



INVESTMENTS IN THE RUSSIAN FEDERATION: GUARANTIES, INCENTIVES AND RESTRICTIONS



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Under The Federal Law dated 09.07.1999 N 160-FZ "On Foreign Investments in the Russian Federation" (the "Law No. 160-FZ") a foreign investor is deemed:

- a foreign legal entity or organization which is not a legal entity, entitled in accordance with the law of the country of its incorporation to make investments in Russia;
- a foreign national entitled in accordance with the law of the country of his/her citizenship to make investments in Russia;
- a stateless individual permanently residing outside the territory of Russia entitled in accordance with the law of the country of his/her permanent residence to make investments in Russia;
- an international organization entitled in accordance with an international treaty of the Russian Federation to make investments in Russia;
- foreign states in accordance with the procedure established by Russian federal laws.

Foreign investors under the Law No. 160-FZ are granted the most favored nation treatment: the legal regime for their activity and use of profits from investments may not be less favorable than the legal regime provided for Russian investors. At the same time, some federal laws provide for:

- exclusions of restrictive character for foreign investors from this regime – to the extent which is necessary for protection of the constitutional system, morality, health, rights and lawful interests of other persons, providing for the state defense and security; and
- exclusions of incentive character for foreign investors from this regime in the form of concessions in the interests of social and economic development of the Russian Federation.

International treaties of the Russian Federation provide for similar regime for foreign investors in Russia: in particular, Article 10 of the Agreement between the Russian Federation and the European Union of 1994, states that "parties provide to each other the most favored nation treatment specified in Art. 1 p. 1 of GATT".

The legal regime for foreign investors in Russia is thus characterized by the complex of guarantees, concessions and restrictions that are described below.

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I. Guarantees for foreign investors

Foreign investors in Russia are granted a number of guarantees according to the Law No. 160-FZ, in particular:

- a. The right for compensation of damages caused to a foreign investor as the result of illegal actions (omission) of state authorities, municipal authorities or officials of such authorities;
- b. The rights to make investments in any forms not prohibited by Russian law (subject to preliminary approval of transactions being entered into by foreign states, international organizations (except for international financial organizations included in the list approved by the Government of the Russian Federation) or entities under control of the latter for acquisition of the right to dispose directly or indirectly of more than 25% of the total number of votes granted by voting shares (participatory interests) in the charter capital of a Russian company or another right to block decisions of the management bodies of a Russian company, according to the Federal Law "On procedures for foreign investments in companies of strategic significance for national defense and state security");
- c. The guarantees of compensation to a foreign investor or profit-making entity with foreign investments of the price of property being confiscated, and in the event of nationalization – of other damages as well;
- d. The guaranty for a foreign investor or a profit-making entity the charter (share) capital of which consists of more than 25% of foreign investors' contributions or implementing a priority investment project against a detrimental change of Russian legislation: in particular, changes of the rates of federal taxes (except for excise duties, VAT for goods manufactured in Russia and contributions to the state extra-budgetary funds (except for contributions to the Pension Fund), increase of the overall tax burden for implementation of priority investment projects or establishment or prohibitions and restrictions for foreign investments shall not apply within the term of the payback period of the investment project but no more than 7 years from the date of start of financing of such project at the account of foreign investments;
- e. the guaranty of use in the territory of Russia and transfer over its borders of income, profit and other legally gained monetary amounts in foreign currency in connection with investments made, subject to payment of taxes and duties provided for by Russian legislation;
- f. the right for unimpeded export from Russia of property and information in documentary form or on electronic media that have been initially imported in Russia as foreign investments (without quotation, licensing and application of other non-tariff measures).

II. Incentives for investors

Foreign investors are granted with certain customs and tax incentive in accordance with Russian legislation. Furthermore, both foreign and domestic investors are granted in Russia with the incentives depending on the territory where they conduct their activities, as well the types of activities.

1. Customs incentives for foreign investors

According to the Decision of the Government of the Russian Federation dated 23.07.1996 No. 883 "On the incentives for payment of import customs duties and VAT with respect to goods being imported as contributions to the charter capital of enterprises with foreign investments" goods being imported in the customs territory of the Russian Federation as a contribution of a foreign founder to the charter (share) capital are exempted from customs duties provided that such goods are:

- not excisable goods;
- basic production assets; and
- imported in terms provided for by the constitutive documents of the legal entity in question for formation of the charter (share) capital.

Excisable goods in accordance with Article 181 of the Tax Code of the Russian Federation (the "Tax Code") are deemed:

- 1) ethyl alcohol made of all types of raw materials;
- 2) alcohol containing products (solutions, emulsion, suspension and other types of products in liquid form with a volumetric share of ethyl alcohol over 9 per cent), except for certain types of products;
- 3) alcoholic products according to the list approved by the Government of the Russian Federation;
- 4) beer;
- 5) tobacco products;
- 6) passenger vehicles;
- 7) motorcycles featuring engine power rating over 112.5 kW (150 h.p.);
- 8) petrol;
- 9) diesel fuel;
- 10) motor oil for diesel and/or carburetor (injector) engines.
- 11) direct-distillation petrol;
- 12) furnace fuel material for domestic use manufactured from diesel fractions of direct distillation and/or of secondary origin that boil within the temperatures interval from 280 to 360 degrees Celsius;
- 13) benzol, paraxilol, ortoxylen;
- 14) aviation kerosene oil;
- 15) natural gas (in cases provided for by international treaties of the Russian Federation);

Importation into the customs territory of the Russian Federation and other territories under its jurisdiction of technological equipment (including components and spare parts thereto) according to the list approved by the Government of the Russian Federation analogues of which are not manufactured in Russia and which is imported as a contribution to the charter (share) capitals of organizations, is exempt from VAT (Article 150 p. 7 of the Tax Code).

