



C/M/S'

Law . Tax

Doing business in Russia



Jean-François Marquaire
 Managing Partner
 Head of Projects
 & Infrastructure
 T +7 495 786 4000
 E jean-francois.marquaire@cmslegal.ru



Leonid Zubarev
 Senior Partner
 Head of Commercial
 Head of Insurance
 T +7 495 786 4000
 E leonid.zubarev@cmslegal.ru



Dear reader,

CMS is a successful, global, future-facing firm providing clients with specialist, business-focused advice in law and tax matters. With 4,800 legal professionals in 76 offices across 43 countries, we combine deep sector understanding with a global overview, giving us the ability not only to see what's coming but to shape it.

Our team members are trained in legal project management. Our key focus is on our clients and their activity sectors.

In a competitive legal market, we stand apart through our deep commitment to understanding our clients' business and our insider knowledge of the countries in which we operate.

From major multinationals and mid-caps to start-ups, we at CMS Russia have been welcoming investors to Russia for more than 25 years. We advise both international clients on every aspect of business in Russia and Russian clients worldwide. Our history and expertise in the local market allow us to provide our clients with efficient, business-oriented and strategic advice. We provide a full range of legal and tax services across 21 expert and sector areas.

As part of our undertaking to create added value for clients, our professionals have put together this introductory guide to the Russian legal system and the principal laws and regulations that are of interest to investors in this challenging but opportunity-full market. It is of course no substitute for the expert advice tailored to your project that we will be pleased to provide to you on request.

Russian legislation is changing rapidly. Although this guide describes the laws as of 1 January 2020, please contact us to check that it remains up-to-date. We would also recommend that you subscribe to our free online service CMS Law-Now through which you will receive our legal and tax eAlerts. You can do this easily by following the QR-code or by getting in touch with any of the CMS Russia key contacts listed at the end of this guide.

We wish you every success.

Jean-François Marquaire
 Managing Partner

Leonid Zubarev
 Senior Partner

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Introduction

Political and administrative structure

Under the Constitution of the Russian Federation all state bodies are divided into:

- federal bodies;
- bodies of the “constituent subjects” of the Russian Federation;
- and local (municipal) bodies.

The holder of the highest office in the Russian Federation is the President.

The President

Under the Constitution of the Russian Federation, originally adopted on 12 December 1993 and from time to time amended (the “**Constitution**”), the President is the Head of State. The term of office of the President is six years. The President may only serve two consecutive terms. In March 2018 Vladimir Putin was re-elected as President, which means he will not be able to run for the post in 2024.

The President appoints the Prime Minister and the Chairman of the Central Bank of Russia. Both appointments must be endorsed by the lower chamber of the Russian parliament (the State Duma).

The President determines the main trends of Russia’s domestic and foreign policy and represents the country

in both domestic and foreign affairs. He is Commander-in-Chief of the Russian Armed Forces.

The President has broad authority to issue executive orders and directives that in practice have the force of law. Under certain circumstances, he has the right to dissolve the State Duma.

The Government

The Government of the Russian Federation exercises executive power at the federal level, with the Prime Minister acting as its head. The Government is required to enact the decisions made by the President and the laws adopted by the federal legislature.

The federal legislature

The Federal Assembly (the “**Parliament**”) consists of two chambers: an upper chamber called the Federation Council and a lower chamber called the State Duma. The Parliament exercises legislative power in Russia at the federal level.

There are 170 seats in the upper chamber of Parliament. They are occupied by representatives of the executive and legislative branches of the Russian regions.

The State Duma consists of 450 deputies who are elected by proportional representation. State Duma members are elected for five-year terms.

Federal bills may originate in the upper chamber of Parliament. Alternatively, they may be submitted by the President, the federal Government, regional legislatures or a member of any chamber of the Parliament. The Constitutional Court and the Supreme Court may originate bills on issues which are within their authority. Bills are first considered by the State Duma and must pass three readings. After being adopted by a majority in the State Duma, bills are considered by the Federation Council. If a bill is rejected by the Federation Council, a Conciliatory Commission may be established. This consists of representatives of the State Duma and Federation Council who review and amend the bill before it is presented to the State Duma again for consideration.

Once a bill is adopted by the Federation Council, it must be signed by the President. The President has the right of final veto which, if exercised, can only be overridden by a resolution passed by two-thirds of the members of the State Duma and the Federation Council.

The judiciary

The judiciary is split into three branches:

- the courts of general jurisdiction;
- the commercial (“*arbitrazh*”) courts; and
- the Constitutional Court.

There is a federal system of courts and a system of local courts in each Russian region.

The courts of general jurisdiction

deal with criminal, civil and administrative cases involving individuals who are not engaged in business activities. Cases are heard by the district court unless they fall within the jurisdiction of the magistrates’ courts or martial courts. The senior court of general jurisdiction is the Supreme Court of Russia (the “**Supreme Court**”).

Decisions of the lower courts can be appealed through the intermediate courts, as far as the Supreme Court.

The commercial (“*arbitrazh*”) courts

deal with economic disputes involving individuals engaged in business activities and disputes between legal entities and their participants (i.e. their shareholders). The commercial court system consists (in an increasing order of hierarchy) of the regional commercial courts, the commercial courts of appeal, the federal district commercial courts and the Supreme Court. Within this system, there is also a court specialised in the review of intellectual property claims, the Intellectual Property Court¹.

The **Constitutional Court** has jurisdiction to decide on the constitutionality of federal and regional legislation and regulations. This court also resolves jurisdictional disputes

¹ Please see the IP Court section on page 132.

between the federal and regional authorities and is able to interpret and provide guidance on the provisions of the Constitution.

Regional and local political structure

In accordance with the Constitution, the Russian Federation consists of 85 “constituent subjects”, i.e. regions within the federation. Regions are granted a certain degree of autonomy over their internal economic and political affairs. As cities of federal significance, Moscow, Saint Petersburg and Sevastopol enjoy the status of region.

The head of the executive branch of each region is directly elected in regional elections or by the legislative body of the respective region (if such option is set out in the Constitution or the law of such region).

The Constitution sets out a general list of powers that are within the exclusive federal jurisdiction. Some powers are jointly exercisable by the federal and regional authorities. The regional authorities are then allocated all residual powers. Regional powers include the authority to manage regional property, establish regional budgets, collect regional taxes and maintain regional law and order. The Constitution also gives regional bodies the authority to pass laws, provided those laws do not contradict the Constitution or existing federal laws.

The lowest level of the political system is local government which operates

under an intricate two-tier system: municipalities are subdivided into city districts on the one hand and municipal districts on the other, with municipal districts being further subdivided into urban and rural settlements. Municipalities have their own budgets and depending on how much authority the regional government has delegated to them, they may enjoy certain limited taxation powers. They are also involved in the management of municipal land (they can act as landlords in lease agreements, allocate land plots for construction and act as sellers during the privatisation of municipal land).

Legal environment

General background

The Russian legal system generally belongs to the continental European legal family. The legal structure developed at a rapid pace during the 1990s. During this period, significant reforms were enacted in almost every area of law as the country moved away from its Soviet command economy.

The Constitution, federal laws and regional laws form the foundation of the Russian legal system. Presidential executive orders, decrees of the Russian Government and the decisions of various ministries are used to support and develop the provisions of primary legislation.

The Constitution states that general principles of international law and international treaties are part of the Russian legal system. Consequently,

if Russia is a signatory to an international treaty containing provisions contrary to the provisions of any domestic legislation, the provisions of the international treaty will prevail. The Constitution, however, takes precedence over any contradicting provision of an international treaty.

The Russian Civil Code (the “**Civil Code**”) sets out the foundation of civil law and is the key source of law for business. As part of the reform, significant amendments to the Civil Code concerning corporate law and the law of obligations came into force in September 2014 and June 2015. These amendments form the most significant development since the shaping of modern corporate and commercial law in Russia. Today, a number of concepts which have for a long time been common to international practice in corporate, debt and general commercial areas, are also recognised and widely used in Russia, in particular:

- corporate agreements;
- the “four-eyes” principle;
- the conditional performance of obligations;
- the concept of representations (“*zavereniya ob obstoyatelstvakh*”) (an intended equivalent of “representations” and “warranties” as used in contracts under English law);
- the concept of the reimbursement of losses arising from the occurrence of certain events specified in a contract (the intended equivalent

of the English law concept of an “indemnity”);

- new types of civil law contracts, such as options, framework agreements and subscription agreements;
- rules for the conduct of negotiations to conclude a contract; and
- new mechanisms to secure the performance of contractual obligations by the parties.

These highly significant changes to the Civil Code are intended to accommodate the growing trend of submitting complicated transaction documents to Russian law and Russian courts instead of English law and international arbitration which were traditionally the “well-trodden path” in Russia. It is yet to be seen how the new concepts and provisions will be enforced by courts and arbitral tribunals. Nevertheless, in practice, companies are actively using the new concepts in their projects.

WTO

Following 18 years of negotiations, Russia finally joined the World Trade Organisation in summer 2012².

At the time, WTO accession sent a positive signal to foreign investors. However, notable changes such as a material drop in tariffs on imported goods and changes to the quotas for foreign participation in the insurance

sector have not yet come into effect because of the long grace periods that are allowed. For example, under WTO rules, foreign insurance companies will be able to open branch offices in Russia, but this is not required to take effect until nine years after accession. The relevant bill to implement this change is in progress and has yet to be submitted to the State Duma.

Foreign investment

Legal regulation

The main legislative act governing foreign investments is Federal Law No. 160-FZ “On Foreign Investment in the Russian Federation” dated 9 July 1999. This law states that foreign investors and investments will be treated no less favourably than domestic investors and investments, subject to certain wide-ranging exceptions.

Exceptions/restrictions may be introduced, amongst others, to protect the Russian constitutional system; the morality, health and rights of third parties; or in order to ensure state security and/or defence. Some of the sectors concerned are commented on separately below. By and large, foreign investment is permitted in most sectors of the Russian economy, including investment in portfolios of government securities, stocks and bonds, direct investment in new businesses, in the acquisition of existing Russian-owned companies and in joint ventures.

Foreign investors are protected against nationalisation or expropriation, unless

this is provided for by federal law. In these cases, foreign investors are entitled to receive compensation for their investment and other losses.

Exclusions/restrictions

In addition to the so-called “Strategic Industries Law”³, restrictions on foreign investment exist notably in the insurance and banking sectors.

Federal Law No. 4015-1 “On Insurance” dated 27 November 1992 currently prohibits foreign investors from owning more than 25% of the total market for domestic insurance. Insurance companies in which foreign shareholders own more than 49% of the charter capital may not engage in certain types of insurance business, including, for example, life assurance. The existing limitations will be partly lifted by the legislative amendments which will be considered in connection with WTO accession.

In the banking sector, the Central Bank of Russia has the right to use reciprocity as a criterion to specify the types of business that subsidiaries or branches of foreign banks may be licensed to operate in Russia. In practice, however, branches of foreign banks are not able to carry out any banking activities on the Russian market. Additionally, a ceiling on the total amount of foreign bank capital, as a percentage of the total bank capital in Russia, can be imposed by federal law; however, no

² Please see the Customs regulations chapter on page 77.

³ Please see the Common forms of business structures for foreign investors chapter on page 34.

such limit applies at the time of writing. Under WTO rules, any such ceiling may not be less than 50%.

Sanctions

In 2014, the European Union and the United States of America (among others) imposed individual sanctions on certain Russian and Ukrainian nationals and entities that they believe to be responsible for the actions which led to the declaration of sovereignty by Crimea, and subsequently, it becoming part of the Russian Federation. Sanctions targeting certain sectors of the Russian economy (or so-called “sectoral sanctions”), as well as regional sanctions prohibiting certain economic activity related to Crimea and Sevastopol, have also been adopted.

In retaliation, Russia adopted counter-sanctions to prohibit the import of certain agricultural products, raw materials and foodstuffs from countries that have imposed sanctions on Russia. In parallel, it also launched an import substitution policy⁴.

2018 marked a turning point in terms of sanctions for Russia. In May, the US enacted legislation that may result in non-US persons being held liable for knowingly facilitating “significant transactions” for or on behalf of persons sanctioned under Ukraine-/Russia-related sanctions imposed by the US (so-called “secondary sanctions”). In October 2018, the EU adopted a new sanctions framework in connection with the use and proliferation of chemical

weapons which does not expressly target Russia, but is expected to be used against Russia in future.

Again, Russia reacted to these developments. Firstly, it adopted a framework law on measures against unfriendly actions of the US and other foreign states in June 2018 and imposed the first sanctions under such law against Ukrainian individuals and legal entities in November 2018. Secondly, it imposed duties on a selection of goods imported from the US from 6 August 2018. Thirdly, a ban on the import to Russia of a number of goods of Ukrainian origin or transiting through Ukraine was declared in December 2018 and expanded in scope in December 2019.

Sanctions against Russia

Even though each national sanctions regime will vary in scope, the restrictions imposed can be broadly characterised as follows.

Under the individual sanctions regime, travel restrictions and asset freezes have been imposed on individuals and entities listed under the relevant legal acts.

Sectoral sanctions have been imposed on the following sectors of Russian economy:

- **Energy sector:** the sale, supply, transfer or export of items for

⁴ Please see the Import substitution and production localisation in Russia chapter on page 183.

certain types of oil exploration and production projects in Russia and the provision of associated services are prohibited, or subject to prior authorisation by the competent authorities of the exporting country. Departing from previous widely worded prohibitions, in December 2019, the US adopted a targeted approach in the energy sector by restricting activities connected with the construction and operation of the Nord Stream 2 and TurkStream pipelines.

- **Financial sector:** major Russian financial institutions, as well as certain defence and energy companies, have been prohibited from dealing with bonds, equity or similar financial instruments with a maturity exceeding 14, 30 or 90 days. It is also prohibited to make loans or credit available to any of the entities covered by the measures.
- **Defence sector:** Russia is subject to a weapons embargo. In addition, supplying dual use goods and technology to Russia is subject to individual authorisation by the respective authorities of the exporting country. The authorisation will be denied if those items are intended for military use or for a military end-user. This type of sanction also affects the manufacture of civil goods and equipment.

The activities prohibited under regional sanctions include importations from and exportations to Crimea, as well as

making new investments (either in general or in certain sectors).

As a result of some recent measures aimed at the Russian state, US banks can no longer participate in the primary market for non-rouble denominated bonds issued by the Russian sovereign and lend non-rouble denominated funds to the Russian sovereign.

Sanctions imposed on Russia are not prohibiting all commercial activity. They are focusing on very specific individuals, entities, regions and economic sectors. Companies wishing to contract with Russian entities should carry out enhanced due diligence to ensure that they do not become involved in activities prohibited under the relevant sanctions regime.

Lobbying

Given how slowly the legal culture has developed in Russia, businesses tend not to expend their lobbying efforts on attempting to influence the drafting of new laws or the actions of those drafting them. Instead, businesses tend to seek *de facto* special treatment, such as tax deferments, customs benefits, operation licences and the right to engage in certain kinds of activity. In doing so, however it may be that these companies expose themselves unduly to “political risk” upon any change of administration and companies entering the market need to consider how secure such concessions might be for their business in the long term.

» The Russian Civil Code sets out the foundation of civil law and is the key source of law for business.



There are not many legally recognised lobbying associations with a large membership base. Prominent examples of associations that do exist are the Association of Russian Banks, the Chamber of Commerce and Industry of the Russian Federation, the Federation of Independent Trade Unions of Russia and the Russian Union of Industrialists and Entrepreneurs.

Common forms of business structures for foreign investors

General approach

Russian legislation provides for several types of business structure, of which the most commonly used are limited liability companies, joint-stock companies, representative offices and branches. A basic description of each of these is set out in Part I of the Civil Code of the Russian Federation (the “**Civil Code**”). Some other specialised structures also exist but are not commonly used by foreign investors. An individual is also entitled to conduct commercial activities in Russia, provided that he/she has the legal status of an individual entrepreneur. Foreign nationals can only register as individual entrepreneurs when they hold a temporary or permanent residence permit. The legal framework for individual entrepreneurs is also set out in the Civil Code.

Main types of structure Russian legal entities

All Russian legal entities are classified into unitary entities (no “shareholding” provided to the founder(s)) and corporations. Corporations, in turn, can be public or private. Private corporations will provide more flexibility to their members in corporate governance issues and will be subject to more limited disclosure obligations. Conversely, public corporations will have

to disclose more information about their activities and the management structure of public corporations will be regulated by mandatory rules to a greater extent.

Joint-stock companies are classified as corporations that can be either public or private and limited liability companies are classified as private corporations. Foreign investors in Russia mostly use the limited liability company and the private joint-stock company forms for their activity in Russia.

Other special forms of legal entity exist, such as the economic partnership which is designed primarily for the holding in common of IP rights (but of little application beyond that).

Limited liability company

A limited liability company (“*obshchestvo s ogranichennoy otvetstvennostyu*” – an “**LLC**”) is designated by the abbreviation “OOO” or “LLC” before or after its name. It is one of the simplest forms of a Russian legal entity and is often used by foreign investors for a wholly owned subsidiary.

Russian legislation prevents an LLC being wholly owned by another company (“*khozyaystvennoye obshchestvo*”), where that holding

company is itself wholly owned by (i) another single legal entity; or (ii) a single individual.

The establishment, reorganisation and liquidation of an LLC is mainly governed by the Civil Code, Federal Law No. 14-FZ "On Limited Liability Companies" dated 8 February 1998 (the "**LLC Law**") and Federal Law No. 129-FZ "On State Registration of Legal Entities and Individual Entrepreneurs" dated 8 August 2001 (the "**Registration Law**").

Charter capital and contributions

The **charter capital** of an LLC is divided into participatory interests ("*doli*"). Unlike the shares issued by a joint-stock company, these participatory interests are not classified as securities and therefore do not need to be registered with the Central Bank of Russia (the "**CBR**")¹.

Each holder of a participatory interest is referred to as a "participant".

The minimum charter capital of an LLC is currently RUB 10,000 (EUR 143). The amount of the monetary fund for the charter capital must not be less than amount of the minimum charter capital.



RUB 70 = EUR 1

*notional exchange rate used for convenience

The decision of the general meeting of participants to increase the charter capital and the list of members that were present at the relevant general meeting have to be confirmed by a notary.

Contributions to the charter capital of an LLC may be made in cash or in kind (e.g. securities, property or other tangible or intangible rights or assets having a monetary value). Any contribution in kind must be valued by an independent appraiser.

A participant may not be released from the obligation to pay its agreed contributions to the charter capital. In case of a charter capital increase, contributions to the charter capital can be made by set off against any existing monetary debt that the company owes to the participant, provided that all the participants agree.

Exemptions from import duties and import VAT may be available for certain types of equipment contributed to the charter capital of a company by a foreign participant.

Net asset requirements and creditor protection

An LLC must ensure that the value of its net assets does not fall below the amount of its charter capital. Failure to comply with this requirement may result in the company being required to decrease its charter capital accordingly or to increase the value of its net assets by one of the available ways.

¹ The CBR performs the function of the securities market regulator and registers the shares issued by joint-stock companies.

Also, if the value of the company's assets is less than the minimum charter capital amount, it may be subject to compulsory liquidation.

Participation

If the number of participants in the company exceeds 50, the company is obliged either to reduce the number of participants or to re-register as a joint-stock company within one year. Failure to do so may lead to compulsory liquidation.

All LLCs must maintain a register of participants. This register sets out the names of the participants and the number of participatory interests that each participant has in the company.

As a general principle, the participants' liability for the company's debts is limited to the payment (in full) of the amount of their participatory interests. In a limited number of cases, the corporate veil can be pierced, resulting in participants having unlimited liability for the obligations of the company. This can happen if, for example, a participant gives binding instructions to the company that lead to the insolvency of the company.

Beneficial owners

All LLCs must know who their ultimate beneficial owners are and take steps to collect certain information on them from the participants in the LLC. Such information must be disclosed to Russian state authorities upon request.

Management structure

The managing bodies of an LLC are:

- the general participants' meeting;
- the collective management body – board of directors (optional);
- the collective executive body – management board (optional); and
- the sole executive body (one or several executives) – general director.

Major decisions, such as amending the company's charter, changing the charter capital, distributing profits and approving the annual reports and balance sheets of the company must be taken by the **general participants' meeting**.

The annual general participants' meeting must be held not earlier than two months, and not later than four months, after the end of the company's financial year (which always corresponds to the calendar year). Extraordinary general participants' meetings may be held at any time. General participants' meetings must be convened according to the procedure set out in the company's charter and the LLC Law unless all participants attend the meeting.

Unless otherwise expressly provided for by the company's charter, a participant's number of votes at the general participants' meeting will normally correspond to the proportion of the company's charter capital that such participant holds.

Generally, decisions are adopted by a simple majority of votes of all participants except for those matters in respect of which the LLC Law requires a qualified majority (e.g. liquidation of the company). In addition, a qualified majority can be set out by the company's charter for other matters at the discretion of the participants.

