



Investments into Russia – tax and other considerations

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CIS Region



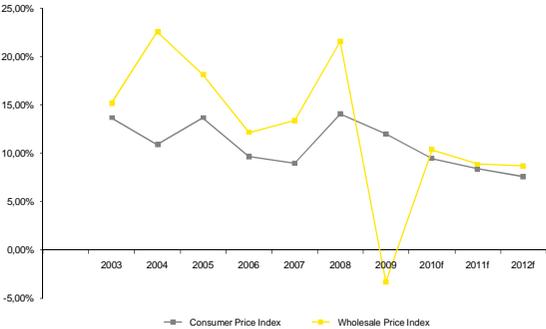
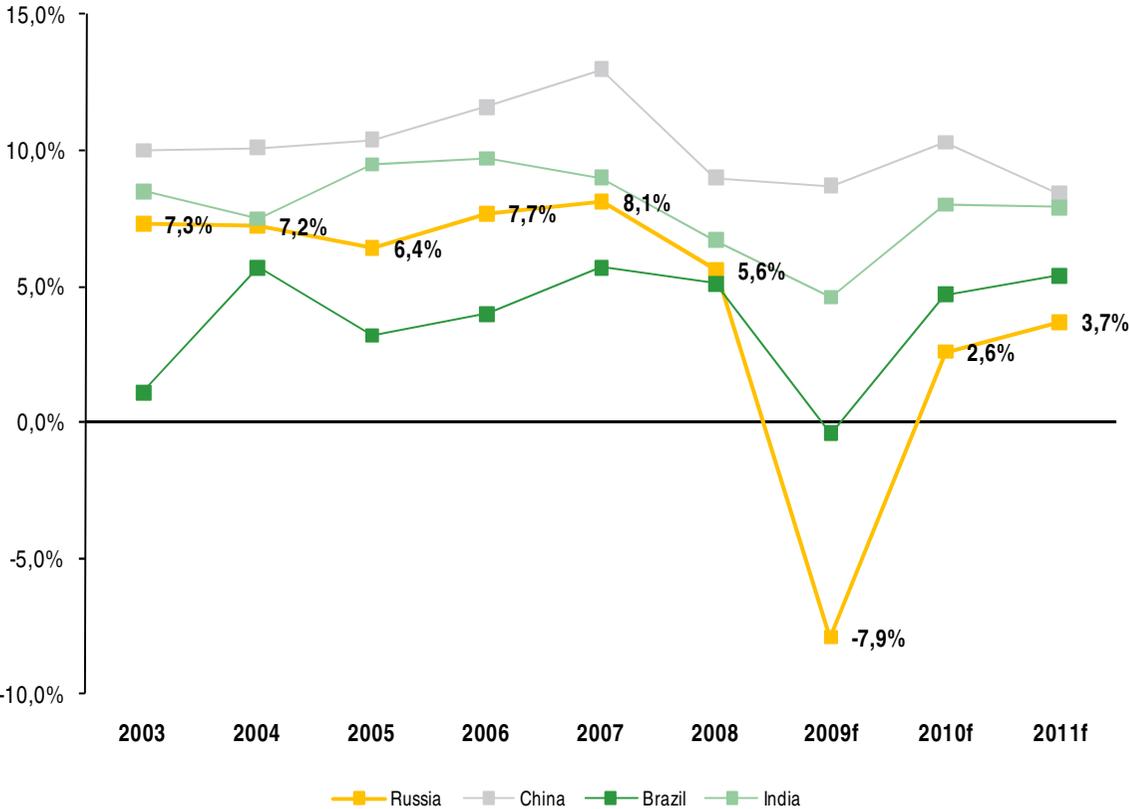
CIS = Commonwealth of Independent States (including Russia)



CIS member states		
▶ Armenia	▶ Kazakhstan	▶ Russia
▶ Azerbaijan	▶ Kyrgyzstan	▶ Tajikistan
▶ Belarus	▶ Moldova	▶ Uzbekistan
▶ Ukraine is not officially a member, but de facto participating		
▶ Turkmenistan is an unofficial associate member of CIS		

Update on Russian Investment Environment

Real GDP growth in Russia and BRIC countries, 2003-2011f



Inflation, 2003-2011f

Source: Global Insight, RBC

Russia - Legal System

Legal system

- ▶ The Russian legal system is based on statutory law rather than case law. The main legal acts are the Constitution, federal constitutional laws, federal laws, presidential decrees, governmental regulations, and laws of regional constituents of the Russian Federation;
- ▶ The Constitution recognizes norms of international law and international treaties and agreements with Russia as part of the domestic legal system. If an international treaty or agreement establishes rules other than those set by domestic law, the rules of the international agreement apply;
- ▶ The judicial branch comprised of the three highest courts: the Supreme Court, the Constitutional Court and the Supreme (Commercial) Arbitration Court. The Supreme Court is the highest judicial body for all lower courts. It considers civil, criminal and administrative cases. The Constitutional Court checks that laws and decrees do not contradict the Constitution. The Supreme Arbitration Court is the final instance in commercial disputes, supervises lower arbitration courts and issues clarifications on interpretations of laws.