2. Regional tax incentives

Most constituent entities (regions) of Russia provide tax concessions to investors, in particular, reduced profit tax and property tax rates for companies. The eligibility criteria typically require that the project fits in with regional business priorities and a minimum amount of investment. Such tax concessions are normally granted for a period not exceeding the payback period of the investment project, and the amount of the tax savings realized, cannot exceed the amount of the initial investment under the project. Additional conditions for eligibility for concessions may be established by regional authorities, in particular, the obligations for employing individuals residing in the region, for developing infrastructure, etc.

For example, investors – legal entities, carrying out investment projects in the territory of Moscow Region, have been granted the following incentives:

- (i) decrease of the company profit tax rate by 4.5% for a period from three to seven years, depending on the type of project;
- (ii) decrease of the company property tax rate, with respect to the assets manufactured and/or bought, as well as with respect to the fixed assets, in the event that the assets in question are expanded, further equipped, reconstructed, modernised and retooled, while implementing:
 - a strategic investment project: up to 0% – within the first tax period, 0.5% – from the second through the fifth tax periods, 1.5% – from the sixth through the eighth tax periods;
 - a priority investment project: up to 0% – within the first tax period, 1.5% – from the second through the third tax periods, 1.5% – from the fourth through the fifth tax periods;
 - a significant investment project: up to 0% – within the first tax period, 1.1% – from the second through the third tax periods.

3. Special regimes in special economic zones (SEZs)

A special economic zones (SEZ) is a part of the territory of the Russian Federation (RF) determined by the RF Government where a special regime for conducting business is applied, as well as the procedure of free customs zone.

SEZs in Russia are established and operated in accordance with the Agreement regarding free (special) economic zones within the territory of the Customs Union and the customs procedure of the free customs zone dated 18 June 2010, other customs regulations of the Customs Union, the Federal Law dated 22 July 2005 No. 116-FZ "On Special Economic Zones in the Russian Federation" (further "Law No. 116-FZ") and the federal laws regulating particular SEZs.

There are four types of SEZs:

- a) industrial production zones – Titanovaya Valley (Sverdlovsk Region), Togliatti (Samara Region); Lipetsk (Lipetsk region), Alabuga (Republic of Tatarstan), Moglino (Pskov Region), and Ludinovo (Kaluga Region);
- b) technical research and implementation zones – Zelenograd (Moscow), Dubna (Moscow Region), Saint Petersburg, Tomsk, and Innopolis (Kazan);
- c) tourism and recreation zones – Altai Valley (Republic of Altai), Baikal Harbour (Republic of Buryatia), Vorota Baikala (Irkutsk Region), and Biryuzovaya Katyn (Altai Region); and
- d) port (logistics) zones – Ulianovsk and Soviet Harbour (Khabarovsk Region).¹

All SEZs are established for a period of 49 years, on the basis of a decision of the Government of the Russian Federation.

The status of a SEZ resident may be obtained by a profit-making organisation (except for a unitary enterprise) or an individual entrepreneur (only in technical research and implementation, as well as tourism and recreation SEZs) registered in the territory of the municipal district where the respective SEZ is located, provided that they enter into an agreement on conducting activities in the respective SEZ with the management authorities of such SEZ. In order to enter into such agreement, an investor must submit an

¹ For more information please see: <http://eng.russeiz.ru/>

application together with the business plan specifying a certain volume of investments to be made within a certain period, in an amount not less than provided for by the Law No. 116-FZ.

In general, a resident of an SEZ is entitled to engage only in the activities prescribed for the respective type of SEZ (an exhaustive list of the types of such activities is provided in the Law No. 116-FZ). However, the residents of complex SEZs in the Kaliningrad Region (effective until 1 April 2031) and the Magadan Region (effective until 31 December 2025), may conduct various types of activities. Residents of SEZs may not have representative offices or branches registered beyond the SEZ where they conduct their activities.

Residents of SEZs in Russia enjoy the following incentives:

- (i) a free customs zone customs procedure, under which goods imported into the SEZ (except for a tourism and recreation SEZ) are exempt from import customs duties and import VAT, provided that certain requirements are met;
- (ii) tax concessions:
 - reduced rate of company profit tax to be paid to the budget of the region (no more than 13.5%) and favourable treatment of certain expenses for company profit tax purposes;
 - 0% company profit tax rate to be paid to the federal budget by residents of technical research and implementation, as well as tourism and recreation SEZs, combined into a cluster under the decision of the Government;
 - exemption from company property tax, on assets manufactured or bought in for the purposes of the activities within the SEZ, for a period of 10 years from the date of their entering into the accounting records;
 - exemption from land tax, with respect to the land plots within the SEZ, for the period of 5 years from the date of acquisition of such land plots into property ownership;
 - exemption from excise taxes with respect to the goods imported into the port SEZs.