Most decisions (except approval of the company's annual reports and balance sheets) may be adopted without holding a participants' meeting through absentee voting.

The general participants' meeting has exclusive competence in respect of the list of matters specified by the Civil Code and LLC Law. This list can be extended in the company's charter at the discretion of the participants.

Resolutions of the general participants' meeting must be certified by a notary unless otherwise provided for by the charter or a notarised unanimous resolution of the general participants' meeting.

A **board of directors** is an optional supervisory body. Its authority typically includes appointing/dismissing the general director or approving certain types of transactions or transactions the value of which exceeds certain thresholds.

The LLC can also have a **management board**. By law, the general director chairs the management board. Unlike

the general director, however, members of the management board must obtain a power of attorney from the general director in order to enter into transactions on the company's behalf.

Powers of the board of directors and the management board are to be defined by the charter at the discretion of participants.

The **general director** (sole executive body) manages the day-to-day running of the company and deals with all other issues not falling within the authority of the other management bodies. The general director acts on behalf of the company, represents its interests, enters into transactions on its behalf, issues powers of attorney and hires and dismisses employees. The general director represents the company without a power of attorney. The general director's powers may be limited by the company's charter and his/her employment contract.

The powers of the sole executive body can be provided to several executives of the company for individual or joint representation, which must be reflected in the Unified State Register of Legal Entities. However, this Register has not yet been amended to allow reflecting the particular authorities of each of the executives. As a result, the general rule that all executives indicated in the Register have equal and unlimited authorities applies and, thus, the four-eyes principle cannot currently be implemented vis-à-vis third parties.

A foreign national may be appointed as the general director of an LLC subject to compliance with work permit regulations².

The general participants' meeting may transfer the general director's authority to a management company (in whole only). In such case the management company will act on the basis of the management agreement entered into with the company.

Audit

The charter may provide for an **internal auditor** (either an individual or an internal audit commission established under the company's own charter). In some cases a company must have an internal auditor – as with companies having more than 15 participants – without which the general participants' meeting will not be able to approve the company's annual reports and balance sheets (as they must first be approved by the internal auditor).

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

Transfer of participatory interests

Participatory interests are freely transferable between participants. However, the charter may specify that a transfer of participatory interests

requires the consent of the other participants and/or the company.

A participant may transfer its participatory interest to third parties, subject to a statutory pre-emption right in favour of the other participants and, if so provided for by the charter, in favour of the company itself.

The procedure for selling participatory interests and for determining their offer price is set out in the LLC Law, although the company's charter and/or participants' agreement may provide a different procedure.

A participatory interest transfer agreement must be notarised. The participatory interest is deemed transferred after the information on the transfer is registered in the Unified State Register of Legal Entities. This creates difficulties in the context of settlements between the parties to Russian agreements for the sale and purchase of participatory interests since the registration of the transfer may take up to seven business days and is outside of the parties' control.

The charter may prohibit the transfer of participatory interests to third parties or make such transfer subject to the consent of other participants or the company. If such consent is not given, the company itself is obliged, by law,

² Please see the Employment and migration chapter on page 109.

to purchase the relevant participatory interests.

Right to withdraw

Participants in an LLC are entitled to withdraw from the company without the consent of other participants if: (i) this is permitted by the company's charter; or (ii) the transfer of participatory interest to a third party or another participant is prohibited and/or blocked by other participants; or (iii) the general meeting of participants approved a major transaction or a charter capital increase (in this event, the right to withdraw is granted to any participant who voted against such decision or did not attend the meeting). The application of a participant for withdrawal from the company has to be notarised.

If a participant withdraws from the company, it has to serve a withdrawal notice to the company. Such withdrawal notice must be certified by a notary. After receipt of the notarised withdrawal notice, the general director has to apply to the Unified State Register of Legal Entities to register the relevant transfer of the participatory interest to the company. The company is then obliged to pay the exiting participant the "actual value" of its participatory interest in cash. The company may, however, pay the exiting participant in kind provided that the participant agrees to this.

The "actual value" of the exiting participant's participatory interest is calculated in accordance with

accounting data as provided in the LLC Law. The statutory payment procedure and timing may be varied in the company's charter.

Expulsion of a participant

Company participants holding more than 10% in the company's charter capital (in aggregate) are entitled to apply to the court for the exclusion from the company of a participant that commits a gross violation of its duties or whose actions or failure to act renders the company's operation impossible or significantly impairs it.

Where a creditor of a participant enforces against the latter's participatory interest, the LLC and/or the other participants are entitled to pay the actual value of such participatory interest to the creditor. If they do so, the participant withdraws from the LLC and its participatory interest is transferred to the other participants and/or to the LLC (depending on which of them satisfied the claim of the creditor).

Joint-stock companies

Joint-stock companies belong to corporations as well and are regulated by the Civil Code, Federal Law No. 208-FZ "On Joint-stock Companies" dated 26 December 1995 (the "**JSC Law**"), the Registration Law and Federal Law No. 39-FZ "On Securities Market" dated 22 April 1996 (the "**Securities Market Law**") and the acts issued by the CBR.

A joint-stock company ("*aktsionernoye obshchestvo*" – a "**JSC**") can either be public or private (non-public). Public JSCs are capable of offering their shares by public offering, which results in their activity being more stringently regulated by law. They must contain the word "public" in their company name.

Private JSCs, on the other hand, enjoy more flexibility:

- the powers can be distributed between corporate bodies in various ways (e.g. management bodies can take over most questions of the general shareholders' meeting);
- the management bodies themselves can be omitted (e.g. the board of directors can act both as a management and supervisory body, a single director may replace the management board);
- the charter may require a qualified majority of votes to adopt certain decisions of the management bodies; and
- shareholders may define shareholders' rights in the charter non-proportionally to their stakes in the company, limit the number of shares or votes held by one shareholder, provide for a pre-emptive right or consent on transferring shares to a third party.

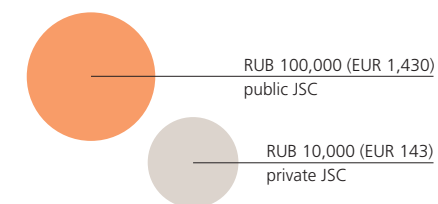
As with LLCs, Russian legislation prevents a JSC being wholly owned by another company ("*khozyaystvennoye obshchestvo*"), where the holding company is itself wholly owned by (i) another single legal entity or

(ii) a single individual.

Charter capital and contributions

The **charter capital** of a JSC is divided into shares (which may be split into ordinary shares and preference shares). These shares are deemed to be securities for the purposes of Russian securities legislation and must therefore be registered with the CBR.

The minimum charter capital



₽ RUB 70 = EUR 1 *notional exchange rate used for convenience

As with LLCs, **contributions** to the charter capital may be paid in cash or in kind. Other types of securities, such as corporate bonds, must be paid in cash only. Contributions in kind must be valued by an independent appraiser. It is possible to pay for new shares issued in a closed subscription by way of a debt-for-equity swap.

The charter capital may be increased by issuing new shares (within the number of authorised shares set out in the company's charter) or increasing the nominal value of the shares already in issue. Each capital increase must be filed and registered with the CBR, which is a lengthy process.

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

Net asset requirements and creditor protection

A JSC must ensure that the value of its net assets does not fall below the amount of its charter capital. Failure to comply with this requirement may result in the company being required to decrease its charter capital accordingly or to increase the value of its net assets.

Also, if the value of the company's assets is less than the minimum charter capital amount, it may be compulsorily liquidated.

In addition to other filing requirements, JSCs must submit information on their net asset value to the Unified Federal Register of Legally Significant Data about the Facts of the Activities of Legal Entities.



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This requirement aims to increase the transparency of the financial state of the company and protect its creditors.

At least 5% of the charter capital of any JSC must be allocated to a reserve fund. This fund is created specifically to cover losses and to redeem bonds and shares of the company.

Beneficial owners

All JSCs must know who their beneficial owners are and take steps to collect the relevant information from their shareholders. Such information is to be disclosed to the state authorities upon request.

Management structure

The managing bodies of a JSC are:

- the general shareholders' meeting;
- the collective management body (optional for private JSCs) – board of directors, supervisory board;
- the collective executive body (optional for private JSCs) – management board; and
- the sole executive body (one or several executives) – general director.

The annual **general shareholders' meeting** must be held not earlier than two months, and not later than six months, after the end of the company's financial year (which always corresponds to the calendar year). Extraordinary general shareholders' meetings may be called by the general director, the board of directors, the external auditor, the internal auditor of the company or by shareholders owning at least 10% of the voting shares in the company.

At general shareholders' meetings most decisions may be passed by a simple majority of the shareholders attending the meeting (e.g. a decision to appoint executives of the company). However, a limited number of more significant decisions require not less than 75% of the votes of the shareholders attending the meeting (e.g. decisions on the liquidation or reorganisation of the company, amendments to the charter or approval of a new version of the charter). Each share entitles the holder to one vote.

Subject to certain exceptions, shareholders may adopt decisions without holding a meeting through absentee voting. In the case of public JSCs, decisions must be certified by the company's registrar. A private JSC may use either the registrar or a notary for certifying its decisions.

The **collective management body** (e.g. board of directors, supervisory board) is responsible for the general management of the company but may not interfere with the exclusive competence of the general shareholders' meeting. It consists of at least five members and is mandatory for a public JSC.

Members of the collective management body are elected by an annual/ extraordinary general shareholders' meeting and serve until the next annual general shareholders' meeting. There is no limit on the number of times a member of the collective management

body may be re-elected.

The **collective executive body** (e.g. management board) is supervised by the collective management body of the company.

The company may have one or several general directors (**sole executive body**). The sole executive body is responsible for the day-to-day running of the company and can represent the company without a power of attorney. In the case of appointment of several general directors, they may be authorised to act individually or jointly and this must be disclosed in the Unified State Register of Legal Entities. However, this Register has not yet been amended to allow reflecting the authorities of each of the executives. As a result, the general rule that all executives indicated in the Register have equal and unlimited authorities applies and, thus, the four-eyes principle cannot currently be implemented vis-à-vis third parties.

Legal entities may be appointed as the sole executive body.

A foreign national may be appointed as the general director of a JSC subject to compliance with work permit regulations³.

³ Please see the Employment and migration chapter on page 109.

Audit

JSCs are required to appoint an **external auditor** to audit the annual accounts.

From 1 July 2020, an **audit committee** (*"komitet po auditu"*) will have to be set up in public JSCs, and the board of directors will have to appoint an executive responsible for organising and conducting the internal audit (including evaluating risk management and the efficiency of internal control systems).

Unless specifically excluded in their charters, JSCs should also have an **internal audit committee** (*"revizionnaya komissiya"*). It audits the company's financial and business activity. Before the annual general shareholders' meeting, this committee prepares an annual report and balance sheet. The report is then communicated to all the shareholders that are entitled to attend the meeting.

Furthermore, the internal audit committee may audit the company at any time:

- at its own initiative;
- upon a decision of the general shareholders' meeting; or
- upon demand of a shareholder or a group of shareholders holding at least 10% of the voting rights in the company.

Issue and transfer of shares

The shares of a JSC, whether public or private, are treated as securities and as such are subject to the registration

requirements of the Securities Market Law. When issuing new shares, all JSCs must carry out the requisite filings with the CBR. The documents that must be filed include among others the decision to issue shares and the report on the results of the share issue as well as, in certain cases, a prospectus for the share issue.

A share transfer takes effect when it is recorded in the register of shareholders that all JSCs are required to maintain. The register of shareholders must be kept by an independent company duly licensed by the CBR with no exceptions.

A **public JSC** may make both closed and public offerings of its shares. There are no statutory pre-emption rights or restrictions on the transferability of shares in the company whether to other shareholders or third parties. When the charter capital is increased by issuing additional shares, however, existing shareholders do have the benefit of statutory pre-emption rights.

Acquisition of more than 30% of the shares in a public JSC by an existing shareholder or a third party triggers a mandatory buyout offer which needs to be supported by a bank guarantee and served to the remaining shareholders.

Shares of a **private JSC** are freely transferable between shareholders, although it is possible to introduce contractual restrictions by means of a shareholders' agreement.

Share sales to third parties are subject to statutory pre-emption rights of the other shareholders in the company (and the company itself if so provided in the charter). Starting from 1 January 2020, JSCs will also have an opportunity to privately offer their shares via crowdfunding platforms.

Redemption of shares

In certain cases where a shareholder disagrees with decisions taken at a general shareholders' meeting, it may be able to require the company to purchase its shares. This applies when:

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

The shares will be redeemed at a price no less than the market value of the shares as determined by an independent appraiser in accordance with the methods prescribed in the JSC Law.

Expelling a shareholder

A shareholder of a **private JSC** may expel another shareholder through court action for causing harm to the company or impeding its activity.

In case of a **public JSC** a shareholder that has acquired more than 95% of the voting shares in accordance with a special procedure may "squeeze out" the minority shareholders.

Economic partnership

The economic partnership (*"khozyaystvennoye partnerstvo"*) is designed for the new technology sector and is meant to provide more flexibility for its participants than the existing LLC and JSC forms.

In general terms, an economic partnership shares many common features with a Russian LLC but with the advantage that the rights and obligations of participants, the management of the company and profit distribution are regulated by a much more flexible and less regulated notarised management agreement.

That said, the prohibition on an economic partnership acquiring or holding shares/interests in other companies and partnerships and on advertising its business generally precludes the use of this business structure for commercial trading operations or as holding companies for joint ventures.



For ease of comparison between the legal entities described above, please refer to the comparative table on pages 26-28.

Comparative table

Summary of legal forms

	Public joint-stock company	Private joint-stock company	Limited liability company	Economic partnership
Activities	Any type of activity (subject to licensing requirements)	Any type of activity (subject to licensing requirements)	Any type of activity (subject to licensing requirements)	Any type of activity (subject to licensing requirements) except for incorporating other legal entities, issuing bonds and other emissive securities, advertising
Term	Unlimited term, unless otherwise provided in charter			
Number of shareholders/ participants	Unlimited	Unlimited	1 to 50	2 to 50
Minimum charter capital	RUB 100,000 (EUR 1,430)	RUB 10,000 (EUR 143)	RUB 10,000 (EUR 143)	None
Type of interest in charter capital	<ul style="list-style-type: none"> • Ordinary shares • Preference shares 	<ul style="list-style-type: none"> • Ordinary shares • Preference shares 	Participatory interests	Participatory interests
Issue of financial instruments	<ul style="list-style-type: none"> • Bonds • Other emissive securities 	<ul style="list-style-type: none"> • Bonds • Other emissive securities 	<ul style="list-style-type: none"> • Bonds • Other emissive securities 	Prohibited
Subscription for shares	<ul style="list-style-type: none"> • Public subscription • Closed subscription 	Closed subscription only	N/A	N/A
Contributions to the charter capital	<ul style="list-style-type: none"> • Monetary funds • Contributions in kind 	<ul style="list-style-type: none"> • Monetary funds • Contributions in kind 	<ul style="list-style-type: none"> • Monetary funds • Contributions in kind 	<ul style="list-style-type: none"> • Monetary funds • Contributions in kind, except securities other than certain bonds
Payment of the charter capital	Not less than 50% must be paid within three months, the rest within 12 months of the state registration of the company	Not less than 50% must be paid within three months, the rest within 12 months of the state registration of the company	The whole charter capital within four months of the state registration of the company	A specific procedure can be stipulated in the management agreement

	Public joint-stock company	Private joint-stock company	Limited liability company	Economic partnership
Capital increase	Only after the charter capital has been fully paid up			A specific procedure can be stipulated in the management agreement
Capital decrease	<ul style="list-style-type: none"> • After notification of creditors and repayment of debts • Mandatory decrease in certain cases 			
Managing bodies	<ul style="list-style-type: none"> • General shareholders' meeting • Collective management body • Collective executive body • Sole executive body (one or several general directors) 	<ul style="list-style-type: none"> • General shareholders' meeting • Collective management body (optional) • Collective executive body (optional) • Sole executive body (one or several general directors) 	<ul style="list-style-type: none"> • General participants' meeting • Collective management body (optional) • Collective executive body (optional) • Sole executive body (one or several general directors) 	<ul style="list-style-type: none"> • Director • The management structure is subject to the management agreement, i.e. any other managing bodies (board of directors, management board) are optional and subject to the management agreement
Transfer of shares/ participatory interests between shareholders/ participants	No restrictions, however acquisition of more than 30% triggers the mandatory offer obligation	No restrictions, unless otherwise provided for in a shareholders' agreement	Without restrictions, unless the charter provides for participants'/ company's consent or unless provided for in a participants' agreement	Without restrictions, unless otherwise provided for by the management agreement
Transfer of shares/ participatory interests to third parties	No restrictions, however acquisition of more than 30% triggers the mandatory offer obligation	<ul style="list-style-type: none"> • Can be subject to shareholders' pre-emption right under the charter • Can be subject to company's pre-emption right under the charter 	<ul style="list-style-type: none"> • Subject to participants' pre-emption right • Can be subject to company's pre-emption right under the charter • Can be restricted by the charter • Can be subject to participants'/ company's consent • Subject to notarisation unless exempted by law 	Subject to all participants' consent and participants' pre-emption right

	Public joint-stock company	Private joint-stock company	Limited liability company	Economic partnership
Exiting the company/ partnership (redemption/ withdrawal)	Shareholders may require the company to buy out their shares in limited cases: when they do not agree with certain decisions, including the reorganisation of the company, charter amendments which limit their rights and the conclusion of major transactions	Shareholders may require the company to buy out their shares in limited cases: when they do not agree with certain decisions, including the reorganisation of the company, charter amendments which limit their rights and the conclusion of major transactions	A participant may withdraw from the company if (i) permitted by the company's charter or (ii) the transfer of participatory interest to a third party or another participant is prohibited and/or blocked by other participants	A specific procedure can be stipulated in the management agreement
Expulsion of a shareholder/ participant	Squeeze-out by a shareholder who has acquired more than 95% of the voting shares	Shareholders may be expelled from the company through court action initiated by another shareholder ⁴	Participants may apply to the court for the exclusion from the company of a participant that commits a gross violation of its duties or whose actions or omissions jeopardise the company's operations or significantly impair them	<ul style="list-style-type: none"> Participants may bring a court action to expel any participant which grossly violates its obligations, or prevents or materially impedes the partnership's activities, or Without bringing a court action if a participant fails to pay its interest
Liability of the company/ partnership	The company/partnership is not liable for the obligations of the shareholders/participants			
Liability of shareholders/ participants	Liability is limited to the value of their shares/participatory interests (unless it can be demonstrated that their binding instructions to the company/partnership led to its insolvency)			

⁴ Concept introduced by the amended Civil Code but yet to be implemented in the special legislation on joint-stock companies.

Other business structures

Although foreign individuals and legal entities can set up wholly owned subsidiary companies and may participate in the various forms of partnership prescribed under Russian law, using a representative office or a branch remains an effective way for a foreign legal entity to enter the Russian market. An investment partnership is also a relatively new form of unincorporated legal structure which may be relevant to investment funds.

Representative office Status

A representative office (*"predstavitelstvo"*) is not a separate legal entity but, rather, is an office set up to represent the interests of the parent company. This does not prevent it, in practice, from conducting business in Russia (and many representative offices do so) and being treated by the tax authorities as a separate profit centre from the parent company. However, as a matter of civil law, a representative office's lack of separate legal identity limits the types of business activities it may undertake. For example, a representative office may not formally import goods for purposes other than its own needs, nor may it register title to immovable property in its own name. A representative office may also experience difficulties in obtaining licences and permits to conduct certain types of business.

A representative office may, however, carry out representative functions on

behalf of the parent company, including arranging marketing and advertising in Russia. It may also assist in other commercial and legal transactions between the parent and Russian organisations, including the rental of property.

Foreign employees of a representative office should obtain personal accreditation. This involves certain practical benefits for the accredited foreign employee, such as the right to import and export personal effects free of customs duty and VAT, and it assists with obtaining multi-entry visas. Such employees must hold work permits in order to work in Russia⁵.

A representative office may hold a number of different types of bank account, including foreign currency and rouble accounts. These accounts enable the representative office to make payments in Russia to both residents and non-residents subject to certain currency control restrictions established by CBR regulations and other applicable legislation⁶.

As a representative office is merely an extension of a foreign parent company, the latter remains responsible for the liabilities of the representative office.

⁵ Please see the Employment and migration chapter on page 109.

⁶ Please see the Currency control chapter on page 84.

Management

A representative office acts on the basis of regulations approved by the parent company and is managed by the head of the office who is authorised to conduct the business of the office and to represent the foreign company under a power of attorney. A representative office should also have a chief accountant.

There is no requirement for either the head of the office or the chief accountant to be Russian nationals although an accountant who understands the intricacies of Russian tax and accounting law is a practical necessity.

Branch
Status

A branch (“filial”) is also an office set up to represent the interests of the parent company. In addition to carrying out the functions of a representative office a branch may formally carry out profit-making activities.