Corporate law

- ▶ If a buyer (together with its affiliates) acquires more than 30% of voting shares in an open joint-stock company, the buyer must make a public offer to the remaining shareholders of the company to acquire their ordinary shares at the fair market value.
- ▶ If the buyer (together with its affiliates) acquires more than 95% of the company's voting shares, the buyer must, at the request of the remaining shareholders, purchase their shares in the company at the fair market value. The owner of 95% of a company's voting shares may, in turn, squeeze out minority shareholders by demanding to sell all shares held by them.

Russia – Investment Climate

Investment law

- ▶ Russia is increasingly considered as a country with a stable investment climate. Russia has witnessed a big increase in foreign direct investment inflows over the last couple of years thanks to a growing domestic market, rich human capital, natural resources and political stability, though this has slowed with the financial crisis.
- ▶ Constraints on foreign business are being abolished and the regulatory environment has improved. However, several sectors remain closed to foreign investment. Current regulations restrict foreign involvement in the banking sector, and the government has restricted foreign access to 39 strategic sectors of the Russian economy, including nuclear energy, natural monopolies, military and special machinery, the space industry, and subsoil development.
- ▶ Russian investment policy includes tax reliefs, decreasing administrative barriers, and developing private-public partnerships. The government is planning to invest in infrastructure projects to promote investment.
- ▶ Russia has seen improvement in corporate governance over recent years. Several major Russian companies meet international and US accounting standards for information disclosure and have introduced open lines of communications with shareholders and analysts. However, there is still plenty of room for improvement, particularly as concerns corporate transparency.
 - ▶ A sharp increase in disclosure of shareholder rights and investor relations procedures is mainly due to companies' efforts to follow the recommendations of the Russian Code of Corporate Conduct, which focuses strongly on disclosure of governance procedures and shareholder rights.
 - ▶ Unlike in developed markets, disclosure of beneficial ownership is voluntary for shareholders in Russia, and there are few volunteers, especially among the ultimate beneficial owners of large stakes. Russian companies are commonly affiliated with each other via their shareholders, who do not disclose such information for fear of anti-monopoly regulations, investigations, and corporate raiders.
 - ▶ Financial information remains a relatively weak area of disclosure for Russian companies. Not all companies report their annual financials under IFRS or US GAAP, but the situation is gradually improving. The most critical area of weakness in disclosure practices include detailed information about related-party transactions (e.g., exact terms and indication whether such transactions are carried out on market terms), exhaustive ownership disclosure (e.g., disclosing every shareholder owning over 10%), auditor engagement (scope of services, non-audit services, and remuneration), ownership structures of affiliates and subsidiaries, and details and principles of board and executive remuneration.

Russia – Investment Climate

The terms and conditions for foreign investment in Russia are now regulated by the Law on Strategic Industries, which came into force 7 May 2008, and the Law on Foreign Investments, which was amended with the adoption of the Law on Strategic Industries.

- ▶ Under the Law on Strategic Industries, certain Russian companies are deemed to have strategic importance for Russia's national defense and security. In addition to industries such as weapons, aviation and space, the law also names natural monopolies, the mass media and companies involved in natural resource exploration and extraction (except where the Russian government owns more than 50% of the company) as strategic.
- ▶ Foreign investors acquiring direct or indirect control over Russian strategic enterprises are required to obtain prior approval, or in certain cases post-transaction approval, of a special government commission. The Federal Antimonopoly Service and Federal Security Service must establish that the acquisition does not threaten Russia's national security, and the foreign investor may have to meet other requirements to gain approval.
- ▶ The Law on Strategic Industries prohibits foreign states, international organizations and legal entities directly or indirectly controlled by foreign states or international organizations from acquiring control over strategic enterprises.
- ▶ According to the latest amendments to the Law on Foreign Investments, any transaction with the participation of foreign states, international organizations or legal entities directly or indirectly controlled by foreign states or international organizations to acquire control over any Russian entity should also be reviewed by the governmental commission to ensure that the entity is not a strategic enterprise.
- ▶ Transactions made in violation of the Law on Strategic Industries are void.