Law No. 116-FZ also provides a state guarantee that, in the event of introduction of any amendments to the tax legislation, which may have a negative effect on the taxpayer's positions, such amendments will not be applied to the residents of the SEZs, generally, during the effective term of the agreement on carrying out activities within the SEZ.

Furthermore, the Federal Law No. 16-FZ dated 10 January 2006 "On Special Economic Zone in the Kaliningrad Region and Amending Certain Laws of the Russian Federation" (further the "Law No. 16-FZ") established the legal regime of SEZ in the Kaliningrad region for the term till 1 April 2031.

A resident of SEZ in the Kaliningrad region may be a legal entity that complies with all the following requirements:

- established under the laws of Russia and registered in the Kaliningrad region;
- manufactures goods exclusively within the Kaliningrad region;
- makes investments in the Kaliningrad region;
- its investment project complies with the requirements provided for by the Law No. 116-FZ (in particular, the investor should makes the capital investments for the total amount of not less than RUB 150 million within 3 years from the date of registration in the register of SEZ residents).

A legal entity should be registered in the register of SEZ residents.

Legal entities that apply special taxation regimes as well as financial organizations (including credit and insurance) and professional securities market participants may not be residents of the SEZ in Kaliningrad region.

A legal entity acquires the status of the SEZ resident from the date of the decision on its registration in the register of SEZ residents which is certified by the respective certificate. From the date of such registration the entity is entitled to apply the special taxation regime.

Within the term of implementation of the investment project by the SEZ resident the guaranties of non-application of federal laws and other regulatory acts involving increase of the total tax burden on the SEZ resident are effective.

In the SEZ in Kaliningrad region the customs procedure of free customs zone is applied: the goods within the SEZ or a part thereof are placed and used free of customs duties, taxes and non-tariff measures and without application of restrictions and bans with respect to the goods of the Customs Union.

Under the customs procedure of free customs zone are placed the goods of foreign origin imported in the SEZ in Kaliningrad region by legal entities registered in the SEZ for installation and usage in accordance with the Law No. 16-FZ.

Tax incentives for the SEZ residents include a special procedure for payment of companies' profit tax with respect to the profit received from implementation of the investment project subject to separate accounting of income and expenses, as well as the right to apply reduced tax rates during several tax periods from the date of registration in the register of SEZ residents:

- before expiry of 6 tax periods starting from 1 January following the year of the registration in the register of SEZ residents - 0 %;
- 6 tax periods starting from 1 January following the expiry of the period of application of 0% tax rate – standard companies' profit tax rates to be paid to the budget of the Kaliningrad region are reduced for 50%.

In addition, the SEZ residents calculate the amount of the companies' property tax with respect to the assets manufactured or acquired in the course of implementation of the investment project separately and pay this tax at the reduced rates within the period of conducting their activity as residents from the date of the registration in the register of SEZ residents:

- Within first 6 calendar years – 0 %;
- From 7th through 12th calendar year inclusive - 1,1 %.

4. Special regimes in the territories of priority socio-economic development

The territory of priority socio-economic development ('TPSED') is a part of the territory of the constituent entity of the Russian Federation, including the closed administrative-territorial formations, where under the Decision of the Government of the Russian Federation a special legal regime is established for business and other activities in order to create favorable conditions for rising investments, socio-economic development, and life support for population.

Principles of the TPSED regime, state support measures and procedure for performance activities in such territories are provided by the Federal Law, dated 29 December 2014, No. 473-FZ 'On the Territories of Priority Socio-Economic Development in the Russian Federation' (the 'Law No. 473-FZ'), as effective from 30 March 2015.

A TPSED is created for 70 years with possible extension upon the decision of the Government.

As of September 2015, the Government of the Russian Federation has adopted resolutions to create the following TPSEDs:

- 'Kamchatka' (Kamchatka region)
- 'Belogorsk' (Amur region)
- 'Priamurskaya' (Amur region)
- 'Kangalassy' (Republic of Sakha, Yakutia)
- 'Mikhailovsky' (Promorsky krai)
- 'Nadezhdinskaya' (Promorsky krai)
- 'Beringovskiy' (Chukotka autonomous region)
- 'Komsomolsk' (Khabarovsk region)
- 'Khabarovsk' (Khabarovsk region).

The management company (joint stock company established by the Government of the Russian Federation, where 100% shares are owned by the Russian Federation, and(or) a subsidiary, established with the participation of the joint stock company) is given in possession of lease the land plots, buildings, structures, facilities owned by the state or being in municipal property and located in the TPSED, according to the terms of the agreement for establishment of the TPSED and in the procedure prescribed by the Government of Russia.

A resident of the TPSED is an individual businessman or legal entity (a commercial organization), which were registered in the TPSED (except for the state and municipal unitary enterprises) and which entered into the agreement for performing activities in the TPSED ('agreement for performing activities') and are included in the register of TPSED residents.

Organizations having the status of a participant of the regional investment project cannot be TPSED residents.

