles, motor scooters or buses, but include other transport vehicles, including aircraft, helicopters, yachts, snowmobiles, etc.

However, aircraft, ships and river vessels owned by companies whose main activity is the transport of passengers or freight are exempt, as are vehicles used in agricultural production.

Tax base and rates

The tax base for transport vehicles subject to transport tax depends on the type of the vehicle. The tax rates are set out in the Tax Code, with those for motorized transport vehicles ranging from RUB 5 to 50 (approximately USD 0.15 to 1.50) per unit of horsepower. Regional authorities have the authority to increase or reduce these rates by a multiple of no more than 10 for certain types of motorized transport vehicles.

Tax payments and filing

Although the tax period for transport tax is a calendar year, most legal entities must make advance tax payments on a calendar quarterly basis. Regional authorities can exempt certain categories of taxpayer from advance tax payments. The amount of advance tax payable is calculated by multiplying the tax base by one quarter of the applicable tax rate for the current tax period.

Filing and payment deadlines are set forth by the regional authorities. The companies shall file annual tax return (and pay the balance of tax) no later than 1 February of the following year.

Just for the reference, the individual taxpayers are required to pay transport tax annually on the basis of notifications issued by the tax authorities in the location where the transport vehicle is registered, but no earlier than 1 November of the following year.

3.8.4. State duty

The Tax Code currently provides an exhaustive list of state duties.

The main items applicable to legal entities include:

- bringing of a court claim;
- the state registration of a legal entity; and on the accreditation of branches and representative offices of a foreign legal entity;
- the state registration of issues of shares, including certain securities placed through subscription;
- the state registration of a mutual investment fund;
- obtaining a license to conduct certain activities;
- services provided by notaries;
- vehicle registration

A 1% levy applies to computers, mobile phones and other recording equipment, along with recording media. The tax base is broadly customs value for imported equipment, or manufacturer's sale price.

Investors should note that additional taxes, levies and fees may exist depending on the region.
These include, for example, license fees for the use of sub-soil resources, pollution levies and timber duties.

3.9. Personal Taxation

3.9.1. Personal income tax

Personal income tax **("PIT")** in Russia depends on the taxpayer's tax residency status. An individual is considered a Russian tax resident if he/she is physically present in Russia for a period of 183 days or more during 12 consecutive months.

Short-term travel (less than 6 months) outside Russia's borders for medical treatment or educational activities does not interrupt the individual's presence in Russia.

The clarifications of the Russian Ministry of Finance state that both days of arrival and of departure should be counted when calculating days of presence in Russia for the purpose of determining an individual's tax residency status. Clarifications also state that if a

company makes a payment locally in Russia, it should determine the individual's tax residency status on each date of payment in order to apply the appropriate withholding tax rate.

Residency is determined on the basis of a 183-day period within the 12-month period immediately preceding the date of income payment. Consequently, the tax withheld may not be final.

Final tax liabilities are determined based on the individual's tax residency status for the reporting calendar year. This status is determined based on a 183-day period in the reporting calendar year. Tax residents are subject to PIT on worldwide income, whereas nonresidents are subject to PIT only on Russian-source income.

Residents are subject to PIT on worldwide income, while nonresidents are liable only with regard to Russian source income.

Tax base

Taxable income includes income received in cash, in kind, and in a form of deemed income. Income in kind is assessed based on the market price of the goods received or services consumed.
Deemed income results when:

- interest payments on loans from organizations and sole proprietors when the payments are benchmarked to a rate of 2/3 the refinancing rate of the Bank of Russia on loans in Russian rubles, or to 9% per annum on loans in other currencies. The use of credit cards issued by non-Russian banks may also trigger deemed taxable income for the card holder.

- favorable prices are paid by an individual for goods or services purchased from related parties.

- securities and financial instruments are acquired at a price below market level.

Tax rates

13% PIT applies to all types of income, with the following exceptions:

- 9% on dividend income received by tax residents (both from the Russian companies and foreign companies), and also to interest income on the specific debt securities;
- 13% on the Russian employment income of tax non-residents who are foreign employees having the status of highly-qualified specialists;
- 13 % on Russian employment income of tax non-residents who are foreign nationals staying in Russia on a visa-free basis and who are individuals engaged based on a special license to work for personal, home and similar needs;
- 35 percent on certain types of non-employment income (e.g., deemed income resulting from favorable interest for the use of loans);
- 15 percent on dividend income received by tax non-residents from Russian companies;
- 30 percent on the Russian-source income of tax non-residents (except for dividend income from the Russian companies, Russian employment income of highly-qualified specialists and income tax payable on license by foreign nationals staying in Russia on
  a visa-free basis).

Generally, tax residents pay PIT on the majority of income types at a 13% flat rate.

Tax deductions

Standard tax deductions

Standard monthly tax deductions of RUB 3,000 (USD93.75) and RUB 500 (USD15.60) could be granted to certain categories of individual taxpayers (such as disabled war veterans, handicapped persons etc.). If a taxpayer is eligible for multiple tax deductions, the higher deduction should apply.

Tax refund

PIT declaration should also be required if individuals want to claim tax deductions or refund PIT which was excessively withheld by the tax agent in certain cases.

3.9.2. Other taxes payable by individuals

Personal property tax

Houses, apartments, cottages, garages and other buildings, premises and constructions owned by individuals are subject to personal property tax.

Tax rates may vary – from 0.1% to 2 % per annum – depending on the inventory value of the property. Certain categories of taxpayers are exempt from personal property tax (e.g. pensioners). Individual property tax is assessed by the tax authorities annually and should be paid by taxpayers based on a tax assessment not later than 1 November of the subsequent calendar year.

Individuals who possess immovable property are subject to personal property tax.

Transport tax

Individuals owning transport vehicles and/or possessing a vehicle based on a power of attorney are subject to transport tax.