As a branch is merely an extension of a foreign parent company, the foreign company remains responsible for the liabilities of the branch.

Foreign employees of a branch should be personally accredited in the same manner as those of a representative office and, in addition, they must hold work permits in order to work in Russia⁷.

Table showing main differences between a representative office and a branch

Business structure	Representative office	Branch
Formation	Two-step accreditation procedure: (i) review of the set of documents and confirmation of the number of foreign employees by the Chamber of Commerce and Industry of the Russian Federation; (ii) followed by registration by the Federal Tax Service	
Capacity	Technically restricted to representation, but functions in practice are often wider. Unable to hold title to property, or to import or export goods. May be unable to obtain certain permits and licences	Wider capacity. Usually able to obtain requisite licences and permits
Taxation	Capable of constituting a permanent establishment for Russian tax purposes and is subject to Russian taxation accordingly	Will constitute a permanent establishment for Russian tax purposes and is subject to Russian taxation accordingly
Foreign staff	Work permits for foreign employees are required	
Accreditation or renewal term	No limitation	

⁷ Please see the Employment and migration chapter on page 109.

Management

Management issues are the same as those concerning representative offices⁸.

Other

The Civil Code provides for a range of other business structures, including simple partnerships (which are not legal entities) as well as full and limited partnerships – which are rarely encountered in practice –, and investment partnerships.

There are also non-commercial organisational forms that may be used for charities, trade associations and other not-for-profit organisations.

Registration, liquidation and reorganisation of business structures

Registration of a Russian company

The Registration Law establishes a single procedure for the registration of companies, regardless of their organisational/legal form and the type of business activities they conduct.

Scope of registration

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

- state registration (in the Unified State Register of Legal Entities);
- tax registration; and
- registration with the Federal Service for State Statistics and the social funds (the Pension Fund and the Federal Social Insurance Fund (the “Social Funds”).

Registration mechanics

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

The application to register the company can be (i) filed by the founder(s) in person⁹; or (ii) submitted by a representative acting on the basis of the power of attorney given by the founder(s) (directly or, through the assistance of a notary, electronically); or (iii) sent by post, which adds significant time to the registration process; or (iv) presented in electronic form via the Federal Tax Service website

 www.nalog.ru

or the unified portal of the government and municipal services.

 www.gosuslugi.ru

Specifically, the electronic filing form stipulates that the documents should contain an applicant’s electronic signature or that an applicant be allowed to have a notary verify his/her signature by electronic signature. However, in practice receiving an electronic signature is a complex and lengthy process for foreign entities and individuals.

⁸ Please see the relevant paragraph above.
⁹ When a company or companies incorporate a Russian legal entity, the applicant must be the CEO of the founding parent company/ies.

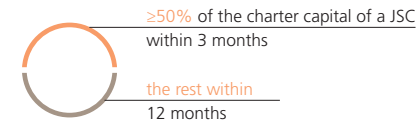
As a result, documents are usually submitted on behalf of foreign investors in paper form.

The time taken for registration is three business days from the date of submitting the documents to the registration authorities. In practice, the whole process of company incorporation, including collecting the documents required, opening the current bank account and registering with the Social Funds, takes approximately from one to two months to complete (i.e. for the company to be fully operational). However, delays are possible.

Payment of charter capital

The whole charter capital of an LLC must be paid within four months of its state registration.

Not less than 50% of the charter capital of a JSC must be paid within three months of its state registration, the rest within 12 months of the state registration of the company.



If a founder fails to pay the total amount of its shares/participatory interests within these time limits, then the non-paid shares/participatory interests become the property of the company. Such shares/participatory interests do not carry voting rights and are to be sold to the JSC's shareholders/

LLC's participants or third parties or cancelled (and the charter capital simultaneously decreased) within one year from the date of their transfer to the company.

Registration of the initial share issue

Since shares in JSCs are treated as securities, certain additional registration requirements imposed by the CBR must be completed following the registration of the JSC's incorporation.

The share issue registration process consists of the following stages:

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

A JSC will be entered in the Unified State Register of Legal Entities provided the issue of the shares to be placed upon its establishment has been registered.

Anti-monopoly control

As a general rule, the formation of a company is not subject to merger control.

In exceptional cases, however, the prior consent of the Federal Anti-monopoly Service (the "FAS") will be required when a company is incorporated by:

- the contribution of assets or shares/participatory interests or rights in another company; or

— the merger of one company with another or consolidation of several companies, provided that, in either case, certain asset values or revenue thresholds are exceeded¹⁰.

Market regulator pre-registration clearance

If the company to be set up in Russia is a bank or non-banking credit institution with foreign investment, then the parent company/ies will require the prior clearance from the CBR.

Licensing

Once a company has been set up, it may need to obtain the requisite licence(s) or other authorisations before it can legally conduct certain kinds of business. Failing this, it may be subject to sanctions, and the contracts it will have concluded in relation to any licensed activity may be subsequently set aside by the courts as potentially voidable.

Accreditation and registration of a representative office and a branch

The function of registering representative offices and branches of foreign legal entities is performed by the Federal Tax Service (except for the representative offices and branches of foreign civil aviation companies and credit institutions that are accredited by Rosaviation and the CBR respectively).

As a result of accreditation, the representative office/branch is included in the State Register of Accredited Representative Offices and Branches of Foreign Legal Entities. Information from

the State Register of Accredited Representative Offices and Branches of Foreign Legal Entities is publicly available on the Internet.



In addition, representative offices and branches must be locally registered with the Federal Service for State Statistics and the Social Funds.

Company reorganisation

The Civil Code provides for five types of company reorganisation: merger, consolidations, de-mergers, spin-offs and transformation. Representative offices and branches may not be reorganised into legal entities.

Company reorganisation is a complex process that may take from three to 12 months to complete. It usually involves an audit by the tax authorities (including tax reconciliation of any missing financial reports, any arrears or overpayments) and notification to the company's creditors.

The creditors of a company can accelerate or terminate current obligations of a company participating in the reorganisation (e.g. a bank may accelerate a loan), however, this right of the creditors is significantly limited by the Civil Code.

¹⁰ Please see the Anti-monopoly issues chapter on page 43.

Liquidation

A legal entity can be liquidated:

- voluntarily, by a decision of its shareholders/participants;
- by the court in the circumstances listed in the Civil Code; or
- through bankruptcy¹¹.

Voluntary liquidation of a company is complex and time consuming as it involves an audit by the tax authorities (and sometimes by the Social Funds) and notification to its creditors.

Closing branches or representative offices is almost as cumbersome as voluntarily liquidating a company. The only major difference is that there is no requirement to notify creditors of the closure of representative offices or branches.

Shareholders' and participants' agreements

The Civil Code provides for a definition of "corporate agreement" that covers both shareholders' and participants' agreements.

These corporate agreements can be governed by non-Russian law (e.g. English law) if one of the parties to such agreement is a foreign person. This does not mean that the mere choice of foreign law will exclude the relevance of Russian law (its mandatory rules cannot be overcome). Also, the foreign law precedent commonly used in international joint ventures will still need some adaptation for a Russian company but importantly, more general

provisions of such agreements and boiler plate clauses can now be retained.

A corporate agreement can be entered into by all the shareholders or some of them. The company itself still cannot be a party to the corporate agreement. The shareholders must notify the company upon the conclusion of a corporate agreement.

A corporate agreement can be entered into with a person who is not a shareholder to the company provided that such person has a legitimate interest in respect of the company (e.g. a creditor, a potential investor).

The corporate agreement survives the exit from the company of one of the participants/shareholders unless otherwise is provided in such agreement.

Private corporations (LLCs and private JSCs) are not obliged to disclose the content of corporate agreements. Public corporations must disclose the content of any corporate agreement within the limits provided by the JSC Law.

Strategic industries

The Foreign Investment Law¹², together with Federal Law No. 57-FZ "On Procedures for Foreign Investment in Companies of Strategic Significance for

National Defence and Security of the Russian Federation" dated 29 April 2008 (the "**Strategic Industries Law**"), provides for a strict regulation of all transactions or agreements involving the participation of foreign investors in any entities engaged in activities in those sectors of Russia's economy which are deemed strategic for Russia's defence and security.

Under the Strategic Industries Law, 45 sectors of the economy have been defined as strategic, including:

- military technology, nuclear power, aircraft and the space industry;
- natural monopolies, such as pipelines, the maintenance of ports and airports (with limited exceptions);
- companies with a dominant market position in certain markets in Russia;
- communication services, including fixed-line telecommunications, but excluding Internet access services;
- television and radio broadcasting; and
- subsoil use.

The Strategic Industries Law does not affect foreign investments which are already governed by other federal laws or by international conventions ratified by Russia.

Restrictions on foreign investors

Under the Strategic Industries Law, transactions that result in foreign investors or Russian corporate groups with a foreign element gaining control over a strategic company must be

cleared by the specifically appointed Governmental Commission (the "**Strategic Approval**").

In June 2018, important changes to the Strategic Industries Law came into force. These changes introduced the amended definition of a "foreign investor" for the purposes of the Strategic Approval. This definition now includes those types of investors mentioned in a comprehensive list provided by the Strategic Industries Law.

The procedure for obtaining a Strategic Approval is lengthy and cumbersome; however, if the Strategic Approval is not obtained for a transaction requiring such approval, the respective transaction is void under Russian law.

If prior approval is obtained, the transaction should be conducted within the timeframe set out in the respective approval.

Foreign investors are deemed to "**gain control**" over a company if they are acquiring:

- directly or indirectly more than 50% of the voting shares in a Russian company operating in a sector deemed to be of strategic importance (a "**Strategic Company**") which does not conduct geological surveys on the subsoil and/or explore and extract minerals on subsoil plots of federal significance (i.e. not "operating federal subsoil plots");
- directly or indirectly less than 50% of the voting shares in a Strategic

¹¹ For more details, please see the Corporate bankruptcy chapter on page 173.

¹² Federal Law No. 160-FZ "On Foreign Investment in the Russian Federation" dated 9 July 1999.



Foreign investors in Russia mostly use the limited liability company and the private joint-stock company forms for their activity in Russia.



Company that is not operating federal subsoil plots, if the acquirer gains effective control over the company;

- directly or indirectly 25% or more of the voting shares of a Strategic Company operating federal subsoil plots; or
- control of a Strategic Company as a result of a change in the number of voting shares in that company.

It should also be noted that certain transactions require **post-transaction notification**, which must be made within 45 days of the change of control taking effect. One example of this is when foreign investors acquire at least 5% of the shares in a Strategic Company.

Restrictions on state and international organisations and non-disclosing entities

The Strategic Industries Law prohibits foreign states, international organisations

and organisations controlled by them, as well as the companies that do not disclose information about their beneficial owners and controlling persons ("**non-disclosing entities**"), from gaining control over a Strategic Company.

It also provides that foreign states, international organisations, organisations controlled by them and non-disclosing entities must obtain **prior approval** from the FAS when acquiring:

- directly or indirectly more than 5% of the voting shares of a Strategic Company operating federal subsoil plots; or
- directly or indirectly more than 25% of the voting shares of a Strategic Company that is not operating federal subsoil plots or otherwise acquiring the right to block decisions of that company's management bodies.

Anti-monopoly issues

General approach

General legal and regulatory framework

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

The Federal Anti-monopoly Service (the "**FAS**"), a Russian executive authority, controls and enforces compliance with anti-monopoly legislation.

Trends

Compliance systems bill

In 2019 a bill was passed in first reading in the Russian State Duma to encourage companies to develop and implement systems that facilitate compliance with anti-monopoly laws and prevent breaches of these laws.

The bill's main provisions can be outlined as follows:

- Setting up an anti-monopoly compliance system will not be mandatory. If a company decides to do so, however, it will have to adhere to special requirements for

the content of internal documents produced within the company or company group.

- These internal documents must include requirements, measures and procedures for (i) assessing anti-monopoly risks; (ii) reducing anti-monopoly risks; (iii) monitoring the compliance system; (iv) making the compliance system known to employees; and (v) providing information about the person in charge of the company's compliance system.
- Companies will be able to send internal documents of this kind in final or draft form to the FAS to confirm their compliance with anti-monopoly laws.
- Companies will have to post information in Russian on their websites, stating whether an anti-monopoly compliance system has been adopted or applies to that company.

Many companies have already adopted similar systems.

Fifth anti-monopoly package

2020 could see the adoption of amendments to the Competition Law, the so-called "fifth anti-monopoly package". While the associated work is still on-going, changes may cover such

issues as digital economy and intellectual property ("IP"). Notably the removal of the IP exemptions currently provided for in the Competition Law and the introduction of more detailed rules have been proposed.

Another area that may be affected is merger control. Transactions could additionally be subject to merger clearance based on their transaction value. This is because the traditional criteria (outlined in the relevant section below) do not always reflect the real impact of a transaction in the digital world. Also, more detailed rules on the review of merger clearance notifications (e.g. governing the role of external experts) could be introduced and the timeframe of the review extended. For the time being, it is unclear when, and to what extent, these initiatives are going to be enacted.

Cartels

Practice shows that the Competition Law and the enforcement agenda of the FAS are constantly evolving; the FAS puts a particular emphasis on the fight against cartels, notwithstanding the criminal and cross-border dimensions. Tackling bid rigging also remains a top priority for the competition authority.

The FAS has drawn up a set of bills (already submitted to the State Duma) aimed at dealing with cartels. These draft laws may introduce further amendments to the Criminal Code and the Criminal Procedure Code (relating to cartel initiators), the Competition Law

(giving the FAS additional rights during cartel investigations) and the Code on Administrative Offences (in terms of liability for impeding FAS investigations).

Cross-border issues

The role of the Eurasian Economic Commission regarding the analysis of cross-border anti-monopoly violations within the Eurasian Economic Union is expected to increase in the near future.

Scope of application of the Competition Law

The Competition Law applies to:

- agreements/actions concluded or carried out in or outside Russia that may in any way influence competition in Russia; and
- agreements/actions concluded or carried out in or outside Russia, between Russian and/or foreign legal entities/individuals, which are related to:
 - main (fixed) production assets and/or intangible assets located in Russia;
 - shares or participatory interests in, or control over Russian legal entities; or
 - control over foreign legal entities engaged in business activities in Russia.

The expression "legal entity engaged in business activities in Russia" encompasses all foreign entities that have supplied goods/works/services to the Russian market for an amount exceeding RUB 1bn (EUR 14.3m) during

the calendar year preceding the date of the respective transaction.

₽ RUB 70 = EUR 1 *notional exchange rate used for convenience

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

Anti-competitive practices and restriction of competition

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

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

The Competition Law also includes rules on transaction clearance.

Abuse of a dominant position

The general rule is that a company is deemed to be dominant if it has a market share of over 50%. However, in practice, dominance may be established in certain circumstances where a company has a market share of less than 50%.

An undertaking with a market share of less than 35% can be viewed as dominant only in the situation of collective dominance or if the thresholds

provided for in the industry specific legislation apply.

A company with a revenue below RUB 400m (EUR 5.7m) cannot be declared dominant if certain other conditions set forth by the Competition Law are met (this exemption is mainly relevant for small and medium enterprises).

Dominance of a market is, in itself, not a violation. However, abuse of the dominant position gives rise to liability.

The actions of a dominant entity can be qualified as abuse if they harm the interests of market players or an unlimited number of consumers.

In addition to the prohibitions outlined below in the *Cartel agreements and concerted actions* section, dominant entities are prohibited from:

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

Cartel agreements and concerted actions

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

- fixing or maintaining prices/tariffs, discounts, bonus payments or surcharges;
- increasing, reducing or maintaining prices during auctions;
- dividing markets by:
 - territory;
 - volume of sales or purchases;
 - assortment of goods/works/services sold; or
 - range of sellers or purchasers/customers;
- refusing to enter into contracts with certain sellers or purchasers; and
- reducing or terminating the production of goods/works/services.

Vertical agreements

If the parties to an agreement are in a seller-purchaser relationship, such a “vertical agreement” must not contain any provisions that lead to a restriction of competition in general and, specifically, must not:

- establish resale prices for goods/works/services, except for maximum resale prices; or
- prohibit the purchaser from selling competing products.

Economic coordination

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

- the Coordinator does not belong to the same group as the entities it coordinates;
- the Coordinator is not active in the market where it coordinates the

business of these other business entities; and

- the coordination results in any of the prohibitions outlined in the *Cartel agreements and concerted actions* or *Vertical agreements* sections above.

Restriction of competition in general

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

- different prices being set for the same product (work, service) without economic or technological justification;
- the imposition of unfavourable terms upon a contracting party;
- the obstruction of other business entities’ access to (or withdrawal from) a certain market; and
- the establishment of membership conditions in professional or other associations, if these conditions lead to or may lead to a restriction of competition.

As a general rule, the restrictions outlined in the *Cartel agreements and concerted actions*, *Vertical agreements*, *Economic coordination* and *Restriction of competition in general* sections above do not apply to agreements or actions between business entities that are part of one group of companies if these entities are controlled by the same company/individual.

Unfair competition

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

- the distribution of false or incorrect information which may cause damage to a business entity, or impair its reputation (disparagement);
- the provision of misleading information in respect of a commodity’s:
 - nature;
 - manner and place of production;
 - consumer characteristics;
 - quality and quantity; or
 - manufacturers;
- the incorrect comparison of the commodities produced by a business entity with those produced or sold by other business entities;
- an unfair acquisition and use of exclusive rights to the means of individualisation of a legal entity, goods, works or services;
- the sale, exchange or other placement into circulation of a commodity in breach of IP rights, except for the means of individualisation of a competitor;
- the creation of confusion with a competitor’s business or products; and
- the unlawful receipt, use and disclosure of commercial secrets, official secrets or other information protected by law.

The above restrictions are closely linked to further restrictions introduced by

Federal Law No. 38-FZ “On Advertising” dated 13 March 2006 (the “**Advertising Law**”).

The FAS is also entrusted with monitoring compliance with the Advertising Law and may hold business entities liable for violating it.

Transaction clearance

Transactions subject to clearance

The following transactions may require pre-transaction approval from the FAS:

- the establishment of a Russian company if (i) its charter capital is paid up by shares and/or tangible or intangible assets of another company; and (ii) the new company, as a result, acquires:
 - more than 25% of voting shares in a Russian joint-stock company;
 - more than 1/3 of the participatory interests in the charter capital of a Russian limited liability company; or
 - more than 20% of the balance sheet value of the main production and intangible assets of the company which owns the assets (and whose assets are located in Russia);
- the reorganisation (in the form of a merger or accession);
- the conclusion of agreements between competitors on joint activities in the Russian Federation, including those on joint ventures;
- the acquisition of more than 25%, 50% or 75% of the voting shares in a Russian joint-stock company;
- the acquisition of more than 1/3,

- 50% or 2/3 of the participatory interests in the charter capital of a Russian limited liability company;
- the acquisition of control over a Russian company;
 - the acquisition of more than 50% of the shares/participatory interests or control over a foreign “legal entity engaged in business activities in Russia”; and
 - the acquisition of the right to own, use or possess the main production and intangible assets of a company if the book value of the acquired assets located in Russia exceeds the following percentages of the total book value of the seller’s main production and intangible assets:
 - 20% for companies operating on commodity markets; or
 - 10% for companies operating on financial markets.

Intragroup transactions

If an intragroup transaction qualifies as being made between legal entities/ individuals that belong to the same “group of persons” under article 9(1)(1) of the Competition Law, then it is exempt from the merger control requirements of the Competition Law.

i

9(1)(1) A company and an individual/ legal entity holding more than 50% of the voting shares or the participatory interests in that company form a group of persons.

Regarding intragroup transactions which (i) are made between parties

that are not under direct control arrangements and (ii) exceed the thresholds stated below, there is uncertainty as to whether the exemption applies. Therefore applicants may consider relying on article 31 of the Competition Law, which provides for a specific clearance procedure for intragroup transactions that would normally require pre-transaction approval. This procedure allows applicants to make a prior disclosure of the group structure to the FAS and then notify the FAS of the transaction once completed (rather than going through pre-transaction clearance).

Thresholds

The thresholds set out on page 43 only apply to companies operating on the commodity markets. For those operating on financial markets, the requirements are different¹.

¹ Please see the Banking sector chapter on page 197 for information on thresholds for banks (credit institutions).

Pre-transaction clearance thresholds

Agreements on joint activities in the Russian Federation among competitors				
Aggregate worldwide value of assets of the groups of companies involved	> RUB 7bn (EUR 100m)			
OR				
Aggregate worldwide revenue of the groups of companies involved from the sale of goods, works and services during the last calendar year	> RUB 10bn (EUR 143m)			
All other transactions ²				
Aggregate worldwide value of assets of the acquirer's group and the target's group of companies	> RUB 7bn (EUR 100m)	and	Aggregate worldwide value of assets of the target's group of companies	> RUB 400m (EUR 5.7m)
OR				
Aggregate worldwide revenue of the acquirer's group and the target's group of companies from the sale of goods, works and services during the last calendar year	> RUB 10bn (EUR 143m)	and	Aggregate worldwide asset value of the target's group of companies	> RUB 400m (EUR 5.7m)

Liability

General remarks

Individuals and legal entities may be subject to administrative and criminal liability for non-compliance with anti-monopoly legislation.