Like SEZ residents, TPSED residents cannot have branches and representative offices outside of the TPSED.

During the term of the agreement for performing activities the TPSED resident undertakes to perform activities provided for by such agreement and to make investments, including capital investments, and the management company undertakes to grant to the TPSED resident into ownership or lease a land plot if it is required to perform the relevant activity.

The special legal regime of activities within the TPSED includes, in particular:

- 1) special regulation of certain relations connected with the TPSED functioning (in particular, labour relations);
- 2) establishment for TPSED residents of preferential rental rates for the use of real property owned by the management company under the right of ownership or lease and located in the TPSED;
- 3) special regime of the state control (supervision), municipal control within the TPSED (including scheduled and unscheduled inspections);
- 4) priority connection to infrastructure facilities of the TPSED;
- 5) application of the customs procedure of the free customs zone (for this purpose the TPSED is treated as a SEZ determined in accordance with the Agreement for free (special) economic zones in

the customs territory of the Customs Union and customs procedure of free customs zone dated 18 June 2010).

- 6) special regime of taxation of the TPSED residents in accordance with the tax laws of the Russian Federation, including:
- a) the right to an accelerated refund of VAT (application of the declarative procedure for VAT refund), subject to submission of the contract of surety of the management company in addition to the a tax declaration;
 - b) application of 0% rate of companies' profits tax payable to the federal budget in the amount during 5 tax periods starting from the tax period when the first profit was earned by the activities carried out in performance of the agreement for performing activities in the TPSED, and provided that such income is not less than 90% of the total income taken into account when determining the tax base for companies' profit tax, and maintaining separate accounting of income (expenses) received (incurred) from activities carried out in performance of the agreement for performing activities in the TPSED and income (expenses) received (incurred) from performance of other activities;
 - c) application of reduced rates of income tax payable to the budget of the constituent entity of the Russian Federation established by the laws of the relevant constituent entity (no more than 5% during 5 tax periods starting from the tax period when the first profit was earned by the activities carried out in performance of the agreement for performing activities in the TPSED, and at least 10% during the next 5 tax periods);
 - d) application of reduced rates of social insurance contributions during 10 years after obtaining the status of a resident starting with the 1st day of the month following the month of such status obtaining:
 - 6% to the Pension Fund;
 - 1.5% to the Social Insurance Fund;
 - 0.1% to the Federal Fund for Mandatory Medical Insurance;
 - e) application of the reduced coefficient featuring the area of mineral mining for the purposes of calculating the tax on mineral extraction, during 120 tax periods, starting with the beginning of the application of the reduced rate of income tax:
 - 0 - for the first 24 tax periods;
 - 0.2 - from 25 to 48 tax period inclusive;
 - 0.4 - from 49 to 72 tax period inclusive;
 - 0.6 - from 73 to 96 tax period inclusive;
 - 0.8 - from 97 to 120 tax period inclusive.
- 7) exemption from companies' property tax and land tax provided by the federal and regional tax laws and regulations of municipal entities for TPSED residents.

5. Tax incentives in connection with conducting certain types of activities

Taxpayers engaged in the certain types of activities enjoy the following tax incentives:

- (i) Companies conducting eligible research and development activities, included in the list approved by the Government, can apply for a 150% deduction of expenses, incurred in connection with such activities, to reduce the company profit tax.
- (ii) Taxpayers engaged, in particular, in the following activities, may apply reduced rates of contributions to the social funds (Social Insurance Fund, Pension Fund and the Federal Fund for Mandatory Medical Insurance) in the interim period from 2011 through 2027:
 - development and sale of software and databases and/or providing services in connection with development, adaptation or modification of software and databases, their assembly, testing and servicing;
 - development, release and/or publishing of mass media (in accordance with the list of activities established by Federal Law No. 212-FZ) as the principal activity, provided that a taxpayer is included in the list maintained by the Federal Service for Supervision in Communication, Information Technologies and Public Communications and the authorities controlling payment of contributions to social funds;
 - agricultural goods production (and deriving more than 70% of its revenues thereof);
 - applying a simplified taxation system and conducting as its principal activity an activity according the list established by Federal Law No. 212-FZ;
 - pharmaceutical activities and paying a uniform tax for imputed income with respect to certain types of activities;
 - engineering activities (except for residents of technical research and implementation SEZs).

as well as by residents of technical research and implementation SEZs, industrial production zones and tourism and recreation SEZs, combined into a cluster under the decision of the Government of the Russian Federation.

- (iii) 0% company profit tax rate for the licensed company engaged in priority medical and educational activities, included in the list approved by the Government of the Russian Federation (and deriving more than 90% of its revenue thereof) with more than 15 employees, as well agricultural goods producers qualifying for similar requirements;
- (iv) Exemption from VAT of technological equipment imported into Russia that has no equivalent produced in Russia, included in the list approved by the Government of the Russian Federation.
- (v) Exemption from import customs duties of goods imported by a foreign investor, being used as a contribution to the charter capital of its Russian subsidiary.