Tax stability for foreign investors

- ▶ According to the Law dated back to 1999, stability of the conditions of the tax and customs regime may be available for certain priority investments projects for the period of recoupment of the investment project (which are differentiated by type of projects), but not for more than seven years from the day of the commencement of the financing of that project using foreign investments. In exceptional cases, the Russian Government may extend the period of validity of the stability regime.
- ▶ Although the Law was enacted in 1999 the practice of its application is very limited. No approved list of priority investments. Was enacted . Not many changes in the tax law happened since 1999 increasing the rates of federal taxes and significantly worsening the position of taxpayers

Antimonopoly Reg's

Competition law

Under the Competition Law, certain transactions (including mergers, acquisitions, establishment of new companies, purchase and sale of shares and/or assets) are subject to antimonopoly control.

- ▶ Timely filling of required documents to FAS is crucial for success of transaction.
- ▶ Any individual, legal entity or group of persons acquiring more than 25%, 50% or 75% of the voting shares in a joint-stock company or more than 1/3, 50% or 2/3 of participatory interest in a limited liability company is required to obtain prior approval from the FAS if:
 1. the aggregate balance value of the assets of the acquirer and its group exceeds RUB 3 billion, and the balance sheet value of the assets of the target and its group exceeds RUB 150 million;
 2. the aggregate revenue of the acquirer and its group from the sale of goods for the past calendar year exceeds RUB 6 billion, and the balance sheet value of the assets of the target and its group exceeds RUB 150 million; or
 3. the acquirer or the target (or any company of its group) owns over 35% of the corresponding market.
- ▶ Prior anti-monopoly approval is also required to acquire assets worth more than 20% of the book value of all the seller's fixed and intangible assets if the above mentioned conditions are met for other legal entities.
- ▶ Transactions with shares of a joint-stock company require registration in the shareholders' register in order to ensure their transfer. The register can be maintained either by the company or by a professional registrar. Registration of the transfer usually takes from one to three days. Transactions with participatory shares of a limited liability company require amending the foundation documents of the company and subsequent state registration. This procedure may take from seven to ten days.
- ▶ Generally, FAS approvals have been routinely granted. However, there have been situations when the FAS used its authority to prevent foreigners from acquiring what FAS regarded as "strategic" assets and enterprises.

Customs Reg's

Overview

- ▶ Customs regulation in Russia is based on international standards. The Russian Federation is a member of the World Customs Organization, the International Convention on Harmonized Commodity Description and Coding System (Brussels, 1983), and the Convention on Temporary Import (Istanbul, 1990). Russia started preparation to enter the World Trade Organization. Starting 2010 Russian Federation is a member of Customs Union with Belorussia and Kazakhstan

Import duties

- ▶ Imported goods are generally subject to import customs duties and import VAT. Certain categories of goods (such as alcohol, tobacco, personal cars, and gasoline) are also subject to excise duties
- ▶ Customs duty rates vary from 0% to 20% of the customs value of the goods. VAT is payable at the standard rate of 18%, which is calculated on the basis of the sum of the customs value and the customs duty. Import VAT paid by the importer is generally subject to credit against its output VAT or to tax refund (upon 0%-rates supplies)

Export duties

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

Benefits

- ▶ Benefits include reductions or abolition of customs duties / VAT duties for certain types of goods / specific companies.
- ▶ Examples of potential benefits:
 - ▶ Technological equipment imported according to a Government list is exempt from VAT.
 - ▶ Certain subcomponents for vehicle assembly in Russia with reduction of customs duty rates
 - ▶ Import of goods into Free Economic Zones exempt provided goods are not released to mainland territory

Currency Reg's

- ▶ It is important that foreign investors address any potential currency control issues in advance of concluding any significant transactions with a Russian resident.

- ▶ Transactions between residents (Russian legal entities, their representative offices (branches) outside of Russia and individuals permanently residing in Russia) and non-residents (foreign legal entities, their representative offices (branches) in Russia and individuals permanently residing outside of Russia) involving payments in foreign currency, Russian currency, securities denominated in rubles and foreign currency can be concluded without any limitations, with the exception of transactions in respect of which special methods of currency regulation could be imposed by the government and/or by the CBRF. Payments between non-residents in rubles are permitted through accounts opened in Russian banks.

- ▶ The law also lists a number of requirements applying to residents, including:
 - ▶ Obligatory repatriation of ruble and foreign currency export proceeds;
 - ▶ Prohibition of foreign currency operations between residents (subject to certain exceptions);
 - ▶ Documentation of currency operations with special passports of the transaction.

- ▶ The penalties for violating the currency regulations can be quite significant. The Code of Administrative Offenses states that prohibited currency operations and non-compliance with currency control limitations are subject to an administrative fine of 75–100% of the amount of the non-compliant currency operation. For certain offenses, additional criminal liability can be imposed on the executives of the legal entity violating such regulations, including imprisonment. Non-compliance of banks with currency control regulations might result in revocation of their licenses.