Taxable vehicles include automobiles, motorcycles, scooters, autobuses, airplanes, helicopters, motor vessels, yachts, sailing boats, boats, snowmobiles, etc. Transport tax is determined on the basis of the vehicle's engine power/capacity and the respective tax rates established by regional laws.

Individuals possessing transport vehicles are subject to transport tax.

4. LABOR AND EMPLOYMENT

4.1. Labor regulations

Relations between employers and employees are primarily regulated by the Labor Code of the Russian Federation (Labor Code).

Employment relations are subject to the Labor Code, other legal acts of the Russian Federation containing labor regulations (including local acts adopted by the employer), the

employer's collective agreement (if any) and direct employment contracts with the employee.

Employees shall enjoy the rights and benefits as granted by the Russian labor legislation, which also governs the types of employment contracts and conditions of their conclusion, amendment and termination.

The Labor Code establishes an important provision ensuring employee rights, according to which employment contracts may not worsen the position of employees as compared to labor legislation.

The Labor Code is the core legal act that is currently regulating labor relations between employees and employers.

4.1.1. Social partnership

According to the Labor Code, the "social partnership" is defined as the system of relations between employees, employers, state and local authorities aimed at regulating and balancing the interests of employees and employers in the area of labor relations. The following areas of interest, among others, are regulated:

- negotiation of collective agreements;
- mutual consultation on employment issues;
- participation of employees in the management of the company;
- participation of parties in preliminary out-of-court negotiations.

4.1.2. Collective bargaining agreement

A collective bargaining agreement may be concluded between an employer and employees. The law does not require a collective agreement if neither party requests it.

Trade unions normally represent employees when such an agreement is concluded. The employer is represented by the general director or his/her authorized representative(s). The law allows the parties to define the content of a collective agreement independently, provided that, however, such conditions may not be less favorable than those set forth by the Labor Code.

The collective bargaining agreement is subject to registration with the appropriate State Labor Office.

According to the Labor Code, the employer should consider the opinion of the trade union(s) on certain matters (if such union exists). Trade unions in Russia are more typically formed at a company level rather than on an industry-wide level.

4.2. Employment conditions

4.2.1. Employee guarantees

General Guarantees

Russian labor legislation provides certain guarantees for employees that can be summarized as follows:

- standard working hours are not to exceed 40 hours per week;

- overtime is permitted for certain categories of employees under specified circumstances, but generally should not exceed four hours in two successive days and 120 hours per year. Overtime is payable at the following rates: 1.5 times normal salary per hour for the first two hours and, 2 times for subsequent hours and for work on weekends and non-working days. Also, employees may demand additional days-off as compensation for overtime;

- an employer may not require an employee to perform functions beyond those set out in his/her employment contract unless business circumstances require that this is done, in which case the employer has the right to transfer the employee to a position in a different line of work for a period not exceeding one month;

- an employee may be assigned to a job which requires lower qualifications subject to the employee's written consent. Performance of additional functions if required from an employee by the employer is subject to the employee's written consent and relevant paperwork should be prepared;

- employees are entitled to 12 paid public holidays and an annual leave of at least 28 calendar days. For some categories of employees, the minimum annual leave established by legislation may exceed 28 calendar days;

- employees are entitled to sick leave allowance paid by the employer and Social Insurance Fund based on an employee's wages and vary between 60 percent to 100 percent of the wage amount, depending on the length of service but may not exceed RUB1,203 per day of sickness (USD37.6);

- wages for time spent away from work, for the performance of the functions of a trade union officer, appearing in court, going to vote, and fulfilling other state or social responsibilities;

- severance pay in certain situations;

- certain social benefits: maternity leave, paid holidays and vacation time;

- overtime is permitted for certain workers, subject to certain conditions.

Guarantees for Women Employees

- women are entitled to maternity leave for 70 calendar days (84 days for multiple births) prior to childbirth and 70 calendar days (86 days in the case of birth complications, and 110 calendar days for multiple births) after childbirth;
- maternity leave is granted together with social insurance benefit paid out in the amount established by statutory legislation;
- regardless of the employment period with a specific company, a woman is entitled to annual paid vacation which may be taken either before or immediately after maternity leave, as well as leave up until the child's third birthday;
- during the period of maternity leave until the child reaches one and a half years of age, the woman is paid a social insurance allowance.
- fathers, grandparents and other relatives are entitled to baby care leave under certain circumstances.

Trade Unions

Employees may organize trade unions and participate in the management of the company.

The primary trade union represents the interests of employees in dealings with the employer, ensures that the terms of the collective agreement are being complied with and participates in the resolution of labor disputes in accordance with statutory legislation.

Labor legislation establishes a number of guarantees for employees such as social benefits and compensation, severance and overtime payments, etc.

Employment contracts

The Labor Code provides that an employment contract should contain “essential” conditions (e.g., place of work, starting date, position, working hours, salary and benefits, other) and “additional” conditions (e.g., trial period, confidentiality, other).

There are following major types of employment contracts:

- an indefinite term contracts; and
- a fixed term contracts concluded for the period not exceeding five years.

The fixed term contracts can only be concluded if the employment relationships cannot be established for an indefinite term and if the specific conditions are satisfied. In particular, the fixed term contracts are permitted to be concluded with the following employees' categories:

- directors, deputy directors, chief accountants;
- employees working in companies created for a specific project;
- part-time workers (having more than one job);
- if the work is temporary in nature.

Employers are required to conclude an individual written employment contract with each employee. After the contract is signed, a respective order for the employee's admission to work should be issued by the general director.

The grounds for termination of employment according to the Russian labor law are as follows:

- by mutual agreement between the parties;
- expiry of the term of the employment contract;
- cancellation of the employment contract at the initiative of the employer (as discussed below) or employee;
- refusal of the employee to continue working due to a change in owner or subordination of the employer, or its reorganization;
- refusal of the employee to continue work owing to relocation of the employer.