Liability may include:

- mandatory directions issued by the FAS to cease a violation and/or transfer to the state budget all revenue received as a result of the violation of anti-monopoly legislation (under the Competition Law);

- fixed fines or fines calculated on the basis of revenue (up to 15% of the revenue gained over the period of the violation of anti-monopoly legislation) and/or disqualification of company officials (under the Code on Administrative Offences); and
- fines and/or disqualification of company officials and, for the more serious anti-monopoly violations, up to seven years’ imprisonment for company officials (under the Criminal Code).

² To assess the assets of the target’s group, the assets of the seller and its group are not taken into account when, as a result of the transaction in question, the seller and its group will no longer have any rights over the target.

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



Specific remarks

Prohibited agreements and leniency

As mentioned above, cartels and concerted actions which violate anti-monopoly regulations are strictly prohibited and may lead to severe sanctions being imposed.

However, the Code on Administrative Offences provides for a “leniency programme”, i.e. a limited opportunity for companies that have participated in illegal anti-competitive agreements or actions to avoid penalties (the “**Leniency Programme**”).

To obtain total immunity under the Leniency Programme, a participant to an anti-competitive agreement (cartel) must: (i) be the first to inform the FAS of the anti-competitive agreement (cartel)’s existence; (ii) submit

sufficient information and/or documents to the FAS to allow an administrative violation to be identified; (iii) fully cooperate with the FAS throughout its investigation; and (iv) cease any involvement in the cartel or other infringement immediately. It is only possible to benefit from the Leniency Programme if the FAS is not aware of the reported infringement.

Collective applications for the Leniency Programme are not accepted.

It is also possible for the FAS to set the minimum amount of administrative fines against those who were the second or third to voluntarily report the conclusion of an anti-competitive agreement (cartel) to the competition authority.

Tax system

General approach

Recent developments

The most important amendments to taxation laws over the last three years include:

- Since 2019, foreign companies and foreign intermediaries providing e-services are obliged to register for VAT purposes in Russia. This obligation applies to all types of clients of such foreign companies (i.e. Russian legal entities, individual entrepreneurs and individuals).
- Special administrative areas were created on Russky Island (Primorsky Krai) and Oktyabrsky Island (Kaliningrad Region). Residents of these areas who meet specific requirements can enjoy some tax benefits.
- A new tax on the added revenue from the sale of hydrocarbon products at a rate of 50% was introduced for oil and gas producers.
- General transfer pricing control was abolished for domestic intragroup operations (except in specific cases).
- Organisations active on the financial market are now under an obligation to collect financial information about their customers, as well as their customers’ beneficiaries and controlling persons, and to provide such information to the tax

authorities. If, at the request of such an organisation, a customer, beneficiary or controlling person refuses to disclose the required information, operations between the customer and the organisation must be suspended.

The overall tax burden for corporate taxpayers remains essentially the same, but a number of developments over the past years (both at legislative level and in terms of practice by the tax authorities) may be viewed as having negatively affected the tax climate for such corporate taxpayers:

- The rules for calculating penalties on the amount of tax debt have been amended. Tax administration and tax control in respect of insurance payments have been expanded.
- Court and administrative tax practices are becoming more comprehensive. In particular, most court cases of transfer pricing in Russia were lost by taxpayers to the tax authorities.
- The tax authorities continued to conduct pricing audits primarily in relation to taxpayers engaged in foreign trade transactions in respect of mineral resources.
- The concept of an “unreasonable tax benefit” was introduced in the Russian Tax Code.

The new provisions will lead to an increase in the scope of the tax authorities' control on aggressive tax minimisation schemes used by taxpayers. Some significant aspects of criminal liability for tax crime were clarified by Resolution No. 48 of the Plenum of the Russian Supreme Court dated 26 November 2019. Failure to pay taxes, fees or insurance contributions could lead to criminal liability for persons duly authorised to sign documents submitted to the tax authorities on behalf of the company (for example, directors or authorised representatives).

Amendments to Russian tax legislation have brought it closer to the best practices developed by the OECD¹. In particular, in recent years:

- Requirements on a “three-tier documentation system” for multinational groups of companies have been implemented in Russia. The new rules impose additional reporting obligations on participants in and parent companies of such groups.
- In 2018, Russia began to automatically exchange financial information with more than 75 countries and territories².
- The Russian tax legislation was amended for the purpose of ratification of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS. In 2019, the Russian Tax Code introduced a mutual agreement procedure mechanism within the

application of double taxation treaties (“DTTs”) in order to settle disputes between parties.

Core legal framework

Part I of the Tax Code dated 31 July 1998 has been in force since 1 January 1999; and Part II of the Tax Code dated 5 August 2000 has been in force since 1 January 2001 (together, the “Tax Code”). The Tax Code sets out general tax principles and applicable taxes, as well as the rights and obligations of taxpayers and the state tax authorities.

According to the Tax Code, taxes in Russia may be categorised as follows:

- **Federal taxes** applied throughout Russia at uniform rates, such as VAT. Certain taxes have a federal and a regional component (e.g. corporate profits tax) and may have their regional component reduced at the discretion of the relevant regional authority.
- **Regional taxes and local taxes** determined by the Tax Code and the local or regional government authorities, which are collected locally or regionally. Lower-tier authorities may not grant concessions for taxes governed by a higher authority.

¹ The Organisation for Economic Cooperation and Development.
² Order No. MMB-7-17/785@ of the Federal Tax Service dated 4 December 2018.

Federal taxes	Corporate profits tax
	VAT
	Excise duties
	Payroll-related levies
	Taxes on natural resources
	Excess-profits tax on hydrocarbon production
	State duties
Regional taxes	Personal income tax
	Water tax
	Corporate property tax
Local taxes	Transport tax
	Gambling tax
	Land tax
	Individual property tax
	Sales duty

As a result of this tax structure, taxpayers may face tax and administrative burdens (including making tax filings and paying tax) both at federal and regional levels. Several tax payments may need to be made when a company has separate subdivisions in more than one Russian region.

In this chapter, we provide an outline of the following aspects:

- corporate taxation;
- taxation of individuals;
- special tax regimes;
- tax incentives; and
- DTTs.

Corporate taxation
Corporate profits tax
Taxpayers

Taxpayers are defined as:

- Russian companies that pay tax on their worldwide income; and
- foreign companies that conduct business in Russia through a

permanent establishment and/or are in receipt of income from a Russian source.

Permanent establishments
Scope
The Tax Code defines a “permanent establishment” as a representative office, branch, division or any other separate fixed place of activity through which a foreign company regularly engages in certain business activities (as specified in the Tax Code) in Russia.

If a foreign company does not have a permanent establishment, it is not subject to Russian profits tax. Any Russian-sourced income (interest, dividends, royalties, etc.) will subsequently be subject to withholding tax.

Since 2017, the following activities are not considered to give rise to a “permanent establishment”:

- functions performed by a foreign investment fund’s managing company in Russia; and
- activities of a foreign company which are carried out through a broker, commissioner, manager of a foreign investment fund, professional participants of the Russian stock exchange market or any other person acting in the framework of its main activities.

Consequences
As a general rule, a foreign company has the right to allocate income and expenses to its Russian permanent

establishment if:

- there is a DTT between Russia and the respective country; and
- the possibility of this allocation is provided for in that DTT.

The costs of a foreign company may be allocated to its Russian permanent establishment, provided that such costs were incurred for the purpose of that permanent establishment.

In the absence of a DTT, only the expenses incurred by the permanent establishment may be deducted for tax purposes.

Definition of tax residency

Foreign companies may be deemed Russian tax residents if certain “key” and “auxiliary” criteria are met.

The key criteria are as follows:

- the activities of the executive body of the legal entity are regularly exercised in Russia, and more so than in any other country; and
- key corporate officials of the legal entity perform their actual daily management activities in Russia.

Auxiliary criteria apply by default when it is impossible to recognise a foreign company as a tax resident by using the key criteria above.

The list of auxiliary criteria notably includes the preparation of accounting and financial statements in Russia, as well as operational personnel

management in Russia and record keeping in Russia.

Tax base

The tax base is the total income received by the taxpayer less income exempted from taxation and expenses, as defined by the Tax Code.

The types of income that are exempt from profits tax include, by way of example:

- income in the form of property received by the Russian company from a parent company (based in a state other than a low-tax jurisdiction included in the Russian Ministry of Finance’s black list), a subsidiary or an individual, if the ownership of the recipient or the transferor in the capital of the other party is more than 50%, and the property received (excluding money) is not disposed of within one year from the date of receipt;
- income in the form of property and non-property rights transferred to the Russian company by its parent company for the purpose of an increase in the net assets of the taxpayer;
- income gained from revaluation of fixed assets and securities;
- income in the form of property received as a contribution to a company’s charter capital; and
- the difference between the nominal value of shares and the value of shares gained by a shareholder as a result of an increase in share capital.

Deductibility of expenses

Expenses are generally recognised on an accrual basis. They are deductible for profits tax purposes if they are related to the taxpayer’s income and if they are economically justified and evidenced by the requisite documentation.

The tax authorities are stringent in their application of these criteria.

The law specifies certain

non-deductible expenses, such as:

- the cost of assets transferred free-of-charge;
- any penalty payments made to the budget; and
- any employee remuneration not provided for in the relevant labour contracts, etc.

Some types of expenses are subject to **limitations on tax deductibility:**

- representative expenses: up to 4% of payroll;
- certain types of advertising expenses: up to 1% of revenues;
- pension and life insurance for employees: 12% of payroll;
- medical insurance for employees: 6% of payroll; and
- with respect to interest on loans and other borrowings:
 - for rouble loans, from 75% up to 125% of the Central Bank of Russia key rate since 1 January 2016;
 - for loans in Euro, from EURIBOR +4% up to EURIBOR +7%; and
 - for loans in US dollars, from LIBOR +4% up to LIBOR +7%.

If the interest rate under a controlled loan is outside the above parameters, it must meet the requirements of the transfer pricing rules³.

Interest is also subject to thin capitalisation rules, with the applicable debt-to-equity ratio being equal to 3:1 (12.5:1 for banks and leasing companies).

In 2017, thin capitalisation rules were amended. Notably, controlled debt is since then calculated with reference to Russian taxpayers’ aggregate debt obligations to foreign related parties (or to Russian companies which are related parties of foreign companies).

Certain DTTs with Russia may provide for exemptions from the deductibility limitations set forth by Russian legislation for specific types of expenses.

Depreciation

Depreciation should be calculated separately for each depreciable asset depending on the depreciation group it is classified as. The method applied should be clearly explained in the taxpayer’s accounting policy. Once chosen, the accounting method may not be modified more than once in five years starting from the beginning of the financial year (1 January to 31 December).

³ Please see the Transfer pricing section on page 50.

Two depreciation methods are available for profits tax purposes:

- the straight-line method; and
- the reducing balance method.

Depreciable property includes fixed and intangible assets with a useful life of at least one year and an initial value exceeding RUB 100,000 (EUR 1,430).



RUB 70 = EUR 1

*notional exchange rate used for convenience

The useful life of depreciable fixed assets is determined, within certain limits, based on a classification adopted by the Russian Government. For intangible assets, the useful life is the utilisation period defined by any agreement (with a default provision of ten years). The tax base for a fixed asset includes all costs incurred in order to place the asset in service for production. Accelerated depreciation is permitted in cases stipulated by the Tax Code (e.g. for leased property under financial lease).

Certain assets (such as environmental facilities, land use facilities, nature facilities, financial instruments and works of arts) are not subject to depreciation.

Losses

Losses can be carried forward and offset against future taxable profits, with the exception of some specific cases, such as under partnership agreements, or in certain types of reorganisation in Russia.

From 2017 until 2021 inclusive, offsetting losses from previous periods is temporarily restricted in terms of the

amounts of losses to be carried forward. As a result of such a restriction, the reduction of the tax base should not exceed 50% of the losses incurred in previous years. Losses from the sale of fixed assets are recognised evenly over the remaining useful life of the assets.

If losses relate to different tax periods, they should be carried forward consistently according to the order in which they took place.

Since 2017, taxpayers continue to actively apply the rules on the offsetting of losses of previous tax periods.

Transfer pricing

The Tax Code contains a specific section dedicated to transfer pricing principles, the tax supervision of transactions between related parties and advance pricing agreements.

Controlled transactions

The list of controlled transactions under the Russian transfer pricing rules includes, among other things, cross-border related-party transactions with a value up to RUB 60m (EUR 858,000) and certain domestic transactions exceeding RUB 1bn (EUR 14.3m).

Since 1 January 2019, domestic transactions between related parties are no longer subject to control, except when the parties to a transaction are subject to different tax treatment in Russia.

Transactions between the members of a Russian consolidated group of taxpayers

are excluded from the list.

The list of related parties is relatively extensive. In general, related parties are identified when “the specifics of relations between them may affect the conditions and/or results of the transactions entered into by such parties, and/or the financial results of their activities or the activities of parties that they represent”.

Specifically, the list of related parties includes:

- two companies, where one holds more than a 25% stake in the other, directly or indirectly;
- a company and an individual holding more than a 25% stake, directly or indirectly;
- two companies with the same parent company that holds more than a 25% stake in each company;
- a company and its general director, or companies with the same general director; and
- groups of individuals/companies with more than a 50% stake.

Methods

Russian legislation provides for the following five transfer pricing methods:

- comparable uncontrolled price method (CUP), which has priority;
- resale minus method;
- cost plus method;
- comparable profitability method; and
- profit split method (treated as the “last resort” method).

These methods are in line with the transfer pricing practices of EU member

states and, in particular, the OECD Transfer Pricing Guidelines.

Each taxpayer can select the method it wishes to apply (and may even choose to use a combination of methods, or another method not expressly provided for by the Tax Code), provided it documents the reasons for this choice.

Advance Pricing Agreements

In 2018, The Russian Ministry of Finance allowed the biggest taxpayers in Russia to enter into advance pricing agreements with the Russian Federal Tax Service.

This type of agreement allows minimising tax risks related to the chosen transfer pricing methodology in controlled cross-border transactions.

Advance pricing agreements replace the annual obligation of taxpayers to file special transfer pricing documentation and can be concluded for a period from three to five years.

Reporting and documentation requirements

Taxpayers are subject to an overall responsibility to prepare documentation justifying the prices applied in all transactions specified as controlled. Upon request from the tax authorities (which may be submitted from 1 June of the year following the year of the controlled transaction), taxpayers must submit the requested documentation.

In addition, companies are obliged on a yearly basis (before 20 May) to notify

their local tax inspectorates of all controlled transactions concluded between the same related parties during the previous calendar year.

The notifications should contain general information on (i) the subject matter of the controlled transactions; (ii) the parties involved; (iii) the transfer pricing methods applied in the definition of prices; and (iv) the amount of profits received and expenses incurred as a result of these transactions.

On 1 January 2018, new transfer pricing requirements for multinational groups of companies (“**MGCs**”) came into force.

The new rules relate to MGC-participants’ obligation to prepare and provide “country reporting”. The content of the new reporting is in line with the OECD principles for “three-tier documentation systems”.

Country reporting consists of the following types of reporting:

- notification of participation in an MGC;
- country report (which corresponds to “CbCR” under OECD principles);
- global documentation (which corresponds to a “master file” under OECD principles);
- national documentation (which corresponds to a “local file” under OECD principles).

Certain Russian taxpayers may be wholly or partly exempt from the new reporting requirements if such obligations are met by other members of the relevant MGC,

or if an MGC’s revenue is lower than the established threshold.

Tax consolidation

Russian companies can elect to form a consolidated tax group, provided they satisfy certain thresholds (in terms of the group’s total tax liabilities, statutory accounting revenue and assets) and other criteria. In this case, a single tax base is calculated for the consolidated tax group, as opposed to the calculation of multiple tax bases for the individual members. This allows the losses of certain members to be offset against the profits of others.

In practice, the impact of this regime is limited for:

- Russian companies in general, as the thresholds are currently so high as to allow only a handful of major corporate groups to be eligible; and
- foreign investors, as:
 - foreign companies cannot become a member of a Russian consolidated tax group; and
 - group members are jointly liable for the group’s tax liabilities.

Currently setting up consolidated tax groups is under a moratorium which is in effect until the end of 2023.

Tax rate

The general profits tax rate is 20%, with 3% of the tax being payable to the federal budget, and the remaining 17% being payable to the appropriate regional budget of the region where the company is incorporated. Starting from

2024, 2% will be paid to the federal budget and 18% will be paid to the relevant regional budget.

In some cases, reduced tax rates apply. By way of example, a 0% profits tax rate applies to companies (domestic and foreign) transferring participatory interests or non-listed shares in Russian companies, provided the equity interest was held for at least five years. Similarly, organisations carrying out special types of socially useful activities like medical and educational services may benefit from a 0% tax rate in relation to their operational profit provided that certain requirements are met.

Taxation of dividends

Dividends received by Russian companies

Dividends received by a Russian company from another Russian company, or from a foreign company, are taxed at a flat rate of 13%. Dividends received from “strategic investments” are exempt from Russian corporate profits tax.

An investment is considered strategic when:

- the recipient of the dividends owns at least 50% of the payer’s capital, or owns depository receipts entitling it to receive at least 50% of the amount paid in dividends; and
- the share or depository receipts have been owned for at least 365 days on the day dividends are declared.

Since 2019, income gained by a Russian shareholder from a company’s liquidation

or a shareholder’s exit, if such income exceeds the amount of the shareholder’s initial contribution, is treated in the same manner as dividends. So the exemption for “strategic investments” can apply to such types of income.

At the same time, since 2019, the following operations are exempt from taxation at shareholder level:

- voluntary reduction of a company’s charter capital; or
- repayment by the company of contributions made by shareholders to the company’s assets.

A revised concept of dividends came into force in 2020. It now includes income paid to a Russian shareholder from its foreign subsidiary, regardless of the qualification of such payment in the foreign state.

Dividends from companies residing in low-tax jurisdictions may not be exempt from Russian corporate profits tax. These jurisdictions are identified in an official list which is updated by the Russian Ministry of Finance.

Dividends paid by Russian companies

The standard 15% tax rate is applicable to dividends paid by Russian companies to foreign companies. The tax should be withheld by the Russian companies paying the dividends.

If there is an applicable DTT, then the standard tax rate may be reduced to a minimum rate of 5%.

Russian depositories acting as tax agents are required to apply the 30% withholding tax on dividends accruing on equity securities of Russian companies kept in the central securities depository (the National Settlement Depository) and paid to foreign companies that are deemed to be acting in the interest of non-disclosed third parties. A foreign legal entity is deemed to be acting in the interest of non-disclosed third parties if it does not provide information on the persons exercising the rights related to these securities.

Funds distributed by Russian companies to their foreign shareholders upon the company's liquidation or a shareholder's exit, if the amount distributed exceeds the amount initially contributed, should be qualified as dividends.

Similar to the tax regime applicable to Russian shareholders, income received by a foreign shareholder upon voluntary reduction of the charter capital of a Russian company or upon repayment by the company of contributions made by shareholders to the company's assets is exempt from taxation in Russia.

Controlled foreign companies ("CFCs")

Definition of CFCs

Under Russian Law, CFCs are defined as foreign companies and structures that meet the following participation criterion: any foreign company or unincorporated structure (such as trusts, funds, etc.) which has a 25% participation interest owned by Russian tax residents (although

the participation threshold is limited to 10% if other Russian residents also participate in the foreign company (or structure), and the total participation of all these Russian residents exceeds 50%).

At the same time, the profits of certain categories of CFCs stipulated by the Tax Code are exempt from taxation in Russia. These include, for example, non-commercial organisations, active companies, residents of the Eurasian Economic Union, companies subject to high effective tax rates.

Requirements

The law provides for two key requirements that must be satisfied by Russian taxpayers who participate in CFCs and/or foreign companies: (i) notification requirements; and (ii) the obligation to pay taxes from the undistributed profits of the CFC.

In terms of the notification requirement, Russian taxpayers who are controlling parties must submit notifications setting out:

- the details of the CFCs controlled by the taxpayer on an annual basis (not later than on 20 March of the year following the tax period in which the taxpayer accounts for the share of profit of the CFC (the latter occurs one year after the year in which the profits were received); so by 20 March 2020 in relation to a CFC's profits received in 2018); and
- the taxpayer's participation interest in any foreign companies or structures other than CFCs, but only

if such an interest exceeds 10% (not later than within one month from the date of exceeding the participation threshold).

Special tax regime for domiciled CFCs

Since 1 January 2019, Russian tax residents can choose to domicile their CFCs in the special administrative areas located on Russky and Oktyabrsky Islands (the so-called "Russian offshore zones").