General Overview of Russian Taxes

Topic	Key Facts
Corporate Tax Rate	15,5% to 20 % (depending on regional tax benefits)
Personal Tax Rate	13% flat rate for residents (30% for non-residents)
VAT	18% / 10% / 0%
Payroll Taxes	26% (in 2010) and 34% (starting 2011) on the annual payroll with a maximum tax base of RUR 415k RUR per employee
Dividend WHT domestic/DTT	<ul style="list-style-type: none"> • 15% / min 5% - for foreign shareholders • 9% - for domestic shareholders
Double tax treaties	<ul style="list-style-type: none"> • Russia is party to 72 effective tax treaties (DTTs) and several initiated • Most DTTs with OECD states are based on OECD MC 1992 • Russia adopted its new MC in 2010, based on UN MC
Tax audit look-back period	3 calendar years preceding the year of tax audit
Potential new changes	<ul style="list-style-type: none"> • Transfer pricing documentation requirements • Tax consolidation • Residence test for unlimited tax liability • anti-treaty shopping rules and CFC rules

Domestic Tax Benefits

- ▶ No tax benefits with respect to the federal portion of corporate profit tax rate (2%)

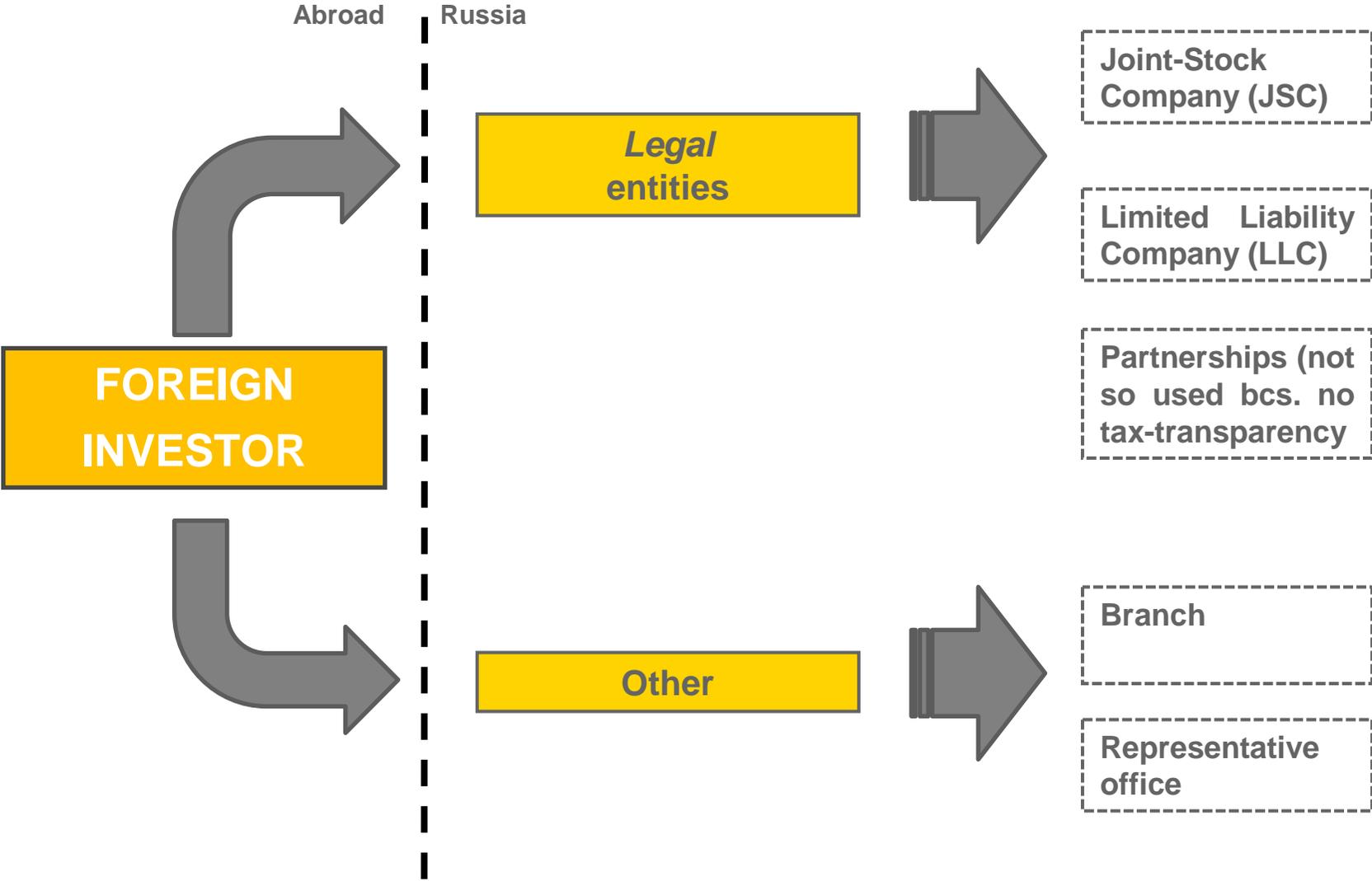
- ▶ Regional portion of the profits tax rate could be reduced up to 13,5% (compared to 18% standard rate) resulting in overall rate reduction up to 15,5% (compared to standard rate of 20%)