In general, an employee may terminate a contract by providing two weeks prior written notice to the company, unless an earlier termination is mutually agreed. The fixed term employment contract may be terminated by an employee if he/she is injured or disabled and unable to perform the required work, management violates employment legislation, the collective agreement or employment contract, or if the employee has other good grounds for doing so.

In some cases, the employee may terminate an employment contract without prior notice.

An employer may terminate a contract under strictly determined circumstances:

- an employee submitted false documents when hired;
- an employee fails to discharge work duties on a regular basis for no good cause – is absent for no good cause, is inebriated at work – or discloses state, commercial information or internal confidential information of the employer, steals from the employer, fails to comply with labor protection requirements, resulting in significant damage;
- the director of a company or company branch commits a single violation of employment responsibilities;
- an employee with financial responsibilities commits an act in breach of the trust of the company.

Russian law further provides that the employment contracts with some categories of employees cannot be terminated at the employer's initiative:

- pregnant women or women with children under the age of three;
- single women with children under 14 or disabled children under 16.

In case the employees are under 18 years of age, an employment contract may be terminated with the approval of the State Labor Inspectorate and Commission on Minors.

It may also appear difficult to terminate the employment contract on the grounds that the employee is not fully matching the position unless there are clearly stated job requirements that can demonstrate failures on the employee's side. The Russian courts generally decide to the favor of the employee when considering cases of alleged wrongful dismissal. In practice, companies seek where possible to secure the employee's voluntary resignation.

The Labor Code prohibits the termination of labor contracts with certain categories of employees at the initiative of the employer.

Work book

Russian labor legislation requires that a work book shall be kept for each employee who has worked for at least five days at a company, if this work is the employee's main employment.
This is the basic document in which is recorded the employment history of each individual over his/her lifetime. This book indicates the grounds for termination of employment contract and records of rewards for achievements at work, work performed by the employee, transfers to another permanent work, etc.

Every entry to the work book is attested by the signature of the authorized representative of the employer and by the employer's stamp.

Trial period for an employee

Trial periods (typically up to a maximum of three months) are permitted to assess the suitability of employees for a position. Certain categories of employees are not subject to a trial period (e.g. pregnant women, minors, transferees). The trial period may be established for six months for directors, deputy directors, chief accountants, deputy chief accountants and directors of branches, representative offices or other divisions.

The trial period for an employee typically lasts for 3 months.

Salary

The Labor Code secures the interests of employees related to timely salary payments as follows:

- the employer should pay salaries at least twice a month. If salary payment is delayed by more than 15 days, the employee has the right to notify the employer and to stop working. In such cases, the employer may be obligated by a court to reimburse the employee for each idle day in the amount of two-thirds of the average salary (calculated based on actual salary accrued and the actual working time for the past 12 months);

- the employer must pay interest for each day of salary payment delay in the amount of no less than 1/300 of the refinancing rate established by the Bank of Russia;

- administrative fines can be levied on employing organizations and their responsible officials for delayed salary payments – RUB 30,000 - 50,000 (USD 937.5 - 1562.5) and RUB 1,000- 5,000 (USD 31.3 - 156.3), respectively.

- in some cases, the employer's activities may be suspended for up to 90 calendar days. If the responsible company's official has already been penalized for delayed salary payments, then they may be prohibited from holding the executive positions for 1 to 3 years.

- if salary payments are delayed for more than two months (three months in case of partial delay of salary payments), the criminal liability may also apply. Under the Criminal Code, if it is proved that the delay was due to the general director's unethical actions or other vested interest of the general director, the general director can be liable to pay a fine in the amount of up to RUB 120,000 (USD 3,750), or in an amount equal to his/her wages or income from another source for a period of up to one year. In addition, the general director may be deprived of the right to occupy certain positions or to be engaged in a certain activity for a period of up to five years; or the imprisonment for a term of up to two years could be imposed.

- if the full amounts of salary payments are delayed for more than two months or salary paid is below federal minimum salary level (RUB 4,611) during that period, the Criminal Code provides for a fine in the amount of RUB 100,000 - 500,000 (USD 3,125 - 15,625) or in the amount equal to the salary or wages or earnings from another source of income of the convicted person for a period of one to three years. In addition, the right to occupy certain positions or to be engaged in a certain activities could be relinquished for a period of up to three years with or without imprisonment for a term of three to seven years.

Minimum statutory monthly wage

Minimum statutory monthly wage is used to regulate wages, compensation and other payments made under labor legislation, and also to calculate taxes, levies, penalties and other payments.

As of 1 June 2011, the federal minimum statutory monthly wage amounts to RUB 4,611 (USD 144). This minimum statutory monthly wage in the amount stated above is used only to calculate labor remuneration and allowances for temporary inability to work.

Different minimum monthly wages may be established by subjects of Russia, but no lower than RUB 4,611. Minimum wage for Moscow is established at the level RUB 11,100 as of 1 July 2011.

For other purposes, such as the calculation of taxes, levies, penalties, liabilities under civil transactions, etc., a minimum statutory monthly wage in the amount of RUB 100 (USD3.1) is applied.

Minimum statutory monthly wage is used to regulate wages and other salary related payments and to calculate taxes, levies and fines.

Use of currency for salary payment

Direct salary payment to employees in Russia in foreign currency is prohibited. In Russia salaries are normally paid in rubles. However, in accordance with collective agreements or employment contracts upon an employee's written request, labor may be remunerated in other forms as long as they do not contradict Russian legislation or international treaties to which Russia is party.

The percentage of remuneration made in non-monetary form may not exceed 20 percent of an employee's total salary.