Residents of these areas that meet certain criteria and fall under the definition of an international holding company ("IHC") can benefit from a preferential taxation regime. It includes the following tax exemptions on:

- income of the domiciled company attributed to its controlled person;
- subsidiaries' income attributed to the IHC;
- income received by the IHC from the disposal of equity investments in subsidiaries (under certain conditions); and
- dividends received by the IHC from its subsidiaries (under certain conditions).

In addition, domiciled IHCs apply a 5% tax rate on dividends instead of the standard 15% rate.

VAT

Taxpayers

VAT applies in particular to companies, including those importing goods into Russia.

If the taxpayer's aggregated income for

three consecutive months, excluding VAT, is below RUB 2m (EUR 28,600), the taxpayer may be exempt if it applies for the exemption.

Tax base

The following operations are subject to VAT (even if they are supplied free of charge):

- sale of goods, works and services within Russia;
- aircrafts services rendered in the Russian airports and airspace;
- sale of e-services in Russia if effected by foreign companies with no presence in Russia (the so-called "Google tax");
- transfer of goods, works and services within Russia for the taxpayer's own purposes, if the relevant expenses are not deducted for the purpose of corporate profits tax;
- construction and building projects for the taxpayer's own use; and
- imports into Russia.

The **taxable base** is generally defined as the market value of the goods, works and services supplied, inclusive of excise duties but exclusive of VAT.

If the goods, works and services are supplied free of charge, an imputed price (set at the market value for identical goods, works or services, excluding VAT) is used.

Exempt supplies

Certain activities, including the following, are exempt from VAT:

- the assignment of loan agreements;
- operations with securities and derivative financial instruments;
- certain banking transactions;
- the issuance of guarantees by non-banking entities;
- transactions with medical equipment and medical services;
- certain research and development services;
- the transfer of exclusive and non-exclusive rights to software, know-how, databases, inventions, and a range of other rights under a licence agreement (except trademarks);
- imports of technological equipment that does not have a Russian equivalent (as per a list approved by the Russian Government); and
- operations related to import of civil aircrafts (starting from 1 January 2020).

Since 1 January 2018, the sale of waste ferrous and non-ferrous metals, as well as aluminium and scrap is no longer VAT exempt and has become a VAT taxable operation.

Tax rates

Since 1 January 2019, the standard VAT rate is 20%. A reduced rate of 10% applies to books, periodicals, medical goods, certain foods and children's clothes. A 0% rate is applicable to the following operations:

- export of goods from Russia (but, since 1 January 2018, Russian taxpayers may waive the right to apply the 0% VAT rate when exporting or re-exporting goods);

- provision of time charter services related to import/export goods in Russia;
- works and services related to the transportation of goods in transit;
- passenger air travel services, provided that both departure and destination (including intermediate points) of transportation are located outside of Moscow and Moscow Region; and
- certain services and goods supplied to foreign diplomatic missions, etc.

Further, the Law on Tax Free⁴ came into force in Russia on 1 January 2018. According to this law, foreign citizens (with the exception of citizens of Eurasian Economic Union member states) can claim a refund of VAT paid on purchases made in Russia. This has recently been implemented in 16 Russian regions as a pilot scheme. Starting in 2020, the Leningrad Region, Primorsky and Khabarovsk Krai also joined the experiment.

The VAT refund is applicable provided that:

- the foreign citizen purchased goods worth at least RUB 10,000 (EUR 143) in Russian shops within a day;
- the goods purchased are on the relevant list which is to be approved by the Russian Ministry of Industry and Trade; and
- the goods are transported outside the Eurasian Economic Union.

⁴ Federal Law No. 341-FZ dated 27 November 2017.

Input VAT

The VAT payable to the tax authorities is the difference between the VAT accountable for transactions subject to VAT ("**output VAT**") and the VAT incurred on purchases subject to VAT ("**input VAT**").

Input VAT is only recoverable in certain cases. Recovery no longer depends on whether it has been paid to the supplier. VAT on imports can be recovered only after payment is made to the customs authorities.

Input VAT related to expenses or assets used for the manufacture or sale of products exempt from VAT may not be offset. In the same way, input VAT related to expenses or assets used for "non-production activities" may not be offset.

Any VAT incurred on purchases and expenses which relate to activities, both subject to and not subject to VAT, must be apportioned. Only the part which is deemed to relate to activities subject to VAT may be offset as input VAT.

Any excess of input VAT over output VAT has to be refunded to the taxpayer. As a general rule, such a refund can only be made after the tax authorities have undertaken an audit. However, an accelerated VAT recovery procedure is also possible. Under this procedure, a taxpayer may recover VAT before the tax authorities complete the tax audit and have made a definitive decision on VAT recovery. According to these rules,

companies which have existed for at least three years and paid taxes exceeding RUB 2bn (EUR 28.6m) over the last three years are eligible for the accelerated procedure, without having to provide a bank guarantee. Other companies can benefit from the accelerated procedure provided that they give a bank guarantee for the amount of VAT to be reimbursed.

VAT invoices serve as the basis for the offset of input VAT. They have to be issued in Russian and must contain the information specified in the Tax Code.

Reverse charge

If a foreign company which does not have a Russian tax registration supplies goods, works or services in Russia, VAT is collected through a withholding mechanism. The tax-registered buyer is required to withhold VAT from the amount payable to the foreign seller and to remit it to the Russian authorities. The tax-registered buyer may then offset the VAT which has been withheld and paid, as input VAT.

Commissioners and agents with a Russian tax registration are considered to be tax agents in relation to goods supplied on behalf of non-registered foreign companies.

Withholding mechanisms are no longer available for the supply of electronic services to Russian clients by foreign companies in respect of B2B and B2C operations. Since 1 January 2019, foreign providers of electronic services

need to register with the Russian tax authorities, file VAT reports and pay VAT to the Russian budget.

Filing and payment

VAT is payable on the earlier of the following two dates:

- the date of *shipment* or *transfer* of goods, works or services; or
- the date of *payment* (in full or in part) for a *future* shipment or transfer of goods, works or services.

Advance payments are included in the VAT base at the time payment is received.

Taxpayers must file their VAT declarations on a quarterly basis. VAT returns must be filed within 25 days after the end of the tax period.

Taxpayers also have the option to pay VAT in three instalments, in the three months following the relevant quarter, except for specific cases, such as payment of VAT by a tax agent. All VAT taxpayers, irrespective of the number of staff, must file VAT tax returns electronically. This obligation also applies to branches and representative offices of foreign legal entities registered in Russia.

Excise duties

Excise duties must be paid⁵ by the producers and/or importers of excisable products. Excisable products are, for example, oil products, alcohol, tobacco and cars.

Starting from 2020, the importation of tobacco products is subject to an

increased excise coefficient.

Excise duties are generally levied on the value of the product.

Corporate property tax

Property tax is payable in accordance with regional regulations and with the Tax Code.

Taxpayers

The following structures are taxpayers for the purpose of corporate property tax:

- Russian companies having fixed assets on their balance sheets;
- permanent establishments of foreign companies having fixed assets on their balance sheets; and
- foreign companies owning immovable assets in Russia.

The above entities are required to pay property tax to the budget of the region where the relevant property is located.

Religious organisations and various types of public organisations are exempt from property tax.

Tax base

Property tax is assessed on fixed assets and “profitable investments in property” (as defined by Russian accounting standards). It may also encompass leased property in certain cases.

⁵ Please see the Customs regulations chapter on page 78.

Intangible assets, movable property accounted for as fixed assets booked after 1 January 2013, inventories, work-in-progress and financial assets (among other categories) are not subject to property tax.

Since 1 January 2019, all types of movable property are exempt from taxation in Russia.

The Russian tax legislation does not currently provide unified criteria to classify assets as movable or immovable for tax purposes. This may give rise to disputes with the tax authorities, as confirmed by the existing court practice.

The tax base for most assets is the average annual residual value of taxable property for financial reporting purposes. The cadastral value is used to calculate the corporate property tax base for the following types of property:

- business centres, shopping centres and premises in these buildings;
- non-residential premises used as offices, shops or to provide catering services or services to consumers, or which are intended for such use;
- any property owned by a foreign company operating without a permanent establishment in Russia or with a permanent establishment in Russia if the property is not allocated to that permanent establishment; and
- residential buildings and premises and some non-residential premises (such as garages, parking slots, construction in progress).

Regional laws establish the features of property tax calculation based on the cadastral value.

Tax rate

The rate is set at regional level.

When the average annual residual value is used to calculate the tax base, the rate may not exceed 2.2%. This maximum rate is currently imposed in most regions, including Moscow and Saint Petersburg.

The tax rate in respect of property for which the tax base is calculated based on the cadastral value may not exceed 2.2%. In Moscow, the tax rate is expected to be progressively increased from 1.7% in 2020 to 2% in 2023 and subsequent years.

Payments

The tax period is a calendar year. Advance tax payments must be calculated and paid on a quarterly basis. Taxpayers must file quarterly tax returns within the 30-day period following the reporting period. Annual returns must be filed by 30 March following the reporting period.

Payroll-related levies

Taxpayers

Several kinds of payroll-related taxes must be paid by employers. This applies to Russian employers as well as to foreign companies.

Insurance contributions

Insurance contributions are paid to three separate non-budgetary funds:

the Pension Fund, the Federal Social Insurance Fund and the Federal Mandatory Medical Insurance Fund.

Since 2017, the administration and monitoring of social contributions for mandatory pension insurance, mandatory social insurance with regard to temporary disability and maternity, and mandatory medical insurance has been transferred to the tax authorities. In the 2020 calendar year, a regressive scale of insurance contributions is applicable: 22% is payable on the part of an employee's annual gross remuneration below RUB 1,292,000 (EUR 18,460) for contributions to the Pension Fund and 10% is payable on the part of any remuneration in excess of this amount; 2.9% (1.8% for foreigners and stateless persons temporary staying in Russia) is payable on the part of an employee's annual gross remuneration below RUB 912,000 (EUR 13,030) for contributions to the Federal Social Insurance Fund; and 5.1% is payable on the part of any remuneration for contributions to the Federal Mandatory Medical Insurance Fund.

However, payments and other compensation made to highly qualified foreign specialists⁶ are exempt from social contributions.

Other payroll contributions

Contributions to the Social Insurance Fund against industrial accidents and

⁶ Please see the Employment and migration chapter on page 111.

diseases are also payable. They vary from 0.2% to 8.5% of monthly salary and depend on the risk category of the employer.

Taxes on natural resources

Taxpayers who use land, either on the basis of ownership rights or rights of permanent use, have to pay **land tax** to the local budget. The tax base used for calculation is the relevant land's cadastral value (which, in practice, is significantly lower than its market value). The tax rate is set at a local level and may not exceed 1.5% of the cadastral value (0.3% in respect of certain types of land).

Water tax is imposed on taxpayers who use water to produce hydroelectricity. The tax rates vary depending on the specific water object.

Mineral resources extraction tax is imposed on subsoil users. It applies to various types of minerals, including oil and gas. It is based on the value of the extracted resources, and the rate varies according to the type of mineral.

Excess-profits tax on hydrocarbon production was introduced for oil and gas producers on 1 January 2019. This tax is aimed at shifting the tax burden to a later period in a field's life cycle. It should be paid in conjunction with the mineral resources extraction tax (under substantially reduced rate) and is applicable not to the volume of the oil and gas extracted but to the income imputed from its sale reduced by the costs related to hydrocarbon production.

Transport tax

This is a tax payable on registered transportation vehicles by the registered owners of these vehicles. The methods of declaration and payment are established by regional authorities.

The transport tax rates are generally fixed at federal level, but the regional authorities are entitled to increase/decrease these rates by a maximum of ten times. In addition, the regions have a right to set different transport tax rates depending on the categories of vehicles, their age and/or emission class.

Sales duty

The provisions on sales duty apply in the territory of Moscow.

The taxpayers of sales duty are companies and individual entrepreneurs carrying out trade activities.

The sales duty base is defined as the value of movable or immovable property used for trade purposes. The amount of the sales duty paid is generally treated as an expense deductible for corporate profits tax purposes.

The sales duty rates are set by the regional authorities depending on the areas used for trade purposes.

State duties

According to the Tax Code, a state duty is a fee charged on companies and individuals for certain services supplied by state bodies.

By way of example, the state duties for registering a Russian company currently amount to RUB 4,000 (EUR 57) and for accrediting a foreign company's branch, RUB 120,000 (EUR 1,714).

The maximum state duties for the consideration of cases by the courts of general jurisdiction and by magistrates' courts ("*mirovye sudi*") are currently RUB 60,000 (EUR 858). The equivalent maximum state duties for the commercial courts now amount to RUB 200,000 (EUR 2,860).

Taxation of individuals Income tax

Taxpayers

Taxpayers are subject to Russian income tax as either tax residents or non-residents.

Tax residents are taxed on their worldwide income. An individual is considered to be a tax resident if he/she is physically present in Russia for at least 183 calendar days during a 12-month rolling period. According to clarifications from the Russian Ministry of Finance, however, the tax residence status of an individual should be defined by counting the days spent in Russia within the relevant calendar year.

Non-residents have tax imposed on their Russian-sourced income, irrespective of the nature of that income.

Taxable income

Taxable income is gross income less deductions and exemptions.

Gross income is defined as any economic gain, in cash or in kind, received by a taxpayer and subject to his/her discretionary disposal.

Deductions and non-taxable income

A Russian tax resident can benefit from five kinds of deductions:

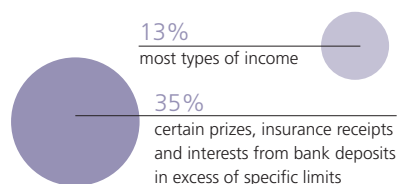
- **Standard deductions** are available for certain categories of taxpayers (disabled persons, war veterans, etc.).
- **Social deductions** are comprised of educational expenditures (per taxpayer and each of his/her children) and medical expenditures (per family), up to a combined annual maximum of RUB 120,000 (EUR 1,714).
- **Investment deductions** relate to certain types of investment income of taxpayers, such as long-term investments in pension and insurance funds.
- **Property deductions** relate to the purchase and sale of property (mainly residential real estate).
- **Professional deductions** are generally permitted for individual entrepreneurs and include, for example, expenditure for the creation of intellectual property rights.

Certain statutory allowances, bank interest (within limits), state pensions (and certain other pensions) and revalued shares (issued as a result of statutory revaluation, merger or reorganisation) are **exempt** from taxation.

Tax rates

Residents

A standard flat rate of 13% applies to most types of income.



A rate of 35% applies to certain prizes, insurance receipts and interests from bank deposits in excess of specific limits.

Non-residents

A general rate of 30% applies to all types of Russian-sourced income except dividends (to which the rate of 15% applies). It may be possible to apply the relevant provisions of a DTT in order to exempt certain types of income from non-resident taxation.



In addition, a 13% personal income tax rate applies to remuneration received from professional activities of non-residents with a highly qualified specialist status under Russian migration law.

On 1 January 2019, a tax exemption applicable to Russian tax residents who sell residential property after a certain period of ownership (the length of the period depends on the ground on which

the seller had initially gained ownership of the property) was extended to non-residents. Initially, such an exemption was applicable only to the income from the sale of immovable property acquired by such non-residents after 1 January 2016. Now it applies irrespective of the date of acquisition of the property.

Tax payments

Withholding of tax

Russian companies, individual entrepreneurs and permanent establishments of foreign companies are considered to be tax agents. They must calculate, withhold and pay income tax on the payments they make to individuals.

As a result, employees are not required to file tax returns for their salary, unless they claim property deductions or have other income which is subject to the obligation to file a tax declaration.

An individual entrepreneur remains personally responsible for meeting his/her income tax obligations.

Tax return

Individuals must file returns and pay the appropriate income tax if:

- income was received from outside Russia (in the case of a Russian tax resident);
- tax was not properly withheld; or
- income was received from the sale of property, etc.

The tax return must be filed by 30 April in the year following the tax period.

The amount of tax due must be paid by 15 July in the year following the relevant tax period. However, if the taxpayer leaves Russia, he/she must file a tax return at least one month before his/her departure and pay the amount of tax due within 15 days after the filing date.

Individual property tax

Taxpayers

The owners of houses, flats, rooms, cottages, garages, other buildings or constructions are liable to pay individual property tax.

Tax rates

The cadastral value of the property is used as a taxable base to calculate individual property tax. The applicable tax rate depends on the type of taxable property concerned.

As individual property tax is a local tax, the local government authorities are entitled to set the tax rate within prescribed statutory limits.

Special tax regimes

The Tax Code provides for the following special tax regimes according to which a corporate taxpayer is entitled to pay one special tax instead of a number of separate taxes:

- simplified tax system;
- tax on imputed income;
- unified agricultural tax; and
- production sharing.

Special regimes may be applicable if the necessary requirements are met, as outlined below.

Simplified tax system

Taxpayers

Companies are eligible for the simplified tax system if they meet the following criteria:

- their annual turnover does not exceed RUB 150m (EUR 2.1m);
- the combined net book value of their fixed and intangible assets does not exceed RUB 150m (EUR 2.1m); and
- they employ fewer than 100 persons.

The Tax Code includes a list of organisations that may not use the simplified tax regime. This includes: (i) foreign companies; (ii) Russian companies with local branches and/or representative offices; (iii) companies in which more than 25% of the capital is owned by other companies; (iv) banks; (v) insurance companies; (vi) pension funds; and (vii) investment funds.

Tax rates

The rate for this tax regime is as follows:

- 6% – if all income (without deductions) is considered to be the tax base; or
- 15% – if income (less deductible expenses) is considered to be the tax base.

The tax rate may be reduced under the relevant regional law down to 1% or 5% respectively.

The simplified tax system is used as a single substitute for profits tax, property tax and VAT unless an exception applies (such as for property whose tax base is

calculated on the basis of its cadastral value (for instance business and shopping centres, offices)). The use of this system does not exempt employers from making obligatory pension insurance contributions or from withholding income tax from their employees' compensation.

Tax on imputed income

Regional authorities have the right to impose this tax on certain categories of taxpayers (e.g. small companies).

The tax rate is 15% on "imputed" monthly revenue and is adjusted by special coefficients which are based on the type of land used, the range of goods being produced, the level of income received each month and seasonal factors. When this tax is applied, the taxpayer becomes exempt from most, but not all, taxes and contributions (for example, obligatory pension insurance contributions remain due).

Unified agricultural tax

This tax system is aimed at reducing the obligatory tax burden on taxpayers involved in agricultural production.

Taxpayers

Taxpayers producing, processing (including industrial processing) and selling agricultural products are entitled to use this tax system, provided that the share of income they receive from the sale of agricultural products is at least 70% of their overall sales income.

Tax rate

The tax rate is set by the regions of the Russian Federation in the range of 0% to 6%.

The tax is calculated as the relevant percentage of revenue less certain deductible expenses that are listed in the Tax Code and include, in particular, the following:

- expenses relating to the acquisition, construction and manufacturing of fixed assets (being allocated during the useful life term of the relevant assets);
- lease payments;
- wages costs;
- expenses connected with certain types of insurance payments (both obligatory and voluntary); and
- the cost of material.

The unified agricultural tax substitutes profits tax and property tax, and in some cases VAT (except for import VAT and VAT withheld as a tax agent, which remain due).

Production sharing

Taxpayers

This simplified tax system may be used by companies (investors) entering into production sharing agreements ("PSAs") under which they are granted an exclusive right to carry out mineral exploration and mining operations on a particular subsoil area.

PSAs provide for the sharing of profitable production between the Russian state and an investor. A part of

"compensational production" is granted to the investor to compensate them for the expenses connected with the project. In general, this does not exceed 75% of the whole amount of production or 90% when the project is implemented on the Russian continental shelf.

The production sharing tax system may be used if the relevant PSA (i) is concluded as a result of an auction; and (ii) provides that, if the project's return on investment exceeds originally agreed expectations, the Russian state's share in the profitable production will increase.

General PSA regime

If a general PSA regime is used, the main characteristics of the production sharing tax system are as follows:

- Certain expenses incurred by the investor for the purposes of performing the PSA are subject to reimbursement by "compensational production".
- VAT, taxes on natural resources, state duties, land tax and excise duties paid in connection with performing the PSA are subject to reimbursement by the state.
- Goods imported to and exported from Russia are exempt from the payment of customs duties.
- Property tax is not payable on fixed assets used solely for performing the PSA.
- Transport tax is not payable on vehicles used solely for performing the PSA.
- The relevant local or regional authority may exempt the investor

from paying any regional or local taxes.

Special PSA regime

Additional tax privileges may apply if (i) the PSA is concluded under a procedure which differs from the general procedure described above; and (ii) the share in the production taken by the Russian state is at least 32%.

Incentives

Regional incentives

Taxpayers implementing major investment projects may, in many Russian regions, benefit from tax and economic incentives fixed at regional level.

To receive beneficial status, the relevant project must meet specific criteria (for example, as a priority investment project or project of particular importance). This presupposes injecting substantial financial resources into the economy of the region and creating jobs at new production facilities.