6. Skolkovo incentives

Russian legal entities – residents of the Skolkovo Innovation Centre (established in 2010 in the Moscow Region) conducting certain research and development activities in one of the five priority directions – energy

efficiency, nuclear engineering, aerospace technology, medicine and information technologies,² and registered as the participants of the Skolkovo project, enjoy, in particular, the following incentives:

- (i) exemption from companies' profit tax within the first ten years from the date of becoming a participant of the Skolkovo project, provided that the revenue amount does not exceed RUB 1 billion, and 0% companies profit tax rate applicable to profits generated by the Skolkovo project participant after losing the right to the exemption from VAT;
- (ii) exemption from companies' property tax (provided that the amount of the profit does not exceed the established amount);
- (iii) exemption from land tax within the Skolkovo territory, with respect to management companies;
- (iv) exemption from VAT within the first 10 years from the date of becoming a participant of the Skolkovo project (provided that the amount of the profit does not exceed the established amount);
- (v) reduced rates of contributions to social funds, in the amount of 14% on the annual remuneration of each employee (provided that the amount of the profit does not exceed the established amount);
- (vi) reimbursement of paid customs duties and VAT, upon the importation of goods;
- (vii) exemption from the obligation to maintain accounting records, unless the participant's annual income exceeds RUB 1 billion; and
- (viii) exemption from the payment of state duties for the issuance of work permits, invitations and visas for foreign employees.

7. Republic of Crimea and Sevastopol City incentives

The Republic of Crimea and the federal city of Sevastopol (hereinafter the "Crimea" and "Sevastopol", respectively) became constituent entities of the Russian Federation on 18 March 2014 under the Treaty between the Russian Federation and the Republic of Crimea on the Accession of the Republic of Crimea to the Russian Federation and on the Formation of New Constituent Entities within the Russian Federation. Starting from that date, Russian laws became, as the general rule, effective on their territories.

From 1 January 2015, the laws of the Russian Federation on taxes and fees became effective in Crimea and Sevastopol, the free economic zone (FEZ) will start to function in Crimea and Sevastopol, as well as a specific legal regime will come into operation, which governs the issues of foreign employee engagement, as well as arrival to and departure from Crimea and Sevastopol of foreigners, and operations in the area of marine transport.

Under the Federal Law dated 29 November 2014 No. 377-FZ "On the Development of the Crimea Federal District and the Free Economic Zone in the Republic of Crimea and the Federal City of Sevastopol" (the "Law No. 377-FZ") the FEZ is established for a period of 25 years, with the possibility of further extension of this term.

FEZ participants cannot operate in the area of subsoil use for the purposes of exploration and production of minerals, deposits development on the continental shelf of the Russian Federation. The Government of the Russian Federation may specify other activities not allowed for FEZ residents.

A special regime of doing business and conducting other activities within the FEZ includes:

² For more information please see: http://community.sk.ru/foundation/about_fund/

- special regulations for town-planning activities and land use, when placing objects required for implementation of investment projects by FEZ participants;
- special tax regime, in accordance with the legislation on taxes and fees;
- granting, according to the procedures specified by the budget legislation, of subsidies for reimbursement of the expenses to FEZ participants, including customs duties, taxes and fees in connection with goods (except for excisable goods) imported for use in construction, equipment and technical equipment of facilities, required for the implementation of investment projects by FEZ participants.

Any persons (either Russian or non-Russian) may engage in business and other activities in the FEZ, but the special regime of operation in the FEZ, and the customs procedure of free customs zone, may be applied only by persons having the status of FEZ participant from the date of registration in the unified register of FEZ participants.

To obtain this status, the respective person should be established in Crimea or Sevastopol, be registered with the local tax authority, as well as have an investment policy that complies with the requirements established by Federal Law dated 29 November 2014 No. 377-FZ “On the Development of the Crimean Federal District and the Free Economic Zone in the Territories of the Republic of Crimea and the Federal City of Sevastopol”.

An FEZ participant shall operate in the FEZ in accordance with the agreement on the terms and conditions of operating in the FEZ, concluded between such participant and the supreme executive authority of Crimea and Sevastopol.

A. Free Customs Zone (FCZ)

A customs regime of a free customs zone applies in the FEZ, in accordance with the Agreement on Free (Special) Economic Zones in the Customs Territory of the Customs Union and Customs Procedure of Free Customs Zone dated 18 June 2010.

A specific feature of this regime is that the goods are placed and used within the FEZ territory, or a part thereof, without payment of customs duties and taxes, and such goods are not subject to non-tariff regulation, with respect to foreign goods as well as bans and restrictions on the goods of the Customs Union.

The procedure for, and technologies of customs operations, in respect of goods (including vehicles) imported into and exported from the FEZ territory, will be determined by the Federal Customs Service of the Russian Federation (FCS).

Equipment placed by an FEZ participant under the customs regime of free customs zone and put into operation, as well as goods placed under the same customs regime and used to construct real estate objects in the FEZ, retain the status of foreign goods, and are subject to customs control within 5 years after their placement under this customs procedure, and thereafter the goods are deemed as Customs Union goods free from customs control.