- ▶ Further tax benefits apply in Special Economic Zones (SEZ). SEZs are territories designated by the Government as follows:
 - ▶ industrial production zones (currently in Lipetsk Region and the Republic of Tatarstan)
 - ▶ technology development zones (currently in Moscow, Tomsk and the Moscow Region)
 - ▶ tourism and recreation zones (currently in the Republics of Altai, Buryatia and other regions)
 - ▶ port zones (planned to be created in the Khabarovsk and Krasnoyarsk Regions)

- ▶ Two more SEZs in the Kaliningrad and Magadan Regions. These SEZs were created before the SEZ Law came into force and are regulated by separate federal laws. So, benefits provided to their residents differ from benefits provided to residents of other SEZs registered under the SEZ Law
 - ▶ Reduction of customs duty rates or exemption from duties for import of certain components for industrial assembly of motor vehicles and parts in Russia (so-called Decree “566 procedure”).

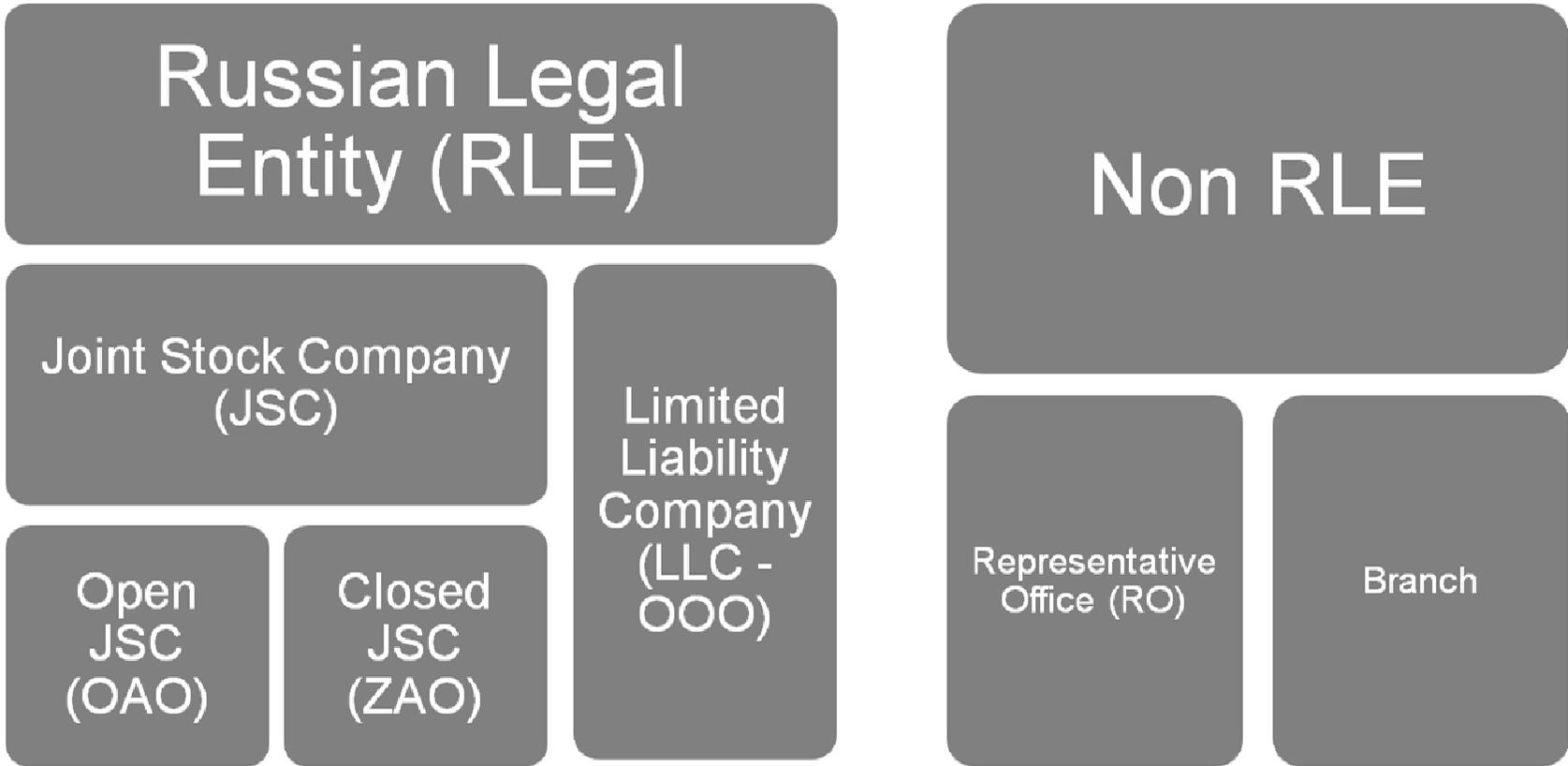
 - ▶ Other benefits could also apply with respect for asset tax (standard rate 2,2%) at regional level