These incentives may include:

- reduced total corporate profits tax rate to 17% (instead of 20%);
- exemption from property, land and transport taxes;
- exemption from customs duties and import VAT; and
- subsidies compensating taxes paid to the regional budgets and/or interest paid to Russian banks on loans and credits.

Special economic zones

Taxpayers can benefit from incentives granted to special economic zones (“SEZs”) which have been created to promote economic growth in specific areas and regions of Russia⁷.

The general aim of SEZs is to attract foreign investment. As SEZs are exempt from customs duties, they are an effective means of promoting import and export business. The tax advantages provided for the residents of these zones are as follows:

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

Types of SEZ

There are four types of SEZ:

- technical research and implementation zones (such as Saint Petersburg, Dubna, Tomsk, Zelenograd);
- industrial production zones (such as Lipetsk, Tatarstan, Voronezh);
- recreation and tourism zones (such as Altai, Buryat Republic, Kaliningrad); and
- port zones.

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

⁷ Federal Law No. 116-FZ “On Special Economic Zones in the Russian Federation” dated 22 July 2005.

Skolkovo innovation centre

The participants in the Skolkovo initiative (created in the Moscow Region to conduct and commercialise research and development) benefit in particular from the following tax, customs and accounting incentives:

- 0% corporate profits tax rate applicable to income generated as a result of research, development and commercialisation for the first ten years of a participant’s registration in the Skolkovo project;
- exemption from property tax and land tax;
- reduced payroll-related taxes;
- VAT exemption;
- reimbursement of customs duties and VAT payable upon the importation of goods;
- exemption from the obligation to keep financial accounting, unless the participant’s annual income exceeds RUB 1bn (EUR 14.3m); and
- exemption from the payment of state duties for the issuance of work permits, invitations and visas for foreign employees.

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

Territories of advanced social and economic development

Taxpayers can benefit from specific incentives granted to residents of territories of advanced social and

economic development (“TASEDs”) created to boost the development of the economy and attract foreign investment in those territories. Each TASED is established by a Decree of the Russian Government.

There are 19 TASEDs located in the Far East of Russia (e.g. Kamchatka, Khabarovsk) and in Yakutia (in the industrial park Kangalassy). To obtain the TASED resident status, legal entities and individual entrepreneurs must conclude an investment agreement with the regional authorities.

In 2019, new TASEDs were created in certain Russian regions including the Nizhny Novgorod, Samara, Sverdlovsk, Kurgan, Orenburg and Tomsk Regions.

TASED residents have a right to apply reduced corporate profits tax rate subject to conditions stipulated by the Tax Code and applicable regional regulations.

Free port of Vladivostok

The legislation on the free port of Vladivostok (created for a renewable term expiring in 2085) allows legal entities and individuals having obtained the resident status to benefit from certain tax, customs and administrative benefits and incentives.

In order to obtain such resident status, the applicant must fulfil the following criteria:

- implementing a new investment project; and

- investing an amount of at least RUB 5m (EUR 71,500) in the project's implementation (in the form of capital expenditures) within a period not exceeding three years as from the date when the investor obtained the resident status.

Legal entities or individual entrepreneurs satisfying the above conditions must (i) apply to the management company of the free port of Vladivostok (by submitting a set of supporting documents including, notably, the business plan of the investment project); and (ii) conclude an agreement on the conduct of the investment activity with the management company.

Incentives and benefits granted to the residents of the free port of Vladivostok include the following:

- **tax:** corporate profits tax at 0% (for a five-year period starting from the date on which the profits from activities in the free port were obtained) or 10% (for subsequent periods), a simplified system of VAT refund and reduced rates of social contributions (in cases when the resident is subject to the general taxation regime and its proceeds from business activities in the free port constitute at least 90% of the total amount of its proceeds);
- **customs:** possibility of benefiting from the customs regime of free customs zone;
- **migration:** a simplified procedure of entry into Russia for foreigners employed by the residents of the free port of Vladivostok.

DTTs

General remarks

DTTs exist between many countries on a bilateral basis in order to prevent double taxation, i.e. taxation which is levied twice on the same income, profit, capital gain, inheritance or other item. The treaties generally guarantee non-discriminatory tax treatment and provide for cooperation between the tax authorities of the respective signatory countries.

Tax treaties signed by Russia are usually based on the OECD Model Treaty and the United Nations Model Convention. The provisions of these treaties override Russian domestic law.

The table on page 71 contains the tax rates applicable under several DTTs to which Russia is a signatory. The rates apply to withholding taxes on Russian sourced income. The numbers in brackets refer to the notes below the table.

Foreign companies wishing to obtain benefits under DTTs must provide Russian tax agents with a statement on beneficial ownership and a tax residency certificate. The look-through approach can be applicable to the payment of passive income in any forms (dividends, royalties or interest).

Recent developments

In 2019, amendments to DTTs with Austria and Sweden were ratified. These DTTs contain special provisions that limit tax benefits for taxpayers if they have tax evasion or avoidance objectives.

Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (the "MLI")

The MLI is an OECD convention that updates DTTs to counteract tax avoidance and attempts by taxpayers to receive unjustified tax benefits.

As of 1 October 2019, amendments to local tax legislation required by the MLI that Russia signed in 2017 came into force. However, some internal formalities have not been finalised. Therefore, the MLI's implementation has been delayed until approximately 2021.

Currently, the MLI has been ratified by 20 states (including Australia, Austria, Belgium, the United Kingdom, Luxembourg, the Netherlands, the United Arab Emirates, Singapore, Finland and France) whose DTTs with Russia are adjusted by the MLI, but the amended versions will reportedly come into force in 2021. It is planned that upon final ratification of the MLI, Russia will extend this to DTTs with more than 70 states.

Mutual agreement procedure (the "MAP")

In 2019, the Tax Code was amended in line with the minimum standard of the dispute resolution mechanism proposed by the OECD.

The MAP is now in place to resolve disputes on taxation of income, profits and property of the person under the applicable DTT.

Specific aspects of the MAP depend on the other state involved in the dispute with Russia. They should be determined with reference to the provisions of the relevant DTT.



Russian tax authorities continue to tighten control over the activities of multinational groups of companies as well as Russian corporate taxpayers that carry out foreign trade transactions. In particular, the requirements for transfer pricing have been significantly amended and strengthened.



Country	Dividends	Interest	Royalties
Austria	5 or 15% ⁽¹⁾	0%	0%
Belgium	10%	0 or 10% ⁽²⁾	0%
Canada	10 or 15% ⁽³⁾	10%	0 or 10% ⁽⁴⁾
China	5 or 10% ⁽⁵⁾	0%	6%
Cyprus	5 or 10% ⁽⁶⁾	0%	0%
France	5, 10 or 15% ⁽⁷⁾	0%	0%
Germany	5 or 15% ⁽⁸⁾	0%	0%
Hong Kong	5 or 10% ⁽⁹⁾	0%	3%
Ireland	10%	0%	0%
Italy	5 or 10% ⁽¹⁰⁾	10%	0%
Japan	5 or 10% ⁽¹¹⁾	10%	0%
Korea (South)	5 or 10% ⁽¹²⁾	0%	5%
Luxembourg	5 or 15% ⁽¹³⁾	0%	0%
Netherlands	5 or 15% ⁽¹⁴⁾	0%	0%
Singapore	0,5 or 10% ⁽¹⁵⁾	0%	5%
Spain	5, 10 or 15% ⁽¹⁶⁾	0 or 5% ⁽¹⁷⁾	5%
Switzerland	5 or 15% ⁽¹⁸⁾	0%	0%
Ukraine	5 or 15% ⁽¹⁹⁾	10%	10%
UK	10%	0%	0%
USA	5 or 10% ⁽²⁰⁾	0%	0%

Notes:

⁽¹⁾ 5% for shareholdings of 10% or more, otherwise 15%;

⁽²⁾ 0% for bank loans or loans granted (or guaranteed) by a contracting state, otherwise 10%;

⁽³⁾ 10% for shareholdings of 10% or more, otherwise 15%;

⁽⁴⁾ 0% for (i) copyright royalties and other like payments in respect of the production or reproduction of any literary, dramatic, musical or other artistic work; (ii) royalties for the use of computer software; or (iii) royalties for the use of patents where the payer and the beneficial owner of the royalties are not related persons, otherwise 10%;

⁽⁵⁾ 5% for shareholdings of 25% or more, provided the investment is at least EUR 80,000, otherwise 10%;

⁽⁶⁾ 5% if the initial investment is greater than EUR 100,000, otherwise 10%;

(7) 5% if the investment is not less than EUR 76,225 and if the recipient pays tax; 10% if only one of these two circumstances applies; otherwise 15%;

(8) 5% for shareholdings of 10% or more, provided the investment is at least EUR 80,000, otherwise 15%;

(9) 5% for shareholdings of 15% or more, otherwise 10%;

(10) 5% for shareholdings of 10% or more, provided the investment is at least USD 100,000, otherwise 10%;

(11) 5% for shareholdings of 15% held for more than 365 days, otherwise 10%;

(12) 5% for shareholdings of 30% or more, provided the investment is at least USD 100,000, otherwise 10%;

(13) 5% for shareholdings of 10% or more, provided the investment is at least EUR 80,000, otherwise 15%;

(14) 5% for shareholdings of 25% or more, provided the investment is at least EUR 75,000, otherwise 15%;

(15) 0% for government and state institutions, 5% for shareholdings of 15% or more, otherwise 10%;

(16) 5% for shareholdings of at least EUR 100,000 and if the dividends are exempt from tax; 10% if either condition is met; otherwise 15%;

(17) 0% if the actual recipient of interest is the government of the other contracting state, or for long-term bank loans (exceeding seven years); otherwise 5%;

(18) 5% for shareholdings of 20% or more, if the investment is at least CHF 200,000; otherwise 15%;

(19) 5% for shareholdings of at least USD 50,000; otherwise 15%; and

(20) 5% for shareholdings of 10% or more, otherwise 10%.

Customs regulations

General approach

Russia is a member of the Eurasian Economic Union (the “**EEU**”) of Armenia, Belarus, Kazakhstan, Kyrgyzstan and Russia, and the World Trade Organisation (the “**WTO**”).

Customs are regulated by the new Customs Code of the EEU (the “**EEU Customs Code**”) that came into force on 1 January 2018, together with Federal Law No. 289 dated 28 November 2018 “On Customs Regulation in the Russian Federation”. This law is aimed at perfecting the manner in which the authorities handle customs matters, simplifying customs procedures and clarifying the rights of importers and exporters.

The first stage of the creation of the EEU was the establishment of the Customs Union which resulted in the creation of a single customs territory between the founding states (Belarus, Kazakhstan and Russia). Following that achievement, the member states continued their phased economic integration by forming the Single Economic Space, which was technically established on 1 January 2012. The integration process was completed by the signing of the Treaty on the Establishment of the EEU, which came into force on 1 January 2015, and the EEU superseded the Eurasian

Economic Community (the previous integration stage). Ultimately, the EEU will result in the creation of a common market allowing the free circulation of goods, services, capital and labour between its member states. Another aim of the EEU is the adoption of unified policies with respect to competition and natural monopolies. The scope of matters regulated at the EEU level is expanding and includes key aspects, such as a unified competition law, the free movement of capital and labour, a macroeconomic policy.

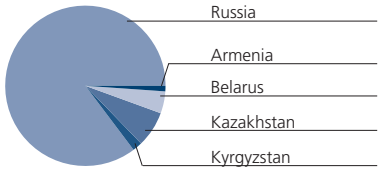
The customs borders of the EEU also gradually expanded. Armenia joined the EEU at the end of 2014, while Kyrgyzstan joined the EEU in 2015. Currently, Syria and Tunisia are in the list of potential member states.

The EEU actively engaged in negotiations on the creation of a free commerce regime with China, India and Turkey. In 2018, a temporary agreement on the creation of a free commerce custom zone between the EEU and Iran was ratified.

Customs regulation in the EEU Key features

- Communications with the customs authorities are gradually moving to online and electronic formats.

- Customs control has been moved from the borders between the member states of the EEU to the outside borders of the EEU. As a result, customs, veterinary, sanitary and border control are all performed at the outside borders of the EEU.
- Import duties are payable to a special accumulation account and are allocated between the members of the EEU according to the following proportion: Armenia – 1.22%; Belarus – 4.56%; Kazakhstan – 7.06%; Kyrgyzstan – 1.9%; and Russia – 85.27%.



- Joint inspections by the customs authorities of the EEU member states (such as transport, vehicular control on the outside border of the EEU and sampling of goods for obligatory veterinary control) are made on a “single window – one stop” clearance basis to accelerate border crossings.
- No obligatory customs-clearance procedures exist between the member states.
- Customs duties and other economic restrictions do not apply to trade between the EEU members, with the exception of special protective, anti-dumping and compensatory measures.

- Each member of the EEU is obliged to use a unified nomenclature of goods and non-tariff regulatory measures for trade with non-member states.
- Customs duty rates with respect to export to non-EEU countries are indicated in the laws of the respective exporting state. Export duties are paid to the budget of the country of production and are not allocated between the EEU members.
- 0% value-added tax (“VAT”) is charged on goods exported within the EEU territory. Goods imported within the EEU territory are exempted from excise duties and indirect taxation.
- Customs authorities may challenge the declared customs value for customs clearance for a period of up to three years following the goods’ release. For certain types of goods, this term may be extended up to five years by internal legislation.
- There is a unified register for items of intellectual property registered in the territory of the EEU.
- Authorised economic operators (“AEOs”) are in operation and provide simplified customs clearance procedures. They are permitted to store goods at their own warehouses and release them into free circulation before submitting a customs declaration. To carry on such an activity, a legal entity must obtain a special status of AEO under the national legislation of each member state of the EEU.

- Statistical databases for streamlining the control and analytical functions of the customs authorities, as well as enabling the exchange of information between the EEU member states are in place.

Recent developments of the EEU’s customs regulation

The EEU Customs Code, which came into force on 1 January 2018, was developed in close cooperation with business representatives. It encompasses a large number of changes in the customs legislation that should significantly improve the business climate in the territory of the EEU member states.

The main changes introduced by the new EEU Customs Code are as follows:

- Customs declarations must be provided in electronic form, and they no longer need to be accompanied by supporting documentation. Declarations in paper form are carried out in exceptional cases. In Russia, the registration procedure for declarations of goods submitted electronically is regulated by Order No. 150 of the Ministry of Finance dated 20 September 2019.
- Automatic release of goods is now possible using systems that contain all pertinent information relating to the goods.
- The period for the release of goods under the new EEU Customs Code has been reduced to a maximum of four hours. Formerly, the period of release of goods under the Customs Code of the Customs Union was

- one working day.
- The level of red tape has been significantly reduced. Notably, the customs authorities are not entitled to request documents that have already been provided.
- Alternative methods for determining the cost of goods if the “actual cost” is not readily determinable are used.
- AEOs have been introduced for companies carrying out import/export activities that enjoy a high level of trust from the customs authorities.

In addition to the EEU Customs Code, 25 decisions of the Eurasian Economic Commission¹ that regulate other issues of customs regulation came into force on 1 January 2019.

Due to the “de-offshorisation” trend, special simplified procedures for AEOs importing goods from, or paying for imported goods through, territories listed as offshore territories by the Ministry of Finance were revoked.

The customs internal risk management system was extended to cover operations with residents of offshore territories and operations potentially related to the non-repatriation of currency by Russian residents.

EEU member states are working on the unification of their currency control and anti-monopoly legislation and are aiming

¹ A supranational body comprising of representatives of the EEU member states.

to adopt principles which unify the currency control policy within the EEU.

EEU member states are working on improving customs valuation methods. The **requirement** to prove the absence of interdependence between the declarant and its supplier when determining the customs value of goods has been replaced by the **right** to do so.

Significant changes have also been introduced to the law “On Customs Regulation in the Russian Federation”:

- The customs authorities are obliged to make a “preliminary decision” on the customs value, if so requested. A preliminary decision can be requested by a customs declarant or its representative.
- Since 1 January 2018, customs payments can be made by a third party on behalf of a customs declarant.
- The timeframes for carrying out customs audits and expert reviews, as well as for appeals in relation to the correction of declarations, have been set.
- It is now possible to defer customs payments by up to one month.
- The amount to be paid by export customs representatives as a security for the settlement of customs payments has been reduced.

On 26 November 2019, the Plenum of the Russian Supreme Court issued Resolution No. 49 aimed at aligning and streamlining the application of EEU customs legislation. The Supreme Court

recommends that the courts and customs authorities adopt a unified approach when determining the value and classification of goods. In particular:

- It should be presumed that any information that a customs declarant provides to the customs authorities as part of customs control is reliable.
- If the prices of imported goods significantly differ from prices attributed to the same or similar goods in the special database of the customs authorities, this may indicate that the declarant has improperly determined the customs value.
- If the declarant fails to confirm the goods’ customs value, this can trigger customs control. However, this should not in itself evidence that the declarant incorrectly determined the customs value.
- The decisions adopted by the Eurasian Economic Commission on the classification of goods cannot be applied retroactively if this will result in an additional customs charge.

On 29 May 2019, EEU members entered into an “Agreement on a Traceability Mechanism of Goods Imported into the EEU”. Russia ratified this agreement, but national legislation needs to be amended accordingly. These amendments are expected to be finalised in 2020.

The traceability system will apply to individual entrepreneurs and companies that conduct operations with goods subject to traceability. It will allow access to information on a product throughout its life cycle.

The list of goods subject to this system in Russia was approved by Russian Government Decree No. 807 dated 25 June 2019. This list includes, amongst others, certain household and electronic appliances, as well as industrial trucks.

The implementation of this system is expected to improve control over operations related to the circulation of goods and exclude the possibility for customs and tax evasion within the EEU.

WTO

After many years of negotiations, Russia finally signed the Protocol on Accession to the WTO on 16 December 2011. Accession took place in the summer of 2012 and is expected, given time, to result in significant changes to the Russian trade market, in particular due to:

- the decrease of the average weighted customs tariff rate for the import of goods to the Russian territory from 10% to 7.8% (for industrial goods from 9.4% to 6.4%, for agricultural products from 13.2% to 10.8%); and
- the lifting of certain restrictions on foreign ownership in specific sectors such as telecoms, insurance and banking.

Various transitional periods were established with respect to certain goods, industries and services.

The longest transitional period has been set for insurance and banking services. Foreign companies will be allowed to establish Russian branches in 2021.

The maximum foreign participation in Russian banks is 50%.

Furthermore, the accession to the WTO Government Procurement Agreements, which was originally envisaged, did not materialise. Thus, Russia has reserved a right to limit access to public procurement to foreign goods and services.

Trade between EEU and non-EEU countries

Overall, there are 17 types of customs procedures, including the import and export procedures established by the EEU Customs Code. Below, we give a brief description of the most commonly used customs procedures and an overview of the general features of importing and exporting.

Most commonly used customs procedures

Release for internal consumption
Importation of goods for internal consumption is a procedure which provides for the foreign goods placed under it to be located and used on the customs territory of the EEU without restrictions as to their use and disposal, provided that all applicable customs duties and taxes have been paid.

Customs transit
Customs transit is a procedure under which goods are transported for a specified period², under the control of -----

² Customs transit may not last longer than a period determined in accordance with the following formula: 2,000km per month from the point of crossing of the EEU border.

the customs authorities, over the customs territory of the EEU without taxes, customs or other kinds of duties (special, compensatory and anti-dumping) being paid. Under this procedure, prohibitions and restrictions can apply.

Customs warehouse

Customs warehouse is a procedure under which foreign goods are stored at a customs warehouse for a specified period without taxes, customs or other kinds of duties (special, compensatory and anti-dumping) being paid.

Goods may not be under the customs warehouse regime for a period exceeding three years, with an option to extend this period with the permission of the customs authorities. Goods with a limited useful life and/or sale duration must be assigned to other customs regimes and shipped from the customs warehouse at least 180 days prior to the expiration of such period.

Temporary import

Temporary import is a procedure under which foreign goods are temporarily located and used on the territory of the EEU with a conditional customs duties exemption.

The customs exemption can be full or partial and depends on the type of imported goods.

As a general rule, goods may not be under the temporary import regime for a period exceeding two years, with an

option to complete this regime before the expiry of the two-year period by switching to another customs procedure.

**Importing
Declaring procedures**

Under the EEU Customs Code, declaration procedures must be completed in the country where the importing company is registered. Therefore, when importing goods to Russia (or to the customs territory of the EEU) a Russian-based company must fulfil customs clearance formalities for imported goods at an appropriate customs office in Russia.

In addition, when imported goods cross the customs border of the EEU in Armenia, Belarus, Kazakhstan or Kyrgyzstan, a border post at the relevant country must fulfil the procedure for the internal customs transit of the imported goods to the destination point within Russia, i.e. to the customs point where the imported goods will be cleared.

Customs payments (VAT, customs and excise duties)

When goods are imported into the EEU from non-EEU countries, customs payments are made (i) on the territory of the member state whose customs authorities release the goods; and (ii) in the currency of that member state.