Severance payments

The Labor Code requires severance pay equal to at least two week's average earnings where an employment contract is terminated due to:

- drafting or enlisting of an employee into military or alternative civil service;
- refusal of an employee to be transferred to work in another location together with the enterprise, institution or organization upon its relocation;
- inability to work under the medical certificate issued in accordance with the legislation;
- refusal to continue work due to a unilateral change of the labor agreement conditions made by the employer (such change is only possible in exceptional cases);
- reinstatement of an employee who previously performed the work;
- refusal of an employee to change work as prescribed by relevant medical authorities or if the employer is not able to offer relevant work.

In the event of the dissolution of an enterprise, institution, or organization, or staffing cuts, a one-off payment of monthly average earnings is required. Additional payments are required if the dismissed employee is unable to find work but no more than two months of payments (three months subject to specific conditions).

4.3. Specifics of employment of the foreign nationals

4.3.1. Work permits for foreign nationals

As a general rule, foreign nationals working on the territory of Russia are required to have a work permit. There are a few exceptions to this rule, mainly related to certain CIS nationals and other foreign nationals who possess residency permits.

Work permits may also not be required for the employees of supplier or manufacturer of imported equipment entering Russia for the purpose of installation, supervision of installation or servicing of this equipment.

The standard work permit application process is quite a lengthy and burdensome procedure consisting of several stages. Each stage involves the submission of applications together with an extensive list of documents. These stages include the following:

- registration with the local employment authorities;
- submission of notification on vacancies available in the company to the Employment Service for subsequent conclusion of the authorities on the extension of the engagement of foreign nationals for such vacancies (“**Conclusion”**);
- application for a corporate quota for engagement of foreign labor at the Federal Migration Service of the Russian Federation **(“FMS”)** or the Department of the Federal Migration Service of the Russian Federation (“**Corporate Quota**”);
- application to the FMS for each expatriate’s individual Work Permit (“**Individual Work Permit”**).

Usually the whole procedure to obtain an individual work permit may take up to four months.

The Individual Work Permit is issued for the period up to one year. Separately, based on the Individual Work Permit, a work visa must be obtained. The procedure for visa issue also includes several stages where the specified set of documents should be submitted to the immigration authorities.

Further, with respect to the regular category of work permit, each year by May 1 companies must report the number of foreign employees they anticipate engaging in the next calendar year. This procedure effectively constitutes a quota application. If the employer does not comply with this and does not receive notification of the approval of a quota, the employer will have work permit applications rejected.

Alternatively, a company that failed to file a quota application or whose application was denied or partially approved may use a list of quota-exempt positions when applying for work permit only if the application meets all the quota-exempt requirements.

4.3.2. Work permit application for Highly-qualified Specialists (“HQS”)

Started from 1 July 2010, simplified procedure of obtaining the work permits for HQS came into force. HQS is a highly-skilled professional who is a foreign employee and has work experience and skills or achievements in a certain area and whose annual salary generally exceeds
RUB 2,000,000 (about USD 62,500).

It should be also noted that the Representative offices of foreign legal entities can not apply for hiring HQS. Obtaining the work permits for foreign national as for HQS has the following advantages:

- obtaining an employment permit for the Russian employer is not required;
- the quota system is not applied to HQS;
- the work permit period can be issued for the term of up to three years;
- HQS may obtain multiple work visa for the term of up to three years;
- the procedure of obtaining work permit for HQS takes about fourteen business days from the moment of submission of such application;
- reduced income tax rate of 13 percent applies to salary paid locally to HQS non-tax residents irrespective of their tax residence status;
- extended length of business trips outside the region/regions for which the HQS work permit was obtained as compared with the standard work permit (30 calendar days

in total during a calendar year or without limitation for HQS with travelling nature of work).

4.3.3. Migration registration procedure

Migration registration is the process of notifying the immigration authorities of a foreign national's whereabouts (international travel, as well as internal trips within Russia). It is the hosting party which is responsible for such registrations. The hosting party for this purpose is either the hotel or the employer (visa sponsor) or a landlord, if the foreign national is not staying in the hotel.

Upon arrival in Russia, each foreign national must be registered in Russia in his host location.

This process should be completed within seven business days of arrival every time a foreign national arrives in Russia or travels to another region (changes location) within Russia for more than seven business days.

HQS and his family members are exempt from registration procedures, if they arrive and stay in Russia for the period not exceeding 90 days and 30 days if they travel in Russia to another region. If HQS and his family members stay in Russia for more than 90 days (or 30 days traveling in another region), they are required to be registered within seven business days.

5. ANTIMONOPOLY REGULATIONS

5.1. General approach

Anti-monopoly issues are mainly governed by Federal Law No. 135-FZ "On the Protection of Competition" dated 26 July 2006 (the "**Competition Law**"), while liability for the violation of anti-monopoly regulations is established (in addition to the Competition Law) mainly by the Code on Administrative Offences and the Criminal Code.

The Federal Anti-monopoly Service (the "**FAS**"), a Russian executive authority, controls and enforces compliance with anti-monopoly legislation. Russia has also recently adopted the long-awaited "Third Anti-monopoly Package" – an extensive set of amendments to the above-mentioned primary acts of anti-monopoly legislation. The summary below provides an outline that reflects the most important issues of the revised regulations.

5.2. Scope of application of the Competition Law

The Competition Law applies to:

- the agreements/actions concluded or carried out in or outside Russia that may in any way influence competition in Russia; and
- the agreements/actions concluded or carried out in or outside Russia, between Russian and/or foreign legal entities/individuals and which are related to:

    (i) main (fixed production assets), shares or participatory interests in, or control over the Russian legal entities; or
    (ii) control over foreign legal entities engaged in business activities in Russia.

The wording "legal entity engaged in business activities in Russia" refers to all foreign entities that have supplied goods/works/ services to the Russian market in the amount

exceeding RUB 1 billion (EUR 25,000,0001) during the past calendar year preceding the date of the respective transaction.

Based on the above, the scope of application of the Competition Law is very broad. In practice, it may cover almost any agreement and may apply to any company directly or indirectly connected with the Russian market or Russia in general.

