

Doing business in Russia

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Forms of Business Activity in Russia

There are several forms in which a foreign company can undertake business activities in the Russian Federation; the basic forms are opening of a representative office and creation of a legal entity in accordance with the RF Legislation.

A Representative Office (RO) is a subdivision of a foreign company opened with the aim to represent and protect the company's interests.

A Branch Office of a foreign company is created with the aim to perform commercial activities.

In accordance with the RF Legislation **a Legal Entity** can be established by a foreign legal entity and/or a physical person either with 100% own investments, or together with other legal entities and/or physical persons, residents of the RF or other countries (with allocation of shares in any proportion).

Each Legal Entity shall have a firm (business) name in the Russian language and, at will, a Russian firm name together with a name in any other foreign language.

Commercial organizations can be established in the RF in the following forms:

- General partnerships;
- Trust partnerships;
- Limited liability companies;
- Double liability companies;
- Close corporations (close joint stock companies);
- Public corporations (joint stock companies);
- Producers' cooperatives.

From among the above mentioned the most prevailing forms of conducting business activities in the RF are joint stock and close joint stock companies.

A Limited Liability Company (obschestvo s ogranichennoy otvetstvennostju - OOO) is an entity with capital stock divided into "parts", the size of which are determined by the formation documents; and the parts are allocated among the participants.

Participants in a limited liability company are not responsible for the company's liabilities and are responsible for losses only up to the value of their parts.

The number of participants may not be more than 50.

The statutory minimum charter capital is 10,000 Russian rubles (apr. 423 USD)

The formation documents of such company are the formation agreement (in case there are more than one OOO participant) and the organizational charter.

A closed joint stock company (zakrytoye aktsionemoye obschestvo - ZAO) is an entity with capital stock divided into a certain amount of shares. ZAO shares can be only distributed among its founders and among a certain number of people, if such has been determined before.

ZAO participants are not responsible for the company's liabilities and are responsible for losses only up to the value of the shares possessed.

The number of participants may not be more than 50.

The statutory minimum charter capital is 10,000 Russian rubles.

The formation document of ZAO is the organizational charter.

Opening of Branch or Representative Office of Foreign Company in Russia Establishment of Legal Entities

A branch or a representative office of a foreign legal entity is eligible to carry out business activities in the territory of the Russian Federation since the day of obtaining accreditation.

Permission (accreditation) to implement activities in the form of a representative office or a branch is issued by specially authorized accrediting bodies which accredit representative offices depending on the industry the company belongs to. Depending on the nature of activity one can apply for accreditation to a federal ministry or to a federal agency, the Chamber of Commerce and Industry, the State Registration Chamber at the RF Ministry of Justice, Bank of Russia or another organization.

The following documents shall be submitted to initiate the procedure of accreditation:

1.* A written request to allow opening of a representative office (branch) of the foreign legal entity (hereinafter referred to as the Company) in the Russian Federation

2* An extract from the Company's trade register certifying the registration of the Company in the country of origin made in accordance with that country's laws;

3.*The Charter (the Articles of Association) of the Company;

4.* The resolution passed by the Board of Directors or other authorized body of the Company to open a representative office (branch) in Russia;

5. Regulations of the Company's representative office (branch) to be opened in the Russian Federation, both the original and a notarized copy (the signature of the person this document is signed by shall be certified by notary);

6.* A letter of recommendation from the Company's bank in the country of residence attesting to the solvency of the Company (the document is valid within 6 months since the

date of issuance);

7. **For Representative Offices Only!** At least two (free-form) letters of recommendation from two different reliable Russian business partners of the Company (the letters shall be made on the firms' letterheads, signed by their general managers and sealed);

8.* A notarized copy of the Power of Attorney authorizing the Head of the Company's representative office (branch) in the Russian Federation to act in this capacity;

9. A notarized copy of the Power of Attorney to the person authorized to apply for opening of a representative office and accreditation (required if such person and the Head of the Company's representative office (branch) in the Russian Federation are not one and the same person);

10. For Representative Offices Only! A document certifying the address of the representative office being accredited in the Russian Federation (such document can be a guarantee letter from the landlord of the office premises or a lease agreement, or a notarized copy of the landlord's ownership certificate);

11. The original of the document on agreement reached with administrations of subjects of the Russian Federation (territories, regions, republics, national districts) upon the fact of opening a representative office (branch) in the territory of the subject (the document shall be only submitted if an RO is going to be opened outside Moscow or Saint Petersburg);

12. A data sheet containing details of the Company's representative office (branch) (the document shall be printed, signed by the Company's authorized representative and sealed);

13. For Branches Only! Originals and copies notary certified of conclusions of the pertinent examinations if it is required by the RF Law (issued by the Ministry of Industry and Power of the Russian Federation, the State Committee for Environmental Protection or others);

14.* A certificate from the tax authorities of the country of the Company's origin made in free form and stating that the Company is a taxpayer in its country of origin.