B. Tax Concessions and Reduced Insurance Contributions Rates for FEZ Participants

The Federal Law dated 29 November 2014 No. 379-FZ “On the Introduction of Amendments to Parts One and Two of the Tax Code of the Russian Federation” due to the Adoption of the Federal Law “On the Development of the Crimean Federal District and the Free Economic Zone in the Territories of the Republic of Crimea and the Federal City of Sevastopol” provides, inter alia, for the following tax concessions in the FEZ in Crimea and Sevastopol:

- a reduced rate for corporate income tax (in a part to be credited to the federal budget – 0%, to the budgets of Crimea and Sevastopol – not more than 13.5%);

- exemption of FEZ participants from payment of property tax (for 10 years after the registration of the property acquired for the purpose of relevant operations) and land tax (for 3 years);
- the right of legislative (representative) authorities to reduce the tax rates for taxes payable in connection with special tax regimes (for the period of 2015-2016 the tax rates can be 0%);
- special regulations in connection with determining the tax base for VAT, as well as the calculation and payment of excise duties by taxpayers operating in Crimea and Sevastopol.

The Federal Law dated 29 November 2014 No. 378-FZ, established the following reduced rates of insurance contributions for FEZ participants in Crimea and Sevastopol: insurance contribution to the Pension Fund of the Russian Federation – 6%, the Social Insurance Fund of the Russian Federation – 1.5%, Mandatory Health Insurance Fund of the Russian Federation – 0.1%.

These rates will be valid for 10 years starting from the 1st day of the month following the month when the status of a FEZ participant is granted to the taxpayer.

III. Restrictions with respect to foreign investors

Some Federal Laws establish restrictions on the participation of foreign investors in the charter capital of Russian legal entities engaged in activities in certain domains, establishment and operation of organisations with foreign investments in certain territories in Russia and on the ownership of land plots by foreign investors.

1. Banking Business

Under the Federal Law dated 2 December 1990 No. 395-1 “On Banks and Banking Activities”, the quota of participation of foreign capital in the banking system of the Russian Federation shall be set by Federal Law at the suggestion of the Government of the Russian Federation, coordinated with the Bank of Russia.

This quota is used as the benchmark by the Bank of Russia for:

- suspension of the issue of licenses for banking operations to banks with foreign investments, branches of foreign banks, upon reaching the quota;
- prohibition on the increase in the registered capital of a credit organisation through the use of non-resident resources, and disposal of shares (participation interests) to non-residents, if such transaction may result in the quota being exceeded.

The Bank of Russia also has the authority:

- to impose restrictions on banking operations for credit organisations with foreign investments and branches of foreign banks, if the respective foreign states apply restrictions on banks with Russian investments and branches of Russian banks;
- to establish additional requirements for credit organisations with foreign investments and branches of banks, regarding the procedure of providing reports, endorsement of management personnel and the list of banking operations being carried out.

2. Media Business

The Law of the Russian Federation dated 27 December 1991 No. 2124-1 “On Mass Media” establishes the following restrictions regarding foreign investors:

- (i) a foreign legal entity, as well as a Russian legal entity with 50% or more of its charter capital being owned by foreign persons, may not act as founders of television channels and programmes, radio channels and programmes, or video programmes;
- (ii) a foreign citizen, a person without citizenship, a foreign legal entity, as well as a Russian legal entity with 50% or more of its charter capital being owned by foreign persons, may not act as founders of organisations (legal entities) effecting television broadcasting in half or more of the constituent entities of the Russian Federation, or over a territory where half or more of the population of the Russian Federation resides;
- (iii) a founder of a television channel or programme, radio channel or programme, or video programme, effecting television broadcasting in half or more of the constituent entities of the Russian Federation, or over a territory where half or more of the population of the Russian Federation resides, may not dispose of the shares (participatory interest) of such media, if as the result of such disposal, the stake of a foreign shareholder in its charter (joint) capital shall be equal to or exceed 50%.

On 1 January 2016, come into force amendments introduced by Federal Law dated 14 October 2014 No. 305-FZ, in particular, the prohibitions (unless otherwise provided for by an international treaty of the Russian Federation) with respect to:

- a. foreign states, international organisations and institutions under their control, foreign legal entities, Russian legal entities with foreign investments, foreign citizens, stateless persons, citizens of the Russian Federation, who have another state citizenship (hereinafter the “dual citizenship person”) – to act as a founder (participant) of mass media, be a media desk (i.e., engage in production and publishing of mass media), or a broadcasting company;
- b. foreign states, international organisations and institutions under their control, foreign legal entities, as well as Russian legal entities in which the stake of foreign entities is over 20 percent, foreign citizens, stateless persons, dual citizenship persons - to exercise ownership, management or control, directly or indirectly (including through controlled entities, or by possessing in aggregate more than 20 percent of shares in any entity) over more than 20 percent of shares (interests) in an entity, which is a participant (member, shareholder) of a founder of mass media, media desk, or a broadcasting company.