5.3. Anti-competitive practices and restriction of competition

The Competition Law covers the following types of anti-competitive practices and activities which may lead to a restriction of competition:

- abuse of a dominant position;
- cartel agreements and concerted actions;
- vertical agreements;
- economic coordination; and
- unfair competition.

The Competition Law also includes rules on transaction clearance.

5.3.1. Abuse of a dominant position

The general rule is that a company is deemed dominant if it has a market share of over 50%.

However, in practice, dominance may be established in certain circumstances with a market share of less than 50%. Dominance of a market is, in itself, not a violation. However, abuse of the dominant position gives rise to liability. In addition to the prohibitions as specified below in Section 5.3.2. of this Report, the "dominant" entities are prohibited from:

- fixing or maintaining "monopolistically" high or low prices;
- establishing different prices for the same commodity without technological or economic substantiation; and
- establishing discriminatory conditions.

5.3.2. Cartel agreements and concerted actions

In brief, the following arrangements are expressly prohibited by the Competition Law in agreements (cartels) and concerted actions between competing market players:

- fixing or maintaining prices/tariffs, discounts, bonus payments or surcharges;
- increasing, reducing or maintaining prices during auctions;
- dividing markets by (i) territory; (ii) volume of sales or purchases; (iii) assortment of goods (works, services) sold; or (iv) range of sellers or purchasers/ customers;
- refusing to enter into contracts with certain sellers or buyers; and
- reducing or terminating the production of goods (works, services), main production assets (both tangible and intangible) located in Russia;

5.3.3. Vertical agreements

If the parties to an agreement are in a sale and purchase relationship, such a "vertical agreement" may not contain any provisions which lead to a restriction of competition in general and, specifically, may not (i) establish resale prices for goods (works, services),

except for maximum resale prices; and (ii) prohibit the purchaser from selling competing products.

5.3.4. Economic coordination

The Competition Law also prohibits any economic coordination exercised by one business entity (the "coordinator") over the activities of other business entities if:

- the coordinator does not belong to the same group as the entities it coordinates;
- the coordinator is not active on the market where it coordinates the business of these other business entities; and
- the coordination results in any of the prohibitions as listed in Sections 5.3.2 and 5.3.3 above.

5.3.5. General Restriction of Competition

Agreements in general may not lead to a restriction of competition on the market. In particular, they may not lead to:

- setting different prices for the same product (work, service) without economic or technological justification thereto;
- imposing unfavorable terms upon a contracting party;
- impeding other business entities' access to or withdrawal from a certain market; and
- establishing membership conditions in professional or other associations if these conditions lead or may lead to a restriction of competition.

An important change to the revised version of the Competition Law is that the restrictions outlined in Sections 5.3.2 – 5.3.5 above shall not apply to the agreements or actions between business entities that are part of one group of companies when these entities are controlled by the same company/ individual.

5.3.6. Unfair competition

Unfair competition is not permitted under Russian competition legislation. In particular, unfair competition includes:

- the distribution of false or incorrect information which may cause damage to a business entity or impair its reputation;
- misleading information in respect of a commodity's (i) nature; (ii) manner and place of production; (iii) consumer properties; (iv) quality and quantity; or (v) manufacturers;
- an incorrect comparison of the commodities produced by a business entity with those produced or sold by other business entities;
- the sale, exchange or other placement into circulation of a commodity in breach of third-party intellectual property rights; and
- the unlawful receipt, use and disclosure of commercial secrets, official secrets or other information protected by law.

The above restrictions are closely connected with further restrictions as set forth by Federal Law No. 38-FZ "On Advertising" dated 13 March 2006 (the "**Advertising Law**"). By the Advertising Law the FAS is also authorized to perform monitoring of compliance with the Advertising Law requirements and may hold the companies liable for violation and non-compliance with the respective rules.

5.3.7. Antimonopoly Scrutiny of the Transaction

Description of the transactions

The following transactions may require approval from the FAS or a notification to the FAS:

- the establishment of a Russian company if (i) its charter capital is paid up by shares and/or tangible or intangible assets of another company; and (ii) the new company, as a result, acquires: (i) more than 25% of voting shares in a Russian Joint-Stock Company; (ii) more than 1/3 of the participatory interests in the charter capital of a Russian Limited Liability Company; or (iii) more than 20% of the balance sheet value of main production and intangible assets of the company which owns the assets (and whose assets are located in Russia);
- reorganization (in the form of a merger or accession);
- the acquisition of more than 25%, 50% or 75% of voting shares in a Russian joint stock company;
- the acquisition of more than 1/3, 50% or 2/3 of the participatory interests in the charter capital of a Russian Limited Liability Company;
- the acquisition of control over a Russian company;
- the acquisition of more than 50% of shares/participatory interests or control over a foreign "legal entity engaged in business activities in Russia"; and
- the acquisition of the right to own, use or possess the main production and intangible assets of a company if the book value of the acquired assets located in Russia exceeds the following percentages of the total book value of the seller's main production and intangible assets: (i) 20% for companies operating on commodity markets; or (ii) 10% for companies operating on financial markets.

Thresholds

The transactions as specified above shall be subject to merger clearance (prior or post-transaction) from the FAS if the respective thresholds as established by the Competition Law (please, see the table below) are met.

When the thresholds for prior approval are met, FAS clearance must be obtained before the closing of the transaction. When they are not met, the Competition Law requires post-transaction notification to the FAS within 45 calendar days after closing. The thresholds set out below only apply to companies operating on the commodity markets. For those operating on financial markets, the requirements are different (for example, please see the Section 7 *Banking Regulations* for information on thresholds for banks (credit organizations)

5.4. Liability

5.4.1. General liability

Individuals and legal entities may be subject to administrative and criminal liability for noncompliance with anti-monopoly legislation. Forms of liability may include:

- mandatory directions issued by the FAS to cease a violation and/or transfer to the state budget of all revenue received as a result of the violation of anti-monopoly legislation (under the Competition Law);
- fines calculated on the basis of revenue (up to 15% of the revenue gained over the period of the violation of anti-monopoly legislation) and/or disqualification of company officials (under the Code on Administrative Offences); and

- fines, disqualification of company officials and, for the more serious anti-monopoly violations, up to seven years' imprisonment of company officials (under the Criminal Code).