*) Foreign documents will be accepted only in case they are legalized by the consulate or certified by Apostil unless relief from these procedures is granted under international agreements of the Russian Federation and shall also be enclosed with a translation into Russian which is certified by the notary or consular services. These documents shall be valid for a year from the date of issue, except for Items 6 and 8.

The certificate must include the Company's taxpayer's identification number (or its analogue).

Prior to obtaining permission for opening a representative office (branch) in the

Russian Federation, the state accreditation fees shall be paid.

Accreditation of a representative office is normally made for a period of one, two or three years.

Accreditation of a branch is normally made for a period from one to five years.

On obtaining accreditation the representative office (branch) is entered in the Consolidated Public Register and is assigned the registration number. The function to enter a new representative office (branch) in the Consolidated Public Register is exercised by the State Registration Chamber.

Furthermore, in accordance with the Russian Law all representative offices and branches must be registered with the following government agencies, such as

1. A Tax Inspection;
2. The Pension Fund of Russia,
3. The Social Insurance Fund,
4. The Fund of Obligatory Medical Insurance,
5. The State Committee for Statistics.

On obtaining permission for establishing a representative office (branch) the Company may apply for personal accreditation of its expatriate personnel in Russia to the accrediting body which has issued accreditation. At that personal accreditation can be only granted to the number of people within the limits specified in the permission to open a representative office (branch). Personal accreditation is needed to seek passport and visa support with the accrediting body.

The registration procedure for legal entities with foreign and Russian capital is similar.

For registration of a legal entity it is necessary to submit to the registering body (tax inspection) the following documents:

- An application made in accordance with the form established by the RF Government which is signed by the applicant;
- A decision on creation of a legal entity in the form of the minutes, resolution, agreement or another document;
- Originals or notarized copies of constituent documents of such created legal entity;
- An excerpt from the commercial register of the country of incorporation, or any other equivalent evidence of such investor's legal status in compliance with the legislation of the country of its incorporation or permanent residence;
- A payment document evidencing making payment of the state registration fee.

State registration is performed within not more than 5 working days since the day of submitting the documents.

Registration of the legal entity as a taxpayer, as well as registration in the Social Insurance Fund, the Fund of Obligatory Medical Insurance, the Pension Fund and the State Committee for Statistics is made automatically on the basis of the data contained in the

Consolidated Public Register and provided by the tax inspection to the above-said organs of state authority.

Legal entities with foreign capital have a right to open accounts in Russian bank(s). The number of accounts is not limited.

Application of Labor Legislation

Labor Contracts with Foreigners

At employment of any Russian citizens or foreign nationals by a branch or a representative office of a foreign organization or by a legal entity with foreign investments in the territory of the Russian Federation labor contracts whose provisions are in line with the RF Legislation shall be entered. Provisions of such contracts may not impair conditions of work of employees in comparison with those stipulated by the RF Labor Law.

In case labor or civil contracts are concluded with foreign nationals for performance of work in the territory of the Russian Federation, the employer represented by a branch or a representative office of a foreign organization or a legal entity with foreign investments shall possess permission to invite and hire foreign labor force.

Employees-foreign residents in their turn must possess a work permit confirming their right to work in the RF.

Currency Legislation in RF

At present the RF Currency Law is quite liberal.

In terms of currency regulation branches and representative office of foreign organizations are recognized as non-residents and legal entities are recognized as residents of the Russian Federation.

All currency transactions can be conducted without limitation except for buying and selling foreign currency and cheques (including travel cheques) whose par value is indicated in foreign currency. Such currency transactions in the RF shall be only conducted by authorized banks (i.e. banks specially licensed by the RF Central Bank to perform such operations).

Non-residents have a right to open bank accounts (bank deposits) in foreign currency and in rubles in the authorized banks in the territory of the Russian Federation.

Domestic currency transactions between non-residents can be performed in the Russian Federation through bank accounts (bank deposits) opened in the territory of the Russian Federation.

Non-residents have a right to transfer without limitation both foreign and domestic currency from their bank accounts (bank deposits) opened in banks located outside the RF to their bank accounts (bank deposits) opened in the authorized Russian banks and vice versa.

