

# Doing Business in Russia - Key Business and Legal Aspects -

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## Country-specific feedback

***“I have been the General Manager here in Russia for the last 15 years. I spent the first 10 years trying to get my CEO’s attention and have spent the last 5 years trying to avoid my CEO’s attention”***

CEO of a Russian subsidiary of one of the multinational companies operating in Russia more than 15 years

## Opportunity...

- Russia is the European BRIC (and WTO member)
- Economic numbers are good, especially in comparison to Eurozone
- Across all sectors, companies reporting growth in 2012 at 8-25%
- Russian government budget balance is positive

## ... and risk

- Russian economy is vulnerable to any downturn in the oil price
- Corruption risks: Russia ranked #133 (out of 182) on Transparency International's Perceived Corruption Index 2012
- Lowest ranking by far of the BRIC countries
- Russian Government recognizes that corruption remains one of the major obstacles to foreign investment and economic development

# Key challenges – business environment

- Russian business culture
- Chaotic corporate and asset-holding structures
- Non-transparent business & financial models
- Unwillingness of management to engage in “dialogue”
- Lack of complete and reliable market information, as well as on a potential target

# The business culture

- Business culture built around “taking shortcuts” and “cheating the system”
- “That’s just how things are done here”
- “Everyone else is doing it”
- Form over substance – focus on paperwork and procedure
- Russian corporate culture: unwillingness to challenge authority, unaccountable leadership, the “silo mentality”
- No whistleblower culture
- Multinationals play their part too: reluctance to re-examine business structures and commercial relationships that carry non-compliance risks because they have delivered results in the past

# The danger areas

- “Designated” service providers
- Other intermediaries (distributors, agents, sales representatives)
- Participation in government tenders
- Offshore companies
- Involuntary joint ventures
- Requests for charitable donations or contributions to social projects

## Compliance – possible solutions

- Building a compliance culture from the top down (senior management of most large international companies are still expatriates, largely for this reason)
- Compliance programs supplemented as necessary by reference to local law and rolled out in accordance with local law
- Regular compliance training for local staff and senior management
- Extensive due diligence on prospective JV partners or trading partners
- Either zero tolerance policy for offshore intermediaries or use in only exceptional circumstances
- Russian anti-bribery initiatives and party to OECD Anti-Bribery Convention since 2011

## Key challenges – legal framework

- Russian laws are inflexible and sometimes conflicting
- Russian court precedents are unreliable and largely lacking
- International M&A practices cannot be fully adopted into Russian civil law contracts
- Russian corporate laws may foil an anticipated system of “checks & balances”



# Legal developments – snapshot

## ■ Corporate law reform

- General trend: bring Russian corporate law in line with international standards
- Contemplated amendments to Civil Code (currently reviewed by the Parliament)
  - further recognition of shareholders agreements
  - concept of representations, warranties & indemnities
  - option and escrow agreements
  - clarification of damages concept
- Implemented amendments to Russian Law on *Joint Stock Companies* and Law on *Limited Liability Companies* (July'09)

# Selecting form of presence in Russia

- **Typical corporate forms of presence**
  - Representative office
  - Branch
  - Russian subsidiary (JSC or LLC)
  
- **Impact of proposed changes to Russian Civil Code**
  
- **“Dual structure” (non-commercial Rep Office with LLC)**
  - Deemed permanent establishment for tax purposes on intragroup services by representative office

# Repatriating profits out of Russia

## ■ Dividends

- Most conservative and risk-free approach
- Declared on annually, semi-annually or quarterly basis
- 5% best rate, including under US-Russia double tax treaty (15% statutory rate)
- Double tax treaties can impose minimum capital requirements (e.g. EUR 100k) and/or minimum shareholding percentage for lowest tax rate to apply
- Mind net assets value and other corporate law requirements

## ■ Alternative options

- Royalties
- Interest
- Services
- Share redemption, liquidation

# Customs law developments

- The Customs Union with Belarus and Kazakhstan
- Russia's accession to the WTO
- Duty-free importation of some categories of products, including IT products
- Customs VAT exemption for importation of technological equipment (if on list); customs duty and VAT exemption for in-kind charter capital contributions
- Customs valuation of goods with post-importation royalty stream

## Key challenges – tax regime

- Despite overall favourable tax regime, “policing” practices still dominate
- The target’s tax minimization practices are often quite aggressive
- Hidden historical tax liabilities (Russian balance sheet)
- Unreliability of state tax audits (open periods)
- Tax audit statistics and trends
- Personnel compensation arrangements
- Related-party and/or “chain” transactions

## Russia as tax jurisdiction - snapshot

- 20% corporate income tax (can be reduced by regions down to 13.5%)
- 18% VAT (10% and 0% for certain categories of products)
- 13% individual income tax (no progression)
- Regional and local taxes
- 3-to-1 debt-to-equity ration in thin cap rules
- Special tax regimes
- No CFC, no GAAR, no statutory look-through or substance over form rules, but sporadically appear in case law
- Tax burden cannot be shifted contractually

# Tax law developments – snapshot (1)

- New set of transfer pricing rules (in line with OECD TP Guidelines)
- Tax consolidation for income tax purposes
  - Yet available only to largest taxpayers
- Participation exemption
  - 0% income tax for dividends received by Russian corporations from at least 50%-owned Russian and foreign entities not in Finance Ministry list of “offshore” jurisdictions
- Capital gains tax exemption on long-term investments
  - Minimum uninterrupted holding period of 5 years
    - Applicable to shares acquired starting from January 1, 2011
    - All non-traded shares (covering LLCs and ZAOs)
    - Publicly traded shares of Russian companies operating in high-tech area throughout holding period

## Tax law developments – snapshot (2)

- Development of court-made doctrines of business purpose and unjustified tax benefits
  - Becoming more relevant in cross-border issues
- Evolution of judicial concepts of beneficial ownership
  - Many financing (e.g. traditional sister-company funding bypassing statutory thin cap rules), holding and licensing structures currently in place may be at risk
- Heavier and supporting documentation requirements for deducting intercompany changes (no cost sharing recognized yet)
- As of 2012, new disclosure requirements in Russian entity financial statements for potential future tax costs
  - Simplified variation of Fin 48



# Federal and regional tax incentives

- Regional investment agreements
- Special economic zones
- Skolkovo (attempt to create Silicon Valley analogue in Russia)
- Tax incentives for specific industries
  - Assignment and licensing of intellectual property
  - Innovation & R&D
  - Other
- Trends and perspectives



Thank you!