5.4.2. Specific forms of liability

Prohibited agreements and leniency

As mentioned above, cartels and concerted actions which violate anti-monopoly regulations are strictly prohibited and may lead to severe sanctions being imposed. The Code on Administrative Offences provides a limited opportunity for companies which have participated in illegal cartels or actions to avoid penalties – the "Leniency Program".

To obtain total immunity under the Leniency Program, a cartel Participant must (i) be the first to inform the FAS of the cartel's existence; (ii) submit sufficient information and/or documents to the FAS to allow an administrative violation to be identified; (iii) fully co-operate with the FAS throughout its investigation; and (iv) cease any involvement in the cartel or other infringement immediately.

It is only possible to benefit from the Leniency Program if the FAS is not aware of the reported infringement. Collective applications for the Leniency Program are not accepted.

6. REAL ESTATE AND CONSTRUCTION

6.1. General approach

This section relates to real estate and construction matters in Russia, which are governed by a Complex body of laws and regulations. Key legislation in this respect includes:

- Civil Code of the Russian Federation: Part I dated 30 November 1994; Part II dated 26 January 1996; Part III dated 26 November 2001; Part IV dated 18 December 2006 (the "**Civil Code**");
- Land Code dated 25 October 2001 (the **"Land Code**");
- Town Planning Code dated 29 December 2004 (the "**Town Planning Code**");
- Forest Code dated 4 December 2006;
- Water Code dated 3 June 2006;
- Federal Law No. 102-FZ "On Mortgage (Pledge of Immovable Property)" dated 16 July 1998 (the "**Law on Mortgage**"); and
- Federal Law No. 122-FZ "On the State Registration of Rights to Immovable Property and Transactions" dated 21 July 1997 (the "**Law on State Registration**").

6.2. Rights to real estate

The Land Code provides for two basic types of land rights to (i) land plots; and (ii) buildings, structures and premises: (i) the ownership right (freehold); and (ii) the right to lease (leasehold).

Real estate (including land plots) in the Russian Federation may be owned publicly or privately. In relation to land, we would like to outline a number of local specificities.

Public land ownership

Publicly owned land means that the land is owned by the State (i.e. the Russian Federation or a region) or a municipality. Substantial areas of land in Russia (particularly in the City of Moscow, which has regional rather than municipal status) have always been state-owned.

Until 2001 (when the Land Code was adopted), the delineation of state-owned and municipal land plots was regulated by several legal acts. The process of delineation was complicated and, at times, confusing. It has been clarified by the Land Code and further clarification is ongoing. Pending completion of this, and to ensure that it is still marketable, public land may be disposed of by municipal authorities. They are authorized to act as landlords in lease agreements, allocate land plots for construction and act as seller during the privatization of public land.

Public land plots may be privatized, subject to a number of statutory restrictions. For example, land plots falling within specially protected areas (such as national parks) or areas required for defense (such as military airports) may only be state-owned.

Private land ownership

Any legal entity or individual may own private land in the Russian Federation, subject to certain restrictions which relate to the legal status of the land plot. Generally speaking, foreign nationals and legal entities now enjoy the same rights to land plots as Russian individuals and legal entities.

However, some restrictions apply. In respect of the ownership of land, foreign investors may not, in particular (i) own land in border territories or other territories, specifically designated in the Land Code; and (ii) own agricultural land. This rule also applies to the Russian companies with a foreign participation of 50% or more in their charter capital.
Foreign investors (as widely defined above) may only lease agricultural land, which complicates their Greenfield projects on this type of land.

Other rights to or affecting land plots

Russian land legislation that pre-dated the Land Code also provided for other types of land rights, such as, among others, the right of permanent perpetual use of the land plot, or the right of inheritable use.

The right of permanent perpetual use of the land plot could only be granted to state, municipal or other public enterprises or to municipal authorities. Legal entities must convert the right of permanent perpetual use into leasehold or freehold rights by 1 July 2012.

Starting from 1 January 2013, legal entities will be penalized if they fail to convert their right of permanent perpetual use. As in other countries, an easement (or servitude) may be established in respect of a land plot which is owned by a third party. This grants the land user a variety of rights (including the right to build structures such as cable lines, pole lines, etc.). The easement
may be public or private, depending on the persons who are interested in it. If the easement is required by a particular person or legal entity, then only a private easement may be established in respect of the relevant land; if the general public is interested in the easement, then a public easement may be established.

6.3. Real estate transactions

6.3.1. Sale and purchase transaction

Cadastral and state registration

A publicly or privately owned land plot may be bought and sold provided that (i) it has undergone all cadastral registration formalities; and (ii) the title to the land plot has been registered.

Both procedures require the submission of certain documents to the state registration authority, i.e. the Federal Service for State Registration, Cadastre and Cartography or its regional/local departments (the "**Registrar**"). Failure to comply with this requirement may lead to any real estate transaction connected with it being declared null and void.

Rights to buildings and structures located in Russia are subject to state registration. Rights to a building are not effective until they are registered in the State Register (i.e. a building/structure/premises legally exists only from the moment of their state registration). Moreover, state registration (as evidenced by an ownership certificate) is the only confirmation of the ownership right. Only a court decision may overrule state registration.

Buildings on land plots

A general principle of Russian law is the unity of rights to land plots and buildings. The Land Code prohibits the transfer of land without the buildings and structures standing on it. Ownership rights to a building may only be transferred together with the rights to the land plot beneath this building. In exceptional cases, title to parts of a building may be transferred separately from the land if it is impossible to separate the respective part of the land plot, or if there is a restriction on the acquisition of this land plot.