Foreign currency transactions between residents are prohibited. The exceptions are certain transactions, such as:

- transaction performed under agency contracts if agents are provided services subject to conclusion and execution of contracts with non-residents (e.g. transferring goods, performing works, rendering services);
- certain transport operations, such as transactions under contracts of transport forwarding, carriage and charter services when such services are rendered by forwarders, carriers and freighters and are connected with transporting freight imported to the Russian Federation and exported from the Russian Federation, with transit traffic through the territory of the Russian Federation, as well as under insurance contracts for the said freight;
- transactions involving external securities which are held through organizers of trade in the RF securities markets if rights for such securities are considered in depositories created in accordance with the RF Legislation;
- payments and reimbursements of individual's expenses for business trips abroad.

Corporate Taxation

The Russian Tax Code permits two types of taxation:

- General tax regime, applicable to all taxpayers except those who have a right or an obligation to apply special tax treatments;

- Special tax treatments applicable to taxpayers meeting certain criteria. Special tax treatments include:

- Unified Agricultural Tax
- Simplified Taxation System for small businesses
- Unified Tax on Imputed Income
- Implementing Agreements of Product Sharing Taxation System

General Tax Regime

The general tax regime includes three levels of taxes: federal, regional and local.

The taxes of federal level are:

- Profits Tax
- Value Added Tax (VAT)
- Unified Social Tax (UST)
- Excises
- Federal Pension Fund contributions
- Occupational accidents and diseases insurance contributions
- Some special taxes, fees and dues (state and custom duties, water tax, mineral resources extraction tax, environment negative impact payments, the levy on the right to use animals)

The following taxes are of regional level:

- Enterprise Assets Tax (Property Tax)
- Transport Tax (is paid by companies possessing own transport)
- Gambling Tax

The last level is local taxes, which include

- Land Tax (is paid by companies having land in possession)

From the above-listed there are 4 basic taxes which are subject to payment by all commercial enterprises, foreign representative offices and branches conducting commercial activity in the Russian Federation: VAT, UST, profits tax (tax on organization's profit) and property tax.

Value Added Tax

VAT is levied at the general rate of 18%. A 10% rate is imposed on the sale of certain food products, goods for children and medical goods. A 0% rate is applicable to goods exported outside Russia and services related to transportation of passengers and goods outside Russia.

There are numerous exemptions from VAT, among others:

1. sales of shares in the authorized capital and securities;
2. sale of plots of land;
3. financial services related to transactions with loans;
4. importation of equipment and spare parts as a contribution to the authorized capital of Russian companies;
5. the most important and vital necessary medical equipment;
6. banking transactions (excluding cash collection operations);
7. selling of apartments, dwellings and shares in them.

The VAT is determined on the earliest of the following dates: the day of shipment of goods (works, services), or the day of payment or prepayment for goods (works, services).

Objects of taxation include:

1. sales (passing of property) of goods (works, services) and property rights in the Russian Federation, including those on a gratis basis;
2. goods imported into Russia;
3. construction and installation works for own needs, and
4. transfer of goods (works, services) for own needs expenses on which are not deductible for profit tax purposes.

Russia applies **the destination principle** for VAT purposes. The Tax Code determines the place of provision of works (services) in accordance with the following rules:

1. If services are directly connected with immovable property they are regarded as

provided at the place of location of that property.

2. If services are connected with movable property they are regarded as provided at the place where they are actually rendered.

3. Transportation services are regarded as provided at the place where they rendered, taking into account the distance covered.

4. If the supplier of:

consultancy, legal, accounting, information processing services

intellectual property rights

leases of movable property, or

seconded staff,

is situated in one country and provides his services to the customer in another country, the services are regarded as provided in the country in which the customer carries on the business activity on basis of state registration.

5. If services rendered do not fall into any of the above categories, they are regarded as provided at the place of business activity of the supplier according to his registration.

The VAT payable to other taxpayers according to invoices for goods, works or services actually received and related to the taxable transactions of the taxpayer, including transactions liable to VAT at the zero rate, and VAT paid in the territory of the Russian Federation by purchasers - tax agents is deductible.

The tax period for the VAT is a quarter of a year.

Tax on Organizations' Profit (Corporate Profit Tax)

Taxpayers for profits tax purposes are both Russian legal entities and foreign legal entities that carry out activity in Russia through permanent establishments (branches) or receive income from sources in Russia. Russian legal entities are taxed on their worldwide income. At that the sum of tax paid abroad may be reckoned in sum not exceeding the sum of the tax payable as it is provided by the Tax Code.

The **object of taxation** is the income received reduced by the expenses incurred. For foreign organizations obtaining income on the territory of the Russian Federation the object of taxation shall be income.

The general tax rate for Russian legal entities is 24%, which are divided into two parts paid to different budgets: federal (6,5%) and regional (17,5%). The second part may be reduced by regional authorities down to 13,5 %.