Business Presence in Russia Legal Forms

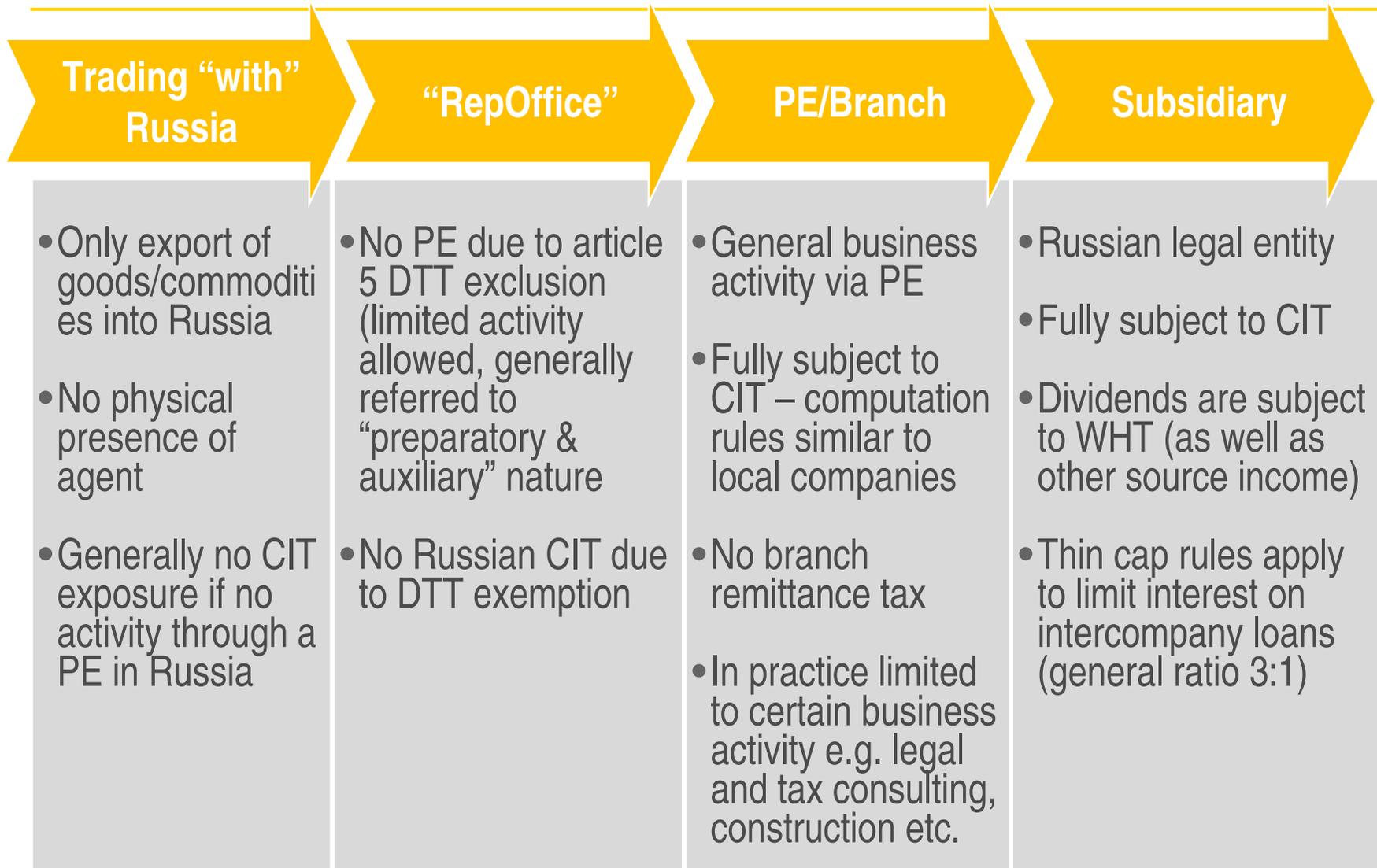


Business Presence in Russia

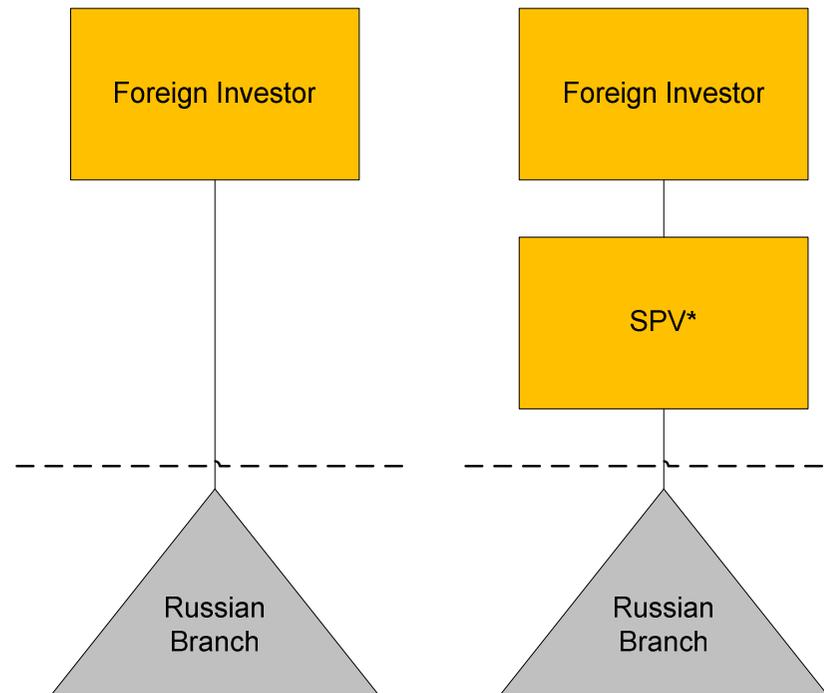
Legal Forms (2)



General inbound Tax Considerations



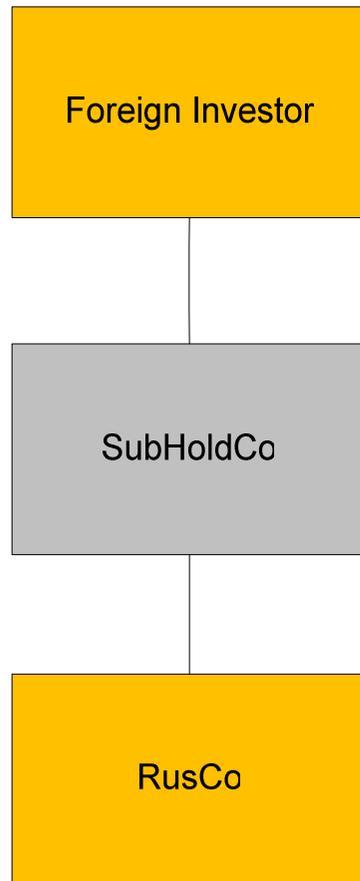
Business Presence in Russia: branch



** SPV may be often needed to circumvent the problem of PE profit allocation through “isolation” of PE revenues and costs within one single legal entity*

- ▶ No branch remittance tax in Russia
- ▶ PE taxation – only revenues and expenses “attributable to the PE” are taken into account when computing the taxable income
- ▶ No definition of “attributable” is given in the law. OECD principles of allocation of profits to PEs generally do not apply in Russia and generally is a grey area creating uncertainty
- ▶ Generally, only “direct” method is respected by tax authorities
- ▶ “Indirect” cost-plus base can be used in very limited circumstances
- ▶ DTTs (art. 7) usually also allows an allocation of HQ overheads if effectively connected to the Russian PE (sometimes disputes arise but position proven in courts if sufficient documentation confirms HQ costs)

Business Presence in Russia: subsidiary



- ▶ Factors of jurisdiction choice:
 - ▶ Type of business activity
 - ▶ Dividends WHT
 - ▶ Capital gains taxation at source (only for real-estate-rich companies)
 - ▶ HQ tax rules e.g. participation exemption, good DTT etc.
- ▶ Common SH jurisdictions (e.g. 5% DTT WHT dividend rate):
 - ▶ Cyprus
 - ▶ Netherlands
 - ▶ Switzerland
 - ▶ Austria
 - ▶ Germany
 - ▶ France
 - ▶ Sweden
 - ▶ Finland etc.