Owners of buildings located on a land plot other than their own generally enjoy a preemptive right to purchase the land plot, or a preferential right to lease it. If a land plot is under state or municipal ownership, the owners of buildings generally have exclusive rights to privatize the land plot.

Privatization

Since 30 October 2001, it has no longer been possible to privatize buildings, structures or industrial facilities without simultaneously privatizing the underlying land.

A building owner has exclusive rights to obtain freehold or leasehold rights to a publicly owned land plot on which the owner's building stands. The building owner is free to choose whether to acquire leasehold or freehold rights to the land plot. During privatization, the building owner must pay a buy-out price for the land to the municipal authorities. The buy-out price depends on the cadastral valuation of the land plot, and is between five and thirty times the amount of annual land tax payments, largely depending on the location of the land plot. The owners of buildings located on municipal and state land may buy out the plots at a preferential price before 1 July 2012.

Sale and purchase contract

Certain conditions of a real estate sale-purchase transaction are deemed material and must be clearly determined in the sale and purchase agreement, such as the subject-matter (i.e. the land plot or building/structure/premises) and the price. In addition, the parties to the agreement are entitled to set out their own list of supplemental contractual provisions that they consider to be material to the transaction.

If the sale and purchase agreement does not meet the above requirements, it is deemed not to have been concluded. This means that the plot or property must be vacated and

returned to its owner in its original state, and the sale price must be returned to the purchaser.

These consequences arise only if the competent court declares the sale and purchase agreement invalid or the transaction void. To purchase publicly owned land for construction purposes, a specific procedure generally applies, which requires a tender to be organized.

Registration of transfer of title

The transfer of ownership rights to real estate must be registered in the Unified State Register of Rights to Immovable Property and Transactions Therewith (the "**State Register**"), whereas the sale and purchase contract itself does not have to be registered. Registration involves filing the sale and purchase contract and other related documents with the Registrar, as evidence of the transfer of ownership rights.

Title is evidenced by an ownership certificate issued by the Registrar. This means that a certificate of ownership of a land plot is *prima facie* evidence: i.e. it is believed to be true and overrules any other evidence, until a court decision proves otherwise. However, rights to property which arose before the Law on State Registration came into force (January 1998) are valid even if they are not registered.

Any member of the public may request general information about real estate (owner, registered encumbrances, etc.) in the form of an extract from the State Register. However, certain information relating to a chain of transactions on the transfer of rights, as well as information about the number of plots and/or properties owned by a certain person or legal entity, may be requested only by the owner of the relevant plot or property. In addition, certain types of encumbrance (buffer zones of hazardous facilities, protective zones of cable lines and gas transmission lines, etc.) are not recorded in the State Register.

They may only be discovered as a result of onsite investigations and legal due diligence of the land plot and any properties located on it.

Real estate acquisition and antimonopoly control

As a general rule, real estate acquisitions (land and/or buildings) are not subject to antimonopoly control.

However, anti-monopoly control will apply if the net value of the land or property that is the subject matter of a real estate transaction (or a series of related transactions) exceeds 20% of the net value of the assets of the seller.

Depending on whether certain asset value or revenue thresholds are exceeded, either the prior consent of, or a post-transaction notification to, the Federal Anti-monopoly Service will be required (please see Section 5 above).

Furthermore, under Federal Law No. 381- FZ "On State Regulation of Trade Activities in the Russian Federation" dated 28 December 2009, food retailers with a market share in a given locality exceeding 25% are prohibited from acquiring or leasing additional outlets in that location.

6.3.2. Leases

Land leases

The following may (subject to certain restrictions) lease a land plot: (i) Russian and foreign nationals; and (ii) Russian and foreign legal entities.

If the lease relates to public land, the land lease agreement will contain the general provisions indicated by the landlord, as they come from legal acts adopted by the relevant municipal or state body. In practice, they may not be changed. The conclusion of the lease will also generally presuppose a tender process (subject to certain exceptions).

A lease agreement in respect of a privately owned land plot may include any provisions provided they do not contradict any mandatory Russian requirements. Material lease conditions, such as the subject-matter (i.e. the land plot itself) and amount of the rent, must be clearly determined in the lease agreement. In addition, the parties may set out their own list of supplemental contractual provisions that are material to the transaction.

If a lease agreement does not meet the above requirements, it is deemed not to have been concluded. In this case, the land plot must be vacated and returned to its owner, and any rents already paid to the landlord must be returned to the tenant.

Term

Russian legislation places no general limit on the term of a lease of a land plot. However, certain limits exist on leases of specific types of land. For example, the maximum permitted term for a lease of agricultural land or forest land is 49 years. The maximum permitted term for a lease of coastal land is 20 years.

Russian legislation may also specify a minimum term for a lease of a particular type of land. In some cases, this term is at least ten years. If this is the case, the impact of the lease term should be assessed before any material investments are made.

Any lease agreement concluded for a term of at least one year is subject to registration in the State Register). If the lease agreement does not meet these requirements, then it is deemed not to have been concluded. The legal effect of this is that the lease is treated as if it was not concluded at all. In such cases the land plot must be vacated and returned to its owner.

The Civil Code provides that, where a lease agreement does not specify a term, then it is deemed to have been concluded for an indefinite term. In such cases, a lease may be terminated simply by either party serving a termination notice on the other party at least three months in advance of the intended date of termination.

Upon expiry of the lease, a tenant has a preferential right to conclude a lease of the same land plot for a new term.

Assignment

It is generally permitted (subject to certain restrictions) to sublet, assign, mortgage or contribute leasehold rights to a land plot to the charter capital of a company. Unless otherwise provided for in the lease agreement, sublease, assignment and mortgage agreements may be entered into without the consent of the landlord (but subject to subsequent notification by the tenant).