Foreign legal entities not carrying out activities in the RF through permanent establishments must pay 20% profits tax from all kinds of their Russian income (e.g. for loans, royalties, licenses, sales of real estate situated in the Russian Federation, penalties paid under conditions of economic agreements, etc.) except income from usage of vehicles

(10%); dividends received by Russian entities from foreign entities or paid by Russian entities to foreign entities are taxable at the rate of 15%.

For foreign legal entities that have no permanent representative office in the Russian Federation this tax may be significantly reduced or completely eliminated under applicable tax treaties.

The RF Tax Code presents a complete list of incomes that are not levied with the tax on organizations' profit (e.g. pre-payments, contributions to the authorized capital, property obtained by a commercial agent for the principal, credit amounts, property obtained by a parent company from a subsidiary if the parent company's share in the authorized capital is more than 50 % and some others).

In order to be recognized, expenditures should be justified by pertinent documentation formalized in conformity with the legislation of the Russian Federation and economically substantiated (justified from an economic viewpoint).

There is no definition of economic substantiation which gives grounds to disputes between tax authorities and taxpayers. In practice economic substantiation shall be understood as follows: expenditures shall be made in reasonable amounts and for purposes of receiving income.

There are some limits for certain groups of expenditures to be charged against income received:

- some kinds of advertisement;
- entertainment expenses;
- expenses for staff training;
- interests on loans;
- some other expenses.

Expenditures connected with purchases of the fixed assets and intangible assets reduce the profit tax in the form of depreciation.

The tax period is the calendar year. Reporting periods are the first quarter, six months and nine months of a calendar year. Advance payments are made quarterly. The taxpayer has a right to make advance payment monthly on the base of income obtained a month before.

Tax on foreign organizations' income which do not have a permanent representative office on the territory of the

Russian Federation is withheld by the tax agent who is a source of an income payment. To avoid double taxation, as it is compliant with the international agreement on avoidance of double taxation, the foreign company should present official confirmation that it is a resident of a certain country. Such confirmation shall be certified by the pertinent organ, translated into Russian and affixed with a stamp "apostil".

The preferable variant is to submit such confirmation before the date of the payment

out of the income as in this case a privileged regime of taxation will be applied.

Tax on Organizations' Property

Enterprise assets tax (organization's property tax) is levied on property belonging to

- Russian entities, including companies with foreign participation,
- Representative offices and branches of foreign legal entities,
- Foreign companies situated in the territory of the Russian Federation, its continental shelf or exclusive economic zone.

Corporate property is taxed at its average annual book value (after depreciation). The tax base includes fixed assets only (land is not taxable within this tax). As for a non-resident entity having no representative office or branch, the tax base includes only the inventory value of immovable property in the Russian Federation. This value is determined by tax authorities.

The tax period is a calendar year and the reporting period is a quarter of a year.

The tax rate is established by laws of subjects of the Russian Federation but cannot exceed 2,2% of the net book value of the property in possession.

Property tax is deductible from the profits tax base.

Uniform Social Tax

The taxpayers of the Uniform Social Tax are legal entities making disbursements for the benefit of natural persons for their work or services rendered.

The object of taxation shall be disbursements and other remunerations accrued by taxpayers for the benefit of natural persons under labor and civil legal contracts the subject matter of which is performance of works or provision of services.

The tax period is a calendar year and the reporting period is a quarter of a year. Advance payments shall be made on a monthly basis.

The tax rate is deemed to be regressive, i.e. the more the amount to be paid the smaller the tax rate is:

- if the taxable amount is smaller than 280,000 roubles, the tax rate is 26%;
- if the taxable amount ranges from 280,000 to 600,000 roubles, the tax rate is 10%;
- if the taxable amount exceeds 600,000 roubles, the tax rate is 2%.

More beneficial taxation rates are provided for certain categories of taxpayers, such as agricultural enterprises, IT companies and some others.

Special tax regimes

The common trait of all kinds of special tax treatments (except the taxation system when implementing agreements of product sharing) is that they substitute the payment of several taxes belonging to the basic system (such as VAT, UST, Profits tax, Enterprise Assets tax) by a unified tax which is calculated by a simplified method. Other taxes are payable as usual.

It is important to know that the taxpayers applying regimes UAT, STS and UTII are not liable to VAT, so their contractors (buyers and customers) who apply the basic tax system will have no possibility to reimburse the sums of the VAT paid.

Unified agricultural tax (UAT)

It is a unified tax for agricultural producers and may be applied on a voluntary basis if the share of income received from selling of agricultural production is not less than 70% of their total income. The tax rate is 6% from the income received.