The forms and the timeframes for customs payment are determined by the legislation of the respective member

state. For instance, under Russian law, customs payments for goods imported into Russia must be made before the customs declaration is submitted to the Russian customs authorities.

VAT, customs duties and excise duties must be paid by separate payment orders. VAT and excise duties are to be paid to the Russian budget, whilst customs duties are transferred to a special accumulation account.

Customs value

The customs value of goods imported into the EEU is determined by Chapter 5 of the EEU Customs Code and by default consists of the price of the goods as well as royalty, insurance and transportation expenses.

To minimise the risk of miscalculating the customs value, importers can use the option to obtain a ruling on the applicable custom value methodology from the customs authorities.

In addition, when the imported goods are designed for release for internal consumption and their value is unknown upon import, the importer can apply the deferred customs value regime. This means that a preliminary customs value will be defined preliminarily by the declarant upon import, and the difference, if any, will be paid after the release of the goods.

The Russian customs authorities often try to challenge the customs value of the goods. When they increase the

customs value, this may be contested in court.

Import duties

The EEU member states are obliged to apply the common customs tariff and unified nomenclature of goods to goods imported into the EEU and to the customs value of such goods.

Tariff privileges

Certain goods imported into the EEU may be subject to tariff privileges, such as exemptions from, or reductions in, import duties.

Tariff preferences

Goods originating from developing countries and the least developed countries fall within the unified system of tariff preferences of the EEU.

The list of such goods is set by the Eurasian Economic Commission.

Non-tariff restrictions

Before a Russian-based company imports goods into the EEU, it is obliged to review its compliance with any existing limitations to the importation of certain goods to Russia (e.g. quotas, special protective, anti-dumping and compensatory measures) and obtain all necessary authorisations and licences.

In connection with non-tariff regulation, the basic trend has been to specify and facilitate the registration procedure, in particular for declaration and certification. The aim is to provide for one non-tariff restriction for conformity confirmation

(registration, declaration or certification) for each product at the EEU level.

Restrictions on the import of certain goods

The importation into Russia of certain agricultural products, raw materials and foodstuffs which originate from the USA, the EU, Canada, Australia, Norway, Ukraine, Albania, Montenegro, Iceland, Liechtenstein and Turkey is prohibited until 31 December 2020³. The end date of the food embargo has, however, been consistently postponed.

To ensure the fulfilment of the above restrictions, “sanctioned products” imported into Russia will be destroyed.

**Exporting
Declaring procedures**

When goods are exported from Russia to countries outside the EEU, Russian-based companies must fulfil their customs clearance formalities for exported goods at an appropriate customs office within Russia.

Any goods being exported will need to comply with the relevant customs procedures. When the goods leave the customs territory of the EEU, the customs authorities located on the border of the EEU make corresponding notes on the export customs declaration.

Customs value

The customs value of goods exported from the EEU by a Russian-based company is determined under the internal legislation of the Russian

Federation and consists of the cost of the goods as well as royalty, insurance and transportation expenses.

The Russian customs authorities often try to challenge the customs value of the goods. When they increase the customs value, this may be contested in court.

Export customs duties and payment

Export duties are to be paid to the country from which the goods originated. Export customs duties are set by the Russian Federation as there is no unified list of export customs duties for the EEU.

Non-tariff restrictions

The member states are intending to unify the non-tariff regulation measures taken with regard to non-EEU countries. These include special protective, compensatory and anti-dumping measures, as well as sanitary and veterinary measures.

Some measures of non-tariff regulation may be introduced in the form of quantitative restrictions or as an exclusive right to export and/or import certain types of goods, which require a licence to be granted by the competent authorities of the member state.

The Eurasian Economic Commission is responsible for taking decisions on introducing, applying and cancelling measures of non-tariff regulation.

³ Please see the Import substitution and production localisation in Russia chapter on page 190.

VAT

Goods exported to non-EEU countries from Russia are subject to a 0% VAT rate and are exempt from excise duties, provided that the export of goods is properly documented. The following documents must be submitted in order to claim the 0% VAT rate:

- the contract for the exportation of goods;
- a customs declaration stamped by the customs authorities confirming that the goods were exported out of Russia;
- copies of transferring documentation (invoice, transfer and acceptance act, VAT invoice or “*shchet-faktura*”).

The above documents must be submitted to the tax authorities within 180 days after the export of the goods, failing which the taxpayer loses the right to apply the 0% VAT rate on exports and must apply the general VAT rate (10% or 20%).

Since 1 January 2018, companies selling goods for export can waive the right to apply the 0% VAT rate.

Further, starting from 2018, the opportunity to apply the 0% VAT rate has been introduced when selling imported goods for re-export when closing the customs procedure for processing on the customs territory of the EEU.

Recycling and environmental fees

The recycling fee must be paid for each wheeled or self-propelled vehicle imported into the Russian Federation.

The procedures and amounts of the recycling fee are established under Government Decree No. 1291 dated 26 December 2013 and Government Decree No. 81 dated 6 February 2016. Certain categories of imported wheeled vehicles are exempt from the recycling fee, namely:

- personal vehicles of refugees or persons under the programme of resettlement of fellow citizens;
- vehicles of diplomatic and consular missions, international organisations; and
- vehicles which were manufactured 30 or more years ago, which are not intended for commercial passenger and cargo carriage, or retro-vehicles.

Importers of goods that are subject to recycling once they have lost their consumption properties must pay an environmental fee⁴.

**Mutual trade between the EEU members
Free circulation of goods
Declaring procedures and customs duties**

As the territories of the member states of the EEU form a common customs territory, there are no customs offices or customs declaration procedures between them.

Customs duties are not applicable to reciprocal trade between the member states.

⁴ Please see the Environmental fees relating to emissions, discharges and waste management section on page 204.

Non-tariff restrictions

No restrictions of an economic nature are applicable to mutual trade between the member states, except for special protective, anti-dumping and compensatory measures.

**Indirect taxation within the EEU
Exporting goods**

Goods exported within the EEU (from a member state to another member state) are subject to a 0% VAT rate and are exempt from excise duties provided that the export of the goods is properly documented.

Importing goods

Goods imported from the territory of one EEU member state to the territory of another EEU member state are subject to indirect taxes (VAT and excise duties) in the importing state.

The indirect taxes paid on imported goods are subject to deductions in accordance with the legislation of the importing state.

Indirect tax rates, which are applicable to goods imported from the territory of one member state in the territory of another member state, must not exceed those applied to similar domestic goods.

Works and services

Works and services are subject to VAT in that EEU member state which is regarded as the place of provision of the services or performance of the works. For example:

- works/services related to immovable or movable property are subject to VAT in the state where this property is located;
- services in the spheres of culture, art, education, physical training, tourism, recreation and sports are subject to VAT in the country where the respective recreational, tourist, sport, etc. facilities are located; and
- consulting, legal, accounting, auditor, designer, marketing, research and development and some other types of services are subject to VAT in the state where the purchaser of these services is located.

In other cases not mentioned above, works and services are subject to VAT in the state where the provider of the services is located.

The tax base, rates, collection procedures and tax concessions vary from one member state to another.

» The operation of the Customs Code of the EEU will result in the creation of a common market allowing the free circulation of goods, services, capital and labour between its member states.

This Code allows companies that carry out import/export activities to minimise their risks. It also simplifies administrative procedures and makes company operations more transparent for customs control purposes.



Currency control

General approach

Most currency restrictions in Russia were removed in January 2007, following amendments to Federal Law No. 173-FZ “On Currency Regulation and Currency Control” dated 10 December 2003 (the “**Currency Control Law**”), which regulates currency transactions. Consequently, most currency transactions can be conducted without limitation.

However, the Currency Control Law, and related regulations, still contain a number of restrictions which should be taken into consideration (i) when dealing with transactions between residents and non-residents (in particular when importing and exporting goods and capital); and (ii) when importing and exporting foreign currency in cash.

Foreign currency transactions between residents

The following persons are considered to be “residents” for the purposes of the Currency Control Law:

- citizens of the Russian Federation;
- foreign nationals and stateless individuals who live permanently in Russia on the basis of a residence permit;
- legal entities duly registered under Russian law, including professional participants of international

- economic activity included in the relevant list approved by the Government of the Russian Federation and the Central Bank of Russia (with the exception of so-called “international companies”¹);
- branches and representative offices of Russian legal entities located outside the Russian Federation;
- diplomatic representatives, consular offices and other official representatives, permanent representative offices at the international organisations and some other official representative offices of the Russian Federation and its bodies; and
- the Government of the Russian Federation, regions and municipal units of the Russian Federation.

Generally, foreign currency operations between residents are prohibited, although there are some exceptions.

¹ As a part of an ongoing campaign on the “de-offshorisation” of the Russian economy, Federal Law No. 290-FZ “On International Companies” dated 3 August 2018 permitted foreign legal entities to change their place of incorporation to Russia and obtain the status of an “international company” (by becoming a participant in special administrative areas located on the Russky and Oktyabrsky Islands). These international companies enjoy some tax benefits (please see the Tax system chapter on page 55) and are considered to be non-residents for currency control purposes.

For example, residents may borrow from, and then repay to, Russian authorised banks² in a foreign currency. Contracts in Russia may be concluded with reference to foreign currencies. However, the actual payment must be made in roubles. This can lead to exchange rate differentials which may arise between the date the transaction is entered into and the payment date.

As a result of amendments made to the Currency Control Law in 2013, certain transfers of foreign currency and roubles are deemed to be currency operations, with the effect that certain limitations exist for residents when transferring funds from their accounts, whether held in Russia or abroad, to either accounts they hold abroad or to those held by third parties.

In addition, certain residents of the Russian Federation have been prohibited from opening accounts abroad, holding currency or valuables in foreign banks or entering into transactions with foreign financial instruments. This prohibition applies to individuals holding the highest state (federal and regional) or municipal official positions (such as the President of the Russian Federation, members of the Government, ministers, members of legislative bodies and of the highest courts), their spouses and minor children (also known as “politically exposed persons” or “PEPs”).

Foreign currency transactions between non-residents

The following persons are considered

to be “non-residents” for the purposes of the Currency Control Law:

- foreign nationals who do not qualify as residents;
- legal entities and all other organisations that are registered under the legislation of a foreign jurisdiction and located outside the Russian Federation;
- Russia-located representative offices and branches of legal entities or other organisations registered under the legislation of a foreign jurisdiction and located outside the Russian Federation;
- diplomatic representatives, consular offices and other official representatives of foreign countries, as well as international and intergovernmental organisations that are located in the Russian Federation; and
- legal entities having the status of an “international company”.

Payments in any currency are permitted without restriction between non-residents, provided that any such payments in Russian roubles within Russia are made to and from those non-residents’ accounts opened with Russian authorised banks. Payments in cash may not exceed RUB 100,000 (EUR 1,430) or the equivalent in a foreign currency.

₹ RUB 70 = EUR 1 *notional exchange rate used for convenience

² Credit institutions established under Russian law and authorised on the basis of the licences issued by the Central Bank of Russia to conduct operations in a foreign currency.

Settlement under rouble transactions for sale of securities between non-residents is also permitted, although it can be subject to Russian securities market, anti-monopoly and other regulations.

Foreign currency transactions between residents and non-residents

Foreign currency transactions between residents and non-residents are also generally permitted subject to a few specific restrictions.

Registration of foreign trade contracts

Pursuant to Instruction No. 181-I of the Central Bank of Russia (the “**Instruction**”), since 1 March 2018, the requirement to open a transaction passport documenting any foreign currency transaction between a resident and a non-resident has been abolished. Instead, Russian authorised banks are now required to generate data on foreign trade transactions of residents (in any foreign currency or in roubles) and of non-residents (in roubles), by registering contracts in respect of such transactions. The list of such transactions is formalised in the Instruction and includes, among others, currency conversion operations of both residents and non-residents and cross-border transactions between residents and non-residents. Transaction passports in place as of 1 March 2018 are considered closed and are stored in a currency control file with the relevant bank.

- Any contract must be registered if its value is equal to or exceeds the equivalent of:
- for import contracts or facility agreements – RUB 3m (EUR 42,900); and
 - for export contracts – RUB 6m (EUR 85,800).

In order to register an **export contract**, the resident-exporter must submit to the Russian authorised bank:

- information on the export contract sufficient for its registration (including type, number, currency, date of the contract, value and date of performance of the obligations, as well as the details of the non-resident counterparty); or
- the export contract itself (or an extract from it containing sufficient information for its registration).

For the purposes of registration, a resident-importer or a resident who is a party to a **facility agreement** must provide the relevant import contract or facility agreement (or an extract from the relevant contract) to the Russian authorised bank.

The bank must register the foreign trade contract or facility agreement not later than the next business day after the submission of the specified documents and must assign a unique number to the relevant contract.

Repatriation of proceeds
As a general rule, residents must repatriate roubles and foreign currency

received from international trade and commercial activities to their bank accounts held with Russian authorised banks. Among the exceptions are payments due to a non-resident lender. These payments may be directly transferred into the lender’s foreign bank account. The bank must also inform the resident of the number assigned to the contract.

However, when giving a loan to a non-resident, a resident lender must ensure that the non-resident borrower repays the amounts due under the loan agreement to the lender’s Russian bank account within the time limit specified in the loan agreement. This rule does not apply if the parties can set off their mutual claims provided that a counterclaim of the non-resident results from a loan agreement where the funds were credited to the resident’s Russian bank account.

In addition, amendments to the Currency Control Law adopted in August 2019 abolished the repatriation requirement in relation to contracts between residents and non-residents, provided that such contracts are denominated in roubles and also envisage payments in roubles. This means that rouble proceeds due to a resident under such contracts can be credited to that resident’s account opened in a foreign bank. The abolition of the repatriation requirement in respect of such contracts is effective from 1 January 2020³, with the exception of supply contracts in relation to certain categories of goods⁴, to which the

abolition of the repatriation requirement will be applied gradually⁵. However, this abolition does not affect (i) the repatriation in relation to proceeds under loan agreements between residents and non-residents; and (ii) the repatriation required when the pre-paid funds must be returned to a resident because the relevant goods, services or IP rights were not delivered or provided by a non-resident.

In May 2014, the Russian Government decided to implement a requirement that a portion of export proceeds must be received by Russian companies in roubles. The Currency Control Law was amended to provide that the Government may determine (i) the portion of the export proceeds that must be received by the residents in roubles; (ii) a list of goods and services to which such requirement applies; and (iii) a list of countries, with residents of which a Russian resident will be obliged to enter into an export operation with such mandatory rouble part payment. For the time being, there is no information indicating whether the Russian Government is intending to prepare these lists or when it expects to do so.

³ Except for supply of wood, charcoal and related goods.
⁴ The list includes, among others, oil products, mineral fuels, copper and nickel. The list should be checked on a case-by-case basis.
⁵ From 1 January 2020, only 10% of proceeds will be exempt from the repatriation requirements. This percentage will gradually be increased on an annual basis and reach 100% on 1 January 2024.

Import and export of foreign currency in cash

Residents and non-residents can import and export foreign currency in cash subject to the following rules, established by the Customs Code of the Eurasian Economic Union, which came into force on 1 January 2018:

Up to USD 10,000 inclusive	No restriction
Over USD 10,000	Subject to a written customs declaration

Consequences of breach / Penalties

Generally, as currency control agents, Russian authorised banks are under a duty to monitor compliance with currency control rules as far as transactions involving their accounts are concerned.

Breaching the currency control rules can result in administrative and criminal sanctions.

The Russian Code on Administrative Offences provides for administrative fines for illegal currency transactions that can range from 75% to 100% of the value of the relevant transaction and up to RUB 30,000 (EUR 429) for company officials.

In addition, this Code prescribes fines for failing to:

- notify the tax authorities when opening or changing details of accounts held with banks located outside Russia;
- comply with the time periods and/or

- form of notification required when opening or changing details of accounts in banks located outside Russia;
- repatriate funds to accounts held in Russia in due time where required by law;
- comply with the requirement to ensure that a designated portion of export proceeds has been received by Russian companies in roubles⁶; and
- comply with rules for providing information or documents in relation to currency operations.

Breaches of these rules can result in penalties of up to RUB 20,000 (EUR 286) for individuals, up to RUB 50,000 (EUR 715) for company officials, up to RUB 1m (EUR 14,300) for legal entities and, in certain cases, fines ranging from 75% to 100% of the value of the relevant transaction. Repeated violation of the rules by company officials may result in disqualification from holding office in the management body or the board of directors (supervisory board) of a legal entity and otherwise managing a legal entity for up to three years.

More serious criminal sanctions may apply under the Russian Criminal Code. In particular, it stipulates that persons failing to repatriate foreign currency over RUB 45m (EUR 643,500) to accounts in Russia, where required by law, may face imprisonment for a term of up to five years with a fine up to RUB 1m (EUR 14,300) or without it.

⁶ Currently – 0%.

Russian authorised banks are under a duty to monitor compliance with currency control rules as far as transactions involving their accounts are concerned.



Lending in Russia

We set out below a brief discussion on certain matters related to lending to companies in Russia, by banks and other companies, with particular focus on foreign currency and secured lending.

Lending documents and governing law

Principles of contract law in Russia are generally flexible, giving parties the freedom to negotiate the terms of credit agreements to suit their commercial needs and requirements. In addition, under Russian conflict of laws rules, the parties to a credit agreement may generally choose a relevant foreign law as the governing law of the agreement, provided it involves a foreign element. It is usual for cross-border credit agreements to be governed by the law of a foreign jurisdiction more commonly used in an international business setting, for example English law or the law of the lending entity.

Nevertheless, each case should be carefully analysed to determine if there are particular enforceability issues that may arise. Care should also be taken in selecting the forum in which disputes may be heard, to ensure enforceability in Russia or abroad, as the case may require.

Jurisdiction

There are few jurisdictions with which Russia has an agreement for reciprocal enforcement of court judgments, or in relation to which a principle of reciprocity may apply. However, Russia is a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, and an arbitral award obtained in another signatory jurisdiction should be enforceable by a Russian court. For this reason, it is common to provide for the jurisdiction of international arbitration in credit agreements, although consideration of the jurisdiction of foreign courts may still be relevant, in particular if the Russian obligor has assets abroad. Moreover, according to recent case law, Russian courts quite consistently recognise and enforce judgments made in the United Kingdom.

In doing so, the Russian courts usually refer to the principles of international comity and reciprocity and confirm that, to the extent Russian judgments are recognised and enforced in the United Kingdom, UK judgments should also be recognised and enforced in Russia.

There used to be a practice in Russia under which a loan agreement governed by a foreign law would provide for a so-called “optional arbitration clause”.

Such clauses provide one party (usually the lender) with the exclusive right to bring a claim either in arbitration or in court, while the other party’s (borrower’s) right is limited to arbitration. In line with case law, such an optional arbitration clause may be interpreted by the Russian courts as giving the borrower the right to bring a claim in court so that both parties enjoy the same rights. Therefore, the current prevailing practice is to use international arbitration as the only option in foreign law governed loan agreements.

International finance transactions and repatriation requirements

In the context of international (and in particular export) finance transactions, a Russian borrower (an exporter) can repay a loan by crediting export proceeds directly to its foreign bank account or that of a lender. That said, if the loan maturity is less than two years or the lender is not a resident in an OECD or a FATF country, the Russian borrower will be under an obligation to receive the export proceeds into its Russian bank account within the period specified in the export contract (a repatriation requirement), otherwise the Russian borrower will be subject to fines, and its officials could face criminal liability, for breach of the Russian currency control legislation¹.

Security interests

The choice of law for security documents usually depends on the location of the

secured assets (e.g. intangible assets), or the governing law of the assets (e.g. contractual rights). In Russia, the principal form of security is a pledge, which normally is entered into in connection with identified assets (subject to the discussion further below). In the case of competing pledges, the first in time by creation generally has priority. However, it is possible to change the priority of pledges by entering into an agreement between the pledgees, or between the pledgees and the respective pledgor. Russian law explicitly allows one pledge to secure different obligations of a borrower owed to different pledgees (lenders). The pledgees in this situation will be ranked equally unless they agree otherwise. In relation to the pledge of movable property (including rights), the priority may depend on the registration date in the register of notices of pledge over movable property (the “**Movables Pledge Register**”) as described below in more detail.

Under Russian law, a universal security instrument (such as an English law debenture), which might secure all assets of a company, is also available. However, it is virtually unregulated and it has not been tested in practice. Given that under Russian law pledging immovable property and pledging a participatory interest both require state registration, the pledge of all of a company’s assets is rarely used in practice. There is also a security instrument called a mortgage of an enterprise under Russian law, which may provide as security real estate, movable property, inventory, etc.

¹ Please see the Currency control chapter on page 88.

However, because of practical difficulties in putting the security in place, it is also rarely used.

Pledges over particular types of assets (e.g. real estate, participatory interests and registered intellectual property rights) are recorded on specific public registers. The pledge of goods in circulation must be recorded in a “pledge book”, which is maintained by the company (pledgor) and which the pledgee may inspect.