In any event, there are a number of circumstances when the tenant's right to sublease or mortgage the plot, or assign lease rights, may not be waived or restricted (such as in the case of leases of public land for more than five years).

Termination

The Civil Code grants both a landlord and a tenant the right to terminate an agreement unilaterally, either in the limited number of circumstances stipulated by the Civil Code (via court procedure) or in the lease agreement itself. In the latter case, both in-court and out-of-court procedures may be used.

The Land Code stipulates additional circumstances in which a landlord may terminate a lease. These include, among others, use of the land in a way that is inconsistent with its land category and permitted use, and appropriation by the state.

In relation to state or municipal land, the Land Code also grants a landlord a specific ground for early termination of a lease which has been concluded for a term of more than five years. If a tenant commits a material breach of the terms and conditions of such a lease agreement, the landlord may apply for a court order enabling it to unilaterally terminate the lease early.

Commercial leases of buildings, structures and premises

Commercial leases have been developing rapidly over the past few years. The market is generally dominated by the private sector of the economy, which means that the legal relationships are heavily influenced by commercial needs, the return on investment and the level of yield.

Therefore, the following legal structure has been developed:

- Preliminary Lease Agreement (the "**Preliminary Agreement**");
- Short Term Lease Agreement (the "**STL**");

and

- Long Term Lease Agreement (the "**LTL**").

This lease structure is also favorable for investment acquisitions since it becomes much easier to calculate the sale value of the property in accordance with international valuation standards.

Preliminary lease

When a building, or any other property, is under construction, and a potential tenant wishes to "mark out" the building, as well as particular premises within the building, and "fix" the amount of rent, it enters into a Preliminary Agreement with the prospective owner to regulate their pre-registration relationship.

Prior to registration of an owner's title to the building, as well as the building itself, in the State Register, no lease agreements may be entered into in respect of the building or premises within the building. The Preliminary Agreement, therefore, contains various obligations (such as the time period for construction, the tenant's requirements for works and fit out of the building and/or premises, etc.).

In order to be legally valid, the Preliminary Agreement must clearly determine its subject matter, sufficiently describe the property to which it relates, and establish all the material

terms and conditions of the main lease agreement to be entered into (the "**Main Agreement**").

The parties to a Preliminary Agreement should determine a time period within which the parties must enter into the Main Agreement. If no time period is specified, the parties should enter into the Main Agreement within one year from the date of execution of the Preliminary Agreement. If the parties fail to enter into the Main Agreement within this time period, the Preliminary Agreement will terminate.

However, if the failure to enter into the Main Agreement was caused by one of the contractual parties, the courts may force the defaulting party to enter into the Main Agreement.

6.3.3. Mortgages

Creating a mortgage

Both freehold and leasehold rights to land and buildings may be mortgaged; there are no restrictions against this in either the Land Code or the Civil Code. Rights to buildings and parts of buildings, including residential buildings and flats, may also be mortgaged.

The terms and conditions of mortgages are governed by the Law on Mortgage, which requires mortgages over the completed buildings and the underlying land plot to be granted simultaneously.

A security interest over a land plot or other property is generally created by the parties entering into an express mortgage agreement. However, a mortgage may arise by operation of law (for example, a bank giving a loan to buy a property will become a mortgagee until the sale price is repaid in full).

According to the latest changes to the Law on Mortgage, a mortgage agreement must be drafted as a single contract, signed by both parties, who may choose to do so before a notary, and then registered by the Registrar.

Mortgage agreements only come into effect upon registration in the State Register. If a mortgage agreement is not state registered, it is null and void.

The parties have two registration options: (i) submit a joint application and a set of necessary documents to the Registrar; or (ii) appoint a notary to submit a notarized application (this option was introduced in 2011 and is available when the mortgage agreement is notarized).

The Law on Mortgage sets out the time period within which the Registrar must complete the registration formalities.

For a mortgage of (i) residential property; or (ii) a land plot and non-residential property under a
notarized agreement, the time period is five working days. For mortgages of land plots and non-residential property under a simple agreement,
the time period is 15 working days.

Enforcing a mortgage

If a significant breach of a secured obligation occurs, the mortgagee may enforce the mortgage. There are two methods of enforcement: (i) through the courts, resulting in the

secured property being sold at a public auction; or (ii) under a notarized out-of-court enforcement agreement between the mortgagee and the mortgagor.

The Law on Mortgage provides for the following options when the mortgagee is using the out-of-court enforcement procedure:

- retention of the mortgaged property by the mortgagee; or
- sale at an auction.

In a number of cases, the use of the out-of- court enforcement procedure is prohibited (for instance: if the first and second ranking mortgages provide for different types of enforcement procedures; and where out-of-court enforcement is prohibited; only court enforcement is possible).

The Law on Mortgage also sets out a procedure for the distribution of the proceeds received as a result of the enforcement of the mortgage. For example, for both the out-of-court and court enforcement procedures, the sale proceeds are distributed subject to the priority of claims between (i) all mortgagees that filed their claims; (ii) other creditors; and (iii) the mortgagor. Such priority would have to be determined on the basis of the entries in the State Register.

If enforcement of the mortgage by the mortgagee in respect of a residential property is by way of retention of the property and the proceeds do not fully cover all of the mortgagee's claims, then the outstanding payment obligation will be deemed to be fully satisfied. Mortgages and reform of the Civil Code Currently, the Civil Code contains only general principles concerning mortgages.

However, according to the draft amendments under discussion, a new chapter will be added to the Civil Code, entitled "Mortgages". The draft chapter provides for the priority of a mortgage, depending on the order of state registration of relevant mortgages. The draft chapter also introduces a new type of mortgage: an "independent mortgage", under which a mortgagee is entitled to choose which obligation of the mortgagor will be secured against the independent mortgage.

The mortgagee must notify the mortgagor of this. An independent mortgage comes into effect once it is registered in the State Register.

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