3. Insurance Business

The Law of the Russian Federation dated 27 November 1992 No. 4015-1 “On the Organisation of Insurance Business in Russia” provides for the following limitations with regard to foreign insurance company subsidiaries operating in Russia:

- (i) Insurance organisations being subsidiaries of foreign investors (principal organisations) or those with a share of foreign investors in the charter capital exceeding 49%, may not carry out: life insurance; mandatory insurance; mandatory state insurance; property insurance connected with the supplies of goods or the performance of contractual works for state needs; the insurance of property interests of state and municipal organisations.
- (ii) Insurance organisations being subsidiaries of foreign investors (principal organisations) or those with a share of foreign investors in the charter capital exceeding 51%, may not carry out in Russia

insurance specified in p. i above as well certain types of personal insurance and civil liability of automotive vehicles owners.³

- (iii) In the event the size (quota) of the share of foreign capital in the charter capital in insurance organisations exceeds 50%, the insurance supervision authority shall cease to issue licenses for insurance activities to insurance organisations being subsidiaries of foreign investors, or those with a share of foreign investors in the charter capital exceeding 49%.
- (iv) An insurance organisation must obtain a preliminary approval from the insurance supervision authority for an increase in the amount of its charter capital with respect to foreign investors and/or subsidiaries thereof, and for assignment of its shares (participation interest) to a foreign investor, and Russian shareholders (participants) must obtain such preliminary approval to assign their shares in an insurance organisation (participation interest) possessed by them, in favour of foreign investors and/or subsidiaries thereof.
- (v) Foreign investors may pay for shares in insurance organisations (participation interest) exclusively in monetary form in Russian roubles.
- (vi) Persons carrying out the functions of sole executive body and chief accountant of an insurance organisation with foreign investments must permanently reside within the territory of Russia.
- (vii) An insurance organisation, being subsidiary of a foreign investor, may conduct insurance activities in Russia, if the foreign investor is an insurance organisation carrying out its activities in accordance with the laws of the respective country during at least fifteen years, and has been participating in the activities of insurance organisations established within the territory of Russia during at least two years.
- (viii) Insurance organisations, being subsidiaries of foreign investors (principal organisations) or with a share of foreign investors in the charter capital of more than 49%, may open branches within the territory of Russia and participate in subsidiary insurance companies, subject to receiving a preliminary approval from the insurance supervision authority.⁴

4. Extraction of Diamonds

According to Law of the Russian Federation dated 26 March 1998 No. 41-FZ “On precious metals and precious stones”, organisations established without direct or indirect participation of foreign persons, stateless persons and foreign legal entities must possess the majority (50%+1) of voting rights taken into account during decision-taking by management bodies of organisations conducting the extraction of diamonds in the territory of Russia.

5. Aviation

³ This restriction is applicable until 22 August 2017.

⁴ The restrictions specified in paragraphs (i), (v), (vi), (vii) and (viii) above shall not apply to insurance organisations that are subsidiaries of foreign investors (principal organisations) of member states of the European Communities being parties to the Agreement on Partnership and Co-Operation establishing a partnership between the Russian Federation, on the one part, and the European Communities and their member-states, on the other part, dated 24 June 1994, or having a share of such foreign investors in their charter capitals of more than 49%.

Under Article 61 p. 2 of the Air Code of the Russian Federation dated 19.03.1997 No. 60-FZ an aviation enterprise may be established in Russia with participation of foreign investors subject to the following conditions:

- a share of foreign investors in the charter capital of the aviation enterprise does not exceed 49 %;
- a chief of the aviation enterprise is a citizen of the Russian Federation;
- a number of foreign citizens in the management body of such enterprise does not exceed 1/3.

6. Private detective and security service

The Law dated 11.03.1992 No. 2487-1 "On private detective and security service in the Russian Federation", Article. 15.1, establishes the prohibition, unless otherwise is provided for by international treaties of the Russian Federation, on:

- making a contribution into the charter capital of a private security service organization (in particular at establishment) by foreign citizens, Russian citizens with other countries' citizenship, stateless persons, foreign legal entities as well as organizations among shareholders of which are such citizens and entities;
- disposal of shares (contributions) by shareholders of a private security service organization to foreign citizens and entities.

7. Ownership title and land use rights

Under the Land Code of the Russian Federation, foreign citizens, persons without citizenship and foreign legal entities:

- are not entitled to own land plots located in the border territories, recorded in a list approved by the President of Russia, and in the other territories of Russia specified by Federal Laws;
- are entitled to acquire land plots into property only for a monetary payment, with the rate thereof being set by the Land Code.

Foreign citizens, foreign legal entities, stateless persons as well as legal entities with more than 50% of the charter capital of which is owned by such persons, may possess agricultural land plots only on the right of lease, according to the Federal Law dated 22 July 2002 No. 101-FZ "On Circulation of Agricultural Land".

Furthermore, foreign citizens, persons without citizenship and foreign legal entities may not own the land plots located within the boundaries of a sea port, under the Federal Law dated 8 November 2007 No. 261-FZ "On sea ports in the Russian Federation and on amendments to certain laws of the Russian Federation".

8. Activity in closed administrative territorial units

According to the Law of Russia dated 14.07.1992 No. 3297-1 "On closed administrative territorial units" in the territory of a closed administrative territorial unit establishment and activity of organizations the founders of which are foreign citizens, stateless persons, foreign legal entities, non-profit making non-governmental organizations, subdivisions thereof as well as activity of international organizations (associations) are not allowed.