The tax period is a quarter of a calendar year.

Simplified tax system for small business (STS)

Branches, subsidiaries and permanent representations of foreign legal entities in the Russian Federation are not allowed to apply the simplified tax system (this prohibition doesn't concern Russian legal entities with foreign participation if its' share doesn't exceed 25%).

Transition to the simplified system of taxation or return to the general taxation regime shall be made by organizations voluntarily. However, the simplified tax regime can be only applied by the following organizations:

- number of employees do not exceed 100 people;
- annual revenue does not exceed 26,800 thousand roubles (this amount is regularly adjusted);
- if the book cost of the fixed and intangible assets do not exceed 100 mln roubles.

It is possible to choose one of the two objects of taxation:

- income at the rate of 6%
- income reduced by the sum of expenses at the rate of 15%

A taxpayer forfeits the right to apply STS if its income for a tax period exceeds RUR 26,800,000.

The tax period is a calendar year.

Unified tax on imputed income (UTII)

The system of taxation in the form of a unified tax on the imputed income is applicable to certain kinds of activity which are established by the Tax Code and laws of Russian regions, as it is a local tax.

Such kinds of activity as domestic services, veterinary services, small retail trade, communal feeding and some others may fall under UTII if approved by local authorities.

If an entity conducts a kind of activity in a region where it falls under ЦТП, it must apply this kind of taxation as obligatory.

UTII may be applied in parallel with the general system or STS if an organization conducts several kinds of activity and some of these kinds don't fall under UTII.

The tax rate makes 15% from the sum of imputed income.

The tax period is a quarter of a calendar year.

Taxation system under agreements of product sharing

This system is obligatory for application by taxpayers who are users of mineral resources and concluded agreements of mineral sharing with the state.

It substitutes the liability to pay some taxes and duties by the liability to share the results of their activity with the state

Personal Taxation

Natural persons are obliged to pay the following taxes:

- Personal Income tax
- Personal property tax
- Transport tax
- Land tax

Personal Income Tax

The payers of this tax are individuals irrespective of their citizenship, residents and non-residents of the Russian Federation. To be considered a resident for tax purposes, a person must spend in Russia at least 183 days during any 12 months going in a row.

The tax is to be paid on a worldwide income for a resident and on income received from the sources in the Russian Federation for a non-resident.

The 13% rate is applied to most types of income of Russian tax residents with the following exceptions:

- winnings and prizes, sums of which are more than RUR 4,000-35%;

- benefit (premium) payments and interest (exception are payments on contracts of insurance of life duration of which is less than 5 years and payments on obligatory insurance contracts) exceeding limit taxable at 13% - 35%

- material gain on interest free or low interest loans (interest levels are considered as low if they are less than three quarters of Central Bank refinancing rate) and arising from receiving benefits in-kind at below market rate or free - 35%;

- income received from dividends - 9%.

Non-residents must pay tax at 30% tax rate on all types of income except dividends which are taxed at the rate of 15%.

An employer is obliged to deduct the amount of tax from a worker's salary.

Certain kinds of income which are taxed at the rate of 13% are deductible from taxable income, among them sums which are spent or received for acquisition and sale of real estate and other property (the deductible sum must not exceed RUR 1,000,000 in case with real estate and RUR 125,000 for other property and this kind of deduction may be applied not more than once), professional deductions related to creation of intellectual property and some others. Deductions are not applicable to income taxed at the rates of 9%, 15%, 30%, 35%.

Personal Property Tax

Personal property tax is levied on houses, flats, garages and other constructions belonging to natural persons.

Personal property is taxed at its inventory value; the tax rate varies from 0.1% to 2% depending on this value.

The tax period is the calendar year. The tax amount is calculated by the tax authorities not later than by 1 August of each year.

Transport Tax

Recognized as the payers of the Transport Tax shall be persons (owners) in whose name transportation facilities are registered.

Seen as the object of taxation shall be transportation facilities (automobiles, buses, aircrafts, helicopters, etc.).

Tax benefits are foreseen for disabled people.

The tax rates are established by the laws of the subjects of the Russian Federation but shall not exceed the maximum determined by the Tax Code. The tax rates are determined in rubles depending on the engine power.

The tax period is a calendar year.

Land tax

Private owners of land and users of state land, except renters, are required to pay an annual land tax. The land tax rate is established as a stable payment per unit of land per year. The taxable base is defined as cadastral value of a unit of land. Land tax rates are determined by municipal authorities and must not exceed:

- 0,3% for agricultural land and land under housing stock and infrastructure;
- 1,5% for all other units of land.

The tax period is a calendar year.

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