Business Presence in Russia – HoldCo Location Cyprus, Netherlands, Switzerland, Austria – brief comparison

Criterion	Cyprus	Netherlands	Switzerland	Austria
Taxes on capital	0,6% on nominal value of issued shares	None	1% on capital contributions	1% on capital contributions
Inbound dividends	None	None	None	None
Minimal investment	N/A	5%	20% or 2 million CHF (reduction from 2011)	10%
Minimal holding period	N/A	N/A	None	1 year
Other requirements	The subsidiary must carry on active business or pay taxes at least 5% rate	Business purpose test, "assets" test or "taxation" test	N/A	"Assets" test, "taxation" test
Capital gains on the sale of shares (conditions are met)	None	None	None, if certain conditions are met (1 year holding period, 20% participation)	None, if certain conditions are met
WHT on dividends				
Without DTT	0%	0% (COOP) / 15% (BV)*	35%	25%
If DTT is applied	0%	0-15%*	0% - 15%	0%-15%
Within the EU	0%	0%*	0%	0%
If dividends are paid to Russia (minimal possible rate)	0%	5% 0% (COOP)	5%	5%
Limitations of interest deduction (thin cap etc.)	None	Yes	Yes	Yes
WHT on interest				
Without DTT	0%	0%	0%	0%
If DTT is applied	0%	0%	0%	0%
Within the EU	0%	0%	0%	0%
WHT on liquidation proceeds	None	None	Yes	None
Is substance required at Parent level?	None	Limited (residence test only)	Yes	Yes
CFC and other similar rules	None	None	None	None

*Also may be taxed in Netherlands under «substantial taxation rules» but planning around those possible

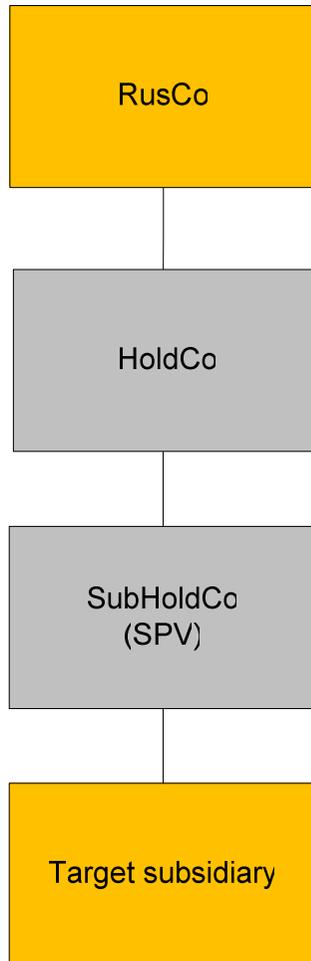
Taxation of Repatriation of Income from Russia to HoldCo (Russian WHT)

Form of distribution	Cyprus	Netherlands	Switzerland	Austria
Dividends	5%, if the shareholder invested in the payer at least US\$100,000 (EUR 100,000 after the Protocol comes into force – see further) or an equivalent amount in local currency, otherwise - 10%	5%, if paid to corporations that hold at least 25% of the capital of the payer and have invested at least EUR 75,000 or an equivalent amount in local currency, otherwise - 15%	5%, if the recipient is a corporation, that holds at least 20% of the capital of the payer and if, at the time when dividends become due, the amount of the recipient's investment exceeds EUR 200,000, otherwise – 15%	5%, if the beneficial owner of the dividends holds directly at least 10% of the capital of the payer and if the participation exceeds US\$100,000, otherwise – 15%
Interest	0%	0%	0% , if the interest is paid with respect to the sale on credit of industrial, commercial or scientific equipment, or of merchandise by one enterprise to another enterprise; 5% rate applies to interest on bank loans; 15% - to any other interest	0%
Royalties	0%	0%	0%	0%

Recent developments: Cyprus DTT Protocol

- ▶ The provisions of the Russia –Cyprus DTT were amended in by the Protocol thereto signed in October 2010
- ▶ If the Protocol is fully ratified (including the exchange of ratification instruments) by the end of 2010 (which is unlikely), the new provisions become largely effective from 2011 (except those specifically deferred until later date)
- ▶ Introduction of “service PE” concept (Art. 5)
- ▶ Full taxation of income from CREIFs at source (Art. 6)
- ▶ Dividends definition also include excessive interest payments reclassified under domestic rules (e.g. thin cap) (Art. 10)
- ▶ Capital gains on real-estate-rich company shares – taxing rights allocated to source state (Art. 13). “Indirect” transfers may also be captured (NB – currently not taxed under domestic law but this may be changed). Entry into force deferred for 4 years
- ▶ Art. 29 “LOB” limits application of treaty benefits to non-registered but tax resident companies in abusive situations
- ▶ New article 27 on mutual collection of tax claims

Russia: Outbound Tax Considerations



Russian tax factors:

- ▶ Participation exemption on dividends, not on capital gains
- ▶ No CFC (yet)
- ▶ No foreign branch exemption. Only direct FTC possible (branch income, passive income taxed at source). Overall limitation on FTC Russian tax on foreign income (not per country or income baskets etc.)

Foreign HoldCo / Sub-HoldCo tax factors:

- ▶ No DWHT in jurisdictions like Luxembourg, Belgium, Sweden, Hungary, the Netherlands (if COOP), the UK
- ▶ Participation exemption in SHC country
- ▶ DTT network of SHC country
- ▶ CFC / other anti-avoidance rules both in Russia and SHC country