9. Investments in Strategic Companies

The Law of the Russian Federation No. 57-FZ “On procedures for foreign investments in companies of strategic significance for national defence and state security” (further the “Strategic Companies Law”) establishes the requirement for preliminary approval of transactions involving establishment of control by foreign investors over companies engaged in activities in the sectors that are deemed strategic (“Strategic Companies”), including:

- works having an active impact on geophysical processes;
- works related to hydro-meteorological processes and events;
- activities in connection with geological research of subsoil and/or mineral exploration and extraction of federal subsoil;
- activities in the nuclear industry and the storage of nuclear and radioactive materials;
- activities in connection aviation equipment and security;
- space activities;
- activities in connection with manufacturing, trade, repair and utilization of weapons and military equipment, and their spare parts and ammunition (excluding bladed weapons, civil and service weapons) and explosive materials for industrial purposes;
- activities in connection with television or radio broadcasting on a territory, where half or more of the population of a constituent entity of Russia resides;
- services provided by a company included in the register of natural monopolies (excluding natural monopolies in the public telephone and wireless communication and postal communications fields, and services for the supply of heat energy and electrical energy through the distribution grid);
- activities in connection with encryption and licensed encryption techniques (excluding distribution and maintenance of encryption techniques and related services performed by Russian banks, which are not directly owned by the Russian Federation);
- activities in connection with confidential obtaining of information in premises and equipment used for these purposes (excluding activities performed for the purposes of the security of legal entities);
- printing performed by a profit-making entity, if it is capable of printing not less than 200 million pages a month; and
- performance of editorial office activities and/or activities of a periodical publisher, publishing publications with individual circulations of not less than 1 million.

The following transactions, involving the acquisition of control over Strategic Companies, are subject to preliminary approval under the Strategic Companies Law:

- 1) acquisition by a foreign investor or a group of persons:

- a) directly or indirectly of more than 50% of the voting shares in a Strategic Company, which does not conduct geological surveys on the subsoil and/or explore and extract minerals on federal subsoil plots (i.e., not “operating on federal subsoil plots”);
 - b) the right to appoint (a) the chief executive officer, and/or more than 50% of the members of the board of directors or another collective executive body of the Strategic Company, not operating on federal subsoil plots;
- 2) acquisition by a foreign investor or a group of persons of:
- a) directly or indirectly not less than 25% and no more than 75% of the voting shares of a Strategic Company operating on federal subsoil plots (except for transactions, as the result of which the share of such investor or such group of persons in the charter capital of such Strategic Company is not increased, if such transactions are entered into in the course of an increase in the charter capital of such company, or entered into by persons being under control of the person controlling the Strategic Company);⁵
 - b) the right to appoint the chief executive officer, and/or 25% or more of the members of board of directors or another collective executive body of a Strategic Company, operating on federal subsoil plots;
- 3) agreements on exercising, by a foreign investor or a profit-making entity or individual entrepreneur or a group of persons, of the functions of a management body of a Strategic Company;
- 4) transactions aimed at the acquisition by a foreign state, international organisation or organisation controlled by them, of the right to dispose directly or indirectly of more than:
- a) 5% of the total number of votes at the shareholder level – for Strategic Companies operating on federal subsoil plots; or
 - b) more than 25% of the total number of votes at the shareholder level – for Strategic Companies engaged in strategic activities other than operating on federal subsoil plots;
- 5) acquisition into property, ownership or use of fixed production assets of a Strategic Company, the price of which amounts to 25% and more of the balance sheet assets of such company, as of the latest reporting date;⁶
- 6) other transactions or actions aimed at the acquisition by a foreign investor or group of persons of the right to determine the decisions of the management bodies of a Strategic Company, including the rights to determine its business activities.

The following transactions do not require a preliminary approval or subsequent notification:

- intergroup transactions between foreign investors that are under the control of one and the same person;
- transactions between foreign investors that possess more than 75% and more in the charter capital of a Strategic Company, operating on federal subsoil plots;

⁵ According to Strategic Companies Law with amendments effective from 6 December 2014

⁶ According to Strategic Companies Law with amendments effective from 6 December 2014

- transactions between companies being controlled by a constituent entity of the Russian Federation.

The standard term for obtaining a preliminary approval for any of the abovementioned transactions is three months from the date of submission of the application to the Federal Antimonopoly Service (FAS), which may be extended for three months. The application is considered on merits by the special Government commission on the basis of conclusions of the federal executive authority in the domain of defence and the federal executive authority in the domain of security and the conclusion of the inter-agency commission for protection of the state secret.

If a preliminary approval is obtained, the transaction should be entered into within the term provided for in the respective approval.

Furthermore, in the event of acquisition of 5% or more of the shares (whether voting or non-voting) in a Strategic Company, the acquirer must send a notification about such a transaction to the FAS within 45 days following its conclusion.

It is expressly prohibited to a foreign state, international organisation or organisation controlled by them, to acquire control over Strategic Companies, as defined by the Strategic Companies Law.

Transactions entered into in a breach of the Strategic Companies Law are deemed void, and the persons who sustained the respective breaches may be brought to administrative liability.

The information above is prepared for the general information for interested persons on the basis of the laws and regulatory acts of the Russian Federation as of the end of September 2015. This information should not be acted upon in any specific situation without appropriate legal advice.

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