A pledgee and a pledgor may register a pledge of movable property in the Movables Pledge Register through a notary. Although registration is not obligatory for the parties, if they do so, they will be afforded with some benefits. The pledgee whose pledge is registered in the first place will enjoy enforcement priority rights. If a subsequent pledge is registered before an initial unregistered pledge, the subsequent pledgee will have the first ranking security of the pledged asset.

A pledgor needs to have title to the secured assets and although the pledge can be “possessory” or “non-possessory”, the secured party need not take possession of the secured assets. A pledge needs to be in writing and needs to accurately identify the pledged assets, the secured obligations and their term.

The following points are worth noting, in relation to certain types of assets.

Shares or participatory interests

A pledge of shares held directly in a joint-stock company must be registered in the joint-stock company’s register (which must be held by an independent licensed company). If shares in a joint-stock company are held by a depository, then its involvement is required, and the pledge is registered with the depository. In this case, the shares may not be disposed of without the pledgee’s consent.

For participatory interests in limited liability companies, pledges must be notarised and registered in the public Unified State Register of Legal Entities. The pledge of participatory interests becomes effective from the date of its registration on such register.

Immovable property

Under Russian law, interests in land (e.g. freehold and leasehold interests) are considered “immovable property” and must be registered. Pledges (or “mortgages”) over the interests must also be registered in the Unified State Register of Immovable Property. A mortgage does not come into effect until it is registered by the relevant land registration authority².

Russian ships and aircraft are similarly immovable assets, and pledges over these also require registration in one of the shipping registers (depending on the type of the ship) or in the state register of rights to aircrafts respectively.

² Please see the Mortgage section on page 161.

Contractual and intellectual property rights

Pledges over rights will require notice to be given to the relevant counterparties, and in some cases the consent of counterparties obtained.

If intellectual property rights are registered, the pledge will require registration with the relevant intellectual property register. Pledges over contractual rights may be registered in the Movables Pledge Register.

Bank accounts

Russian law allows for the pledge of funds credited to the pledgor’s bank account. For these purposes a pledgor will have to open and maintain a specific “pledge bank account”. At the same time, Russian banks also use direct debit arrangements as an alternative.

Recognition of security trusts

Under secured syndicated credit agreements, it is common for security to be held by a representative (i.e. a security agent or trustee) for a syndicate.

Because of the lack of recognition of the institution of a trust in Russia and the accessory nature of Russian security, syndicated loans have been commonly structured to minimise disruption to Russian security upon changes to the syndicate.

The following arrangements have been commonly used:

- bilateral (fronting bank) structures (syndicated through

- sub-participation);
- parallel debt (creating a parallel obligation to benefit a security agent or trustee); and
- joint and several creditor structures.

However, the above structures have their own deficiencies and should be carefully analysed.

Under the provisions of the Russian Civil Code on security agents, a creditor or any third party may, under a pledge management agreement, act as a security agent in favour of all the creditors. The security agent will enter into pledge agreements on behalf of all the creditors. To enforce their security, the creditors will have to act through the security agent; they may not do so individually.

Syndicated loans under Russian law

In 2015, the Association of Regional Banks of Russia prepared a Russian law LMA style syndicated loan agreement, which follows the format and generally reflects the substance of the English law LMA loan agreement subject to certain modifications driven by the Russian law requirements. This loan agreement is designed to be primarily used in syndicated transactions between Russian residents.

To further promote syndicated lending in Russia, in 2018 the Law on Syndicated Loans was adopted. The law introduced the concept of a syndicated facility (loan) into the Russian legislative framework,

confirms some current market practices and closes certain legal loopholes. However, there is still a number of legal issues related to Russian law syndicated loans, which need to be clarified by court practice or further legislative developments.

Syndication

The Law on Syndicated Loans generally recognises the legal nature of a syndicated loan agreement in line with international market practice: several creditors enter into a syndicate undertaking to provide the borrower with funds in concert with each other, with each having independent rights of claim.

One of the resulting drawbacks, however, is that in the event of insolvency proceedings in respect of the borrower, each syndicate member will have to file its claim against the borrower separately. There is no provision permitting delegation of these powers to the facility or security agent. Since this is contrary to the general purpose of the syndicate, we expect that this issue (as well as a few other issues relating to the secondary loan market) will be resolved in the future by way of amendments to the Law on Syndicated Loans and Russian insolvency law, a bill to this effect having been submitted to the State Duma in October 2019.

Further, particular aspects of a Russian law syndicated loan transaction (e.g. the role of the agent, decision-making by

lenders, termination of the agreement) must be governed by the rules of the Russian Civil Code, but the application of these rules is not always clear.

The role of the facility agent

A syndicated loan agreement must provide that one of the syndicate participants, the “facility agent”, exercises the rights of creditors under the syndicated loan agreement on their behalf. The facility agent can be a Russian credit institution, VEB.RF, a foreign bank or an international financial institution. The Russian legal rules on the contract of commission apply to the obligations of the facility agent in relation to the other creditors.

The borrower’s payment obligations to creditors are deemed to be performed when funds are transferred to the facility agent. At the same time, other syndicate members cannot individually exercise their rights as creditors prior to the termination of the loan agreement or until the syndicate members cancel the powers of the facility agent.

One of the criticised provisions of the Law on Syndicated Loans is that the fees of the facility agent (as well as its expenses) are payable by the syndicate participants. This rule contradicts the established practice, in accordance with which the agency fees are usually paid by the borrower (fortunately, the Law on Syndicated Loans allows the parties to derogate from it by agreement).

The role of the security agent

The Law on Syndicated Loans further develops the concept of the security agent. The law points out that the facility agent may only act as the security agent if it is expressly envisaged in the syndicated facility agreement.

The security agent acts on behalf of all the pledgees and represents their interests vis-à-vis the registration authorities (including the submission of notices on pledge and pledge termination notices to the state registers). As a result, if the composition of the syndicate changes, the security agent can take all necessary registration actions (no further involvement of the pledgees is required).

The lenders cannot exercise their pledgee rights individually until the security management agreement or syndicated loan agreement terminates.

Secondary syndicated loan market

The Law on Syndicated Loans also contributes to the development of the secondary market for syndicated loans in Russia. Unless otherwise agreed, a lender may assign its rights to any other person without the consent of the other syndicate participants. A lender may also transfer its obligation to grant a loan to another person who qualifies as a syndicate member under the Law on Syndicated Loans (e.g. foreign and domestic credit institutions). To simplify the procedure, the loan agreement may contain the borrower’s preliminary consent to such transfer.

The assigning lender must notify the security agent and the facility agent, so that the latter can make the relevant changes to the syndicate participants’ register and send a respective notice to the borrower. The facility agent itself cannot transfer its rights as a creditor under the syndicated loan agreement until the termination of its authority.

In addition to the above, a syndicated loan agreement may include provisions for the accession of new lenders.

Enforcement

Enforcement may be carried out through a court or an out-of-court procedure. The court enforcement procedure is usually carried out by way of a public auction. The parties to a pledge agreement may, however, indicate another enforcement procedure to be applied by a Russian court. The out-of-court enforcement procedure includes (i) auction; (ii) the possibility of a direct sale of the assets; or (iii) a creditor appropriating title to the secured assets.

To allow out-of-court enforcement, the relevant pledge agreement need not be notarised, unless the parties want the notary to enforce it.

However, in the case of a dispute between a pledgor and a pledgee, it is likely that any provision for out-of-court enforcement would be referred to the court’s jurisdiction. Proceeds from enforcement through the court would be likely to be in Russian roubles.

Suretyships and guarantees

Russian law suretyships and guarantees are commonly used in connection with financings in Russia. Under Russian law, a “suretyship” refers to a particular type of instrument that a company (or individual) may issue as credit support for the obligations of another. A suretyship is “accessory” in its nature and does not survive the principal obligation.

Independent guarantees may be issued not only by a credit institution (in which case they are called bank guarantees), but also by any other commercial organisation. An independent guarantee constitutes an on-demand guarantee that is independent from the principal obligation. Russian law also expressly provides that an independent guarantee may include a procedure for increase or reduction of the amount of the guarantee on a certain date or upon occurrence of certain events. However, the guarantor may not reduce the amount of the guarantee at its own discretion.

Bankruptcy considerations

Upon the bankruptcy of a debtor or a pledgor, a moratorium against enforcement of the security will be introduced whilst it is being determined if financial rehabilitation, external administration or bankruptcy liquidation should apply. Repayments or arrangements in preference of other creditors are likely to be subject to anti-preference provisions set out in bankruptcy laws.



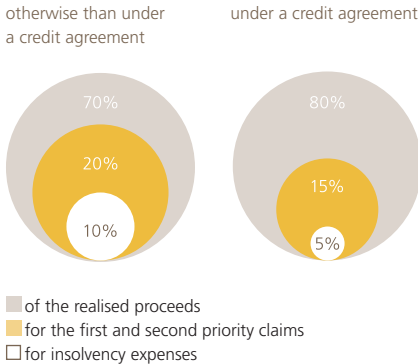
For more information related to bankruptcy and insolvency in Russia generally, please see the *Corporate bankruptcy* chapter on page 173.

During bankruptcy procedures, Russian law applies **mandatory priorities** under which creditors of the same class would rank equally. In brief, these are: (i) “first priority claims” (personal injury); (ii) “second priority claims” (employee related, royalties); and (iii) “third priority claims” (all other claims, including tax liabilities). So-called “current claims” (e.g. insolvency costs, obligations incurred after the company was declared bankrupt by the relevant commercial court) are not included into the order of priorities and should be satisfied as they fall due.

Secured creditors fall within the category of “third priority claims”; however their claims are satisfied in accordance with a special procedure quite separate from unsecured creditors, i.e. out of the proceeds of the sale of the pledged or mortgaged assets, subject to the following statutory thresholds of recovery.

In connection with secured claims (other than under a credit agreement), a secured creditor is entitled to 70% of the proceeds from the enforcement of the relevant security, with the remaining 20% payable for first and second priority claims, and 10% payable to meet insolvency expenses. In connection with secured claims under a credit

agreement, these percentages change to 80%, 15% and 5% respectively.



At the financial rehabilitation or external administration stage, to become entitled to enforce security, a secured creditor must waive its rights to vote at creditors’ meetings. In that case, Russian law allows this secured creditor, with the approval of the relevant commercial court and provided that the assets of the debtor are insufficient for the possible restoration of its solvency, to enforce its security and retain all the proceeds of such enforcement (ahead of the general liquidation of the debtor’s assets, which is usually undertaken during the last possible stage of the bankruptcy proceedings, namely bankruptcy liquidation).

Other lending related issues

Finally, the following additional aspects should also be kept in mind when lending or borrowing in Russia.

Pre-contractual negotiations

The Russian Civil Code establishes:
— a duty on those entering into

contractual negotiations to act in good faith and not to enter into negotiations frivolously; and
— the notion of bad faith negotiations and defines the concept of bad faith as where one party to the negotiations provides the other party with incomplete information or conceals certain facts, or unexpectedly breaks off the negotiations without due cause.

If a party breaches the above requirements, it will have to reimburse the aggrieved party’s losses, which are defined as the expenses incurred by the good faith party for the conduct of the negotiations and any expenses related to the lost opportunity to conclude a contract with a third party.

The rules will clearly apply to negotiations carried out between Russian individuals and entities. We assume they would also apply to negotiations of agreements that shall mandatorily be governed by Russian law. Application of the rules to cross-border negotiations is a more complex issue, which remains uncertain until the relevant court practice has been formed.

To minimise the associated risks, the negotiating parties should establish the time when negotiations have formally started. This could be achieved by way of execution of a letter of intent or any other document that could be used as evidence if a claim for reimbursement of expenses related to termination of negotiations (as described above) is filed.

In order to have an argument that Russian rules on pre-contractual negotiations do not apply to the parties and rules of a foreign jurisdiction apply, it is further advisable that the letter of intent or any document that evidences the commencement of negotiations contain applicable law provisions to avoid automatic application of the conflict of rules principle.

Corporate capacity and authority

As a rule, the general director, or any person acting under properly delegated authority (by way of a power of attorney), has the capacity to bind the company.

If the transaction value equals or exceeds 25% of the balance sheet asset value of the company (and no lower threshold is provided for in the charter), the transaction will constitute a "major transaction". If the value is between 25% and 50% of this balance sheet value, unanimous approval of the board of directors (if appointed) would be required, and if over 50%, approval of a 75% majority of shareholders who participated in the meeting, would be required for a joint-stock company. Similar thresholds apply to a limited liability company, and an approval of a simple majority of all participants would be required, unless otherwise provided for in the company's charter.

In accordance with legislative amendments that came into force on 1 January 2017, "interested party transactions" (e.g. transactions that may involve affiliates or cross-management)

do not require any corporate approval unless the management of the company or a shareholder with no less than a 1%-stake requested such an approval. However, the company's charter may envisage different rules for corporate approvals of "interested party transactions".

Regulatory considerations on enforcement

When taking security over a company's shares (either directly in Russia or through an offshore holding company, under a foreign law), two key aspects must be considered:

- With regards to enforcement of the security, ownership of the Russian entity may be restricted as "strategic" under Federal Law No. 57-FZ "On the Procedure for Foreign Investments in Commercial Organisations of Strategic Importance for the National Security of the Russian Federation" dated 29 April 2008³.
- Ownership may also need approval from the Federal Anti-monopoly Service under Federal Law No. 135-FZ "On Protection of Competition" dated 26 July 2006⁴.

³ For more details please see the Common forms of business structures for foreign investors chapter on page 34.

⁴ For more details please see the Anti-monopoly issues chapter on page 41.

» The Law on Syndicated Loans has introduced the concept of a syndicated facility (loan) into the Russian legislative framework and regulates the relationship between the parties to a syndicated facility transaction. This should further promote syndicated lending in Russia.



Employment and migration

General approach

The Labour Code of 30 December 2001 (the “**Labour Code**”) outlines the main provisions applicable to employment arrangements in Russia, along with numerous decrees and instructions, as approved by the competent state authorities. Migration issues are mainly regulated by Federal Law No. 115-FZ “On the Legal Status of Foreign Nationals on the Territory of the Russian Federation” dated 25 July 2002.

Below is a general description of employment law provisions as they apply to all employees, as well as how they apply to foreign employees specifically.

Formalising the employment relationship

Employment agreement

Under the Labour Code employment agreements must be concluded in writing (except for teleworkers with whom it is possible to conclude the agreement electronically, i.e. using electronic digital signatures) and contain certain mandatory terms and conditions. Such mandatory terms include place of work, job position, job duties, commencement date, term of employment, remuneration, working time regime, etc. Employment agreements may contain additional terms and conditions, such as

probationary period and confidentiality clauses.

The parties’ rights and obligations under the employment agreement must comply with the minimum requirements set by law. An individual employment agreement must not result in an employee’s terms and conditions of employment being worse than the terms and conditions of employment stipulated under the overriding requirements of employment law; otherwise, the legislation will supersede the provisions of the respective employee’s employment agreement.

Term of employment

Employment agreements may be concluded for an indefinite term or for a fixed term; a fixed-term employment agreement may be concluded for a period of not more than five years.

The law provides for a limited number of grounds when an employment agreement may be concluded for a fixed term. These include, in particular, the following (the list is not exhaustive):

- an employee replacing a temporarily absent employee;
- project-related or seasonal employees;
- general directors, deputy general directors or chief accountants;

- employees of companies created for a specific term and purpose;
- employees engaged under the terms of secondary employment.

If a fixed-term employment agreement is concluded in breach of the Labour Code, the competent state authorities may recognise it as concluded for an indefinite term.

Salary

The statutory minimum gross monthly salary is set at RUB 12,130 (EUR 173) for the whole of Russia. At a regional level, a higher minimum monthly salary may be approved. For example, the minimum monthly salary in Moscow is currently set at RUB 20,195 (EUR 288).

 RUB 70 = EUR 1 *notional exchange rate used for convenience

Salary is to be determined in the employment agreements and paid in roubles in instalments at least twice a month.

Probationary period

An employment agreement may provide for a probationary period which must not exceed three months. For general directors, deputy directors, chief accountants, deputy chief accountants and directors of representative offices, branches or other divisions, a longer probationary period may be established. This longer period must not exceed six months.

Both employers and employees are required to give the other party three

calendar days’ written notice when terminating the employment agreement during the probationary period. When dismissing an employee for failure to pass the probationary period, employers have an obligation to provide the employee with reasons for dismissal in writing. The employee may appeal the employer’s decision in court.

The following employees cannot be subject to a probationary period:

- pregnant women and women with children under the age of 18 months;
- under-18s;
- young persons graduating from state-accredited educational institutions of primary, secondary or higher professional education, upon completing their education and applying for their first job within one year of graduation;
- certain other categories of employees as set forth by law and a collective bargaining agreement.

Working hours and leave

A normal working week is 40 hours. Overtime is permitted upon the employer’s written request and, as a rule, requires the employee’s consent. Overtime may not exceed a total of four hours in two consecutive days and is limited to 120 hours in total per year.

An open-ended working day regime may be established for certain categories of employees, if set out in the employer’s internal regulations and relevant employment agreements.

This type of working day regime entails the employee being periodically engaged in additional work upon the written request of the employer without requiring the employee's written consent. Under this regime, the overtime work does not result in additional remuneration but does provide the employee with at least three additional days of paid leave per year.

The statutory annual paid leave for all employees is 28 calendar days. In certain cases expressly stated in the Labour Code, employees are entitled to additional paid leave.

Confidentiality obligation imposed on the employee

Russian law does not contain express provisions imposing confidentiality obligations on employees. If an employer wishes its employees to be subject to this type of obligation, it must (i) incorporate a confidentiality undertaking in the employment agreement of each employee concerned; (ii) adopt a set of internal regulations specifying the procedures for processing and obtaining access to confidential information; and (iii) implement the confidentiality regime provided for by law (i.e. use of safes, stamp "secret", etc.). In the absence of these measures, it will be almost impossible to hold an employee liable in the event of disclosure.

Restrictive covenants

Generally, Russian legal practice remains critical of the use of various restrictive

covenants in employment agreements. For instance, non-competition clauses, though not directly prohibited by Russian law, are deemed as violating an employee's constitutional right to work and, therefore, unenforceable by the courts.

Another example is the narrow scope of the application of the "garden leave" concept (i.e. the practice by which an employee is instructed to stay away from work during his/her notice period). The Labour Code prohibits discharging an employee from further obligations under his/her employment agreement at the employer's discretion, except for a limited number of instances provided in the Labour Code. These exceptions are generally treated as the discharge of an employee from performing his/her work obligations in circumstances where there is a threat to a person's health, life or property.

Liability
Liability of the employee

An employee who breaches obligations established in his/her employment agreement may be subject to disciplinary sanctions and/or bear material liability.

The Labour Code strictly regulates the **disciplinary procedure**, and non-compliance may result in the employee successfully challenging the disciplinary sanction in court.

An employee's **material liability** is generally restricted to compensation for the direct damage caused to the

employer's property at the employee's fault or negligence. This liability is limited to an amount equivalent to the employee's monthly average salary.

However, the Labour Code sets out some exceptions to the limitation of material liability rule. It provides that an employer may, under certain conditions, impose full material liability where an employee:

- fails to protect valuable items entrusted to him/her, as evidenced by documents signed by the employee;
- intentionally damages property;
- causes damage when in a state of alcoholic, drug or other intoxication;
- causes damage as a result of criminal actions for which he/she has been sentenced by a court;
- causes damage as a result of an administrative offence as determined by the relevant state body;
- divulges confidential information;
- causes damage outside of his/her work duties; and/or
- has entered into an individual or a collective agreement on full material liability with the employer.

Full material liability extends to all damage incurred by the employer as a result of the fault of the employee.

Also, in the employment agreement, an employer may provide for full material liability for certain categories of employees (e.g. chief accountant, deputy general director, etc.). The general director of a legal entity is always subject to full material liability regardless of whether his/her

employment agreement includes such a provision.

If the employer wishes to be compensated for the damage it suffered, it must follow a specific procedure and request from the employee a written explanation of the cause of the damage. Following this, the employer must specify the amount and cause of any damage inflicted within one month of the alleged damage having occurred. If the employer does not exercise its right within this time period, compensation may only be recovered with the voluntary consent of the employee or through legal proceedings.

Liability of the employer
The limitation period within which an administrative claim can be brought against an employer for failure to comply with labour laws is one year from the date that the violation was committed or, with respect to ongoing violations, from the date that the violation was discovered by the authorities. The maximum administrative fine that may be imposed on an employer's official for non-compliance with labour law requirements has been increased to RUB 30,000 (EUR 429). Furthermore, in the event of a recurring offence, the official may be disqualified for a term of up to three years. The maximum administrative sanctions that may be imposed on legal entities include an administrative fine of RUB 200,000 (EUR 2,860) and/or administrative suspension of activities up to 90 calendar days.

Notably, in accordance with the current law-enforcement and court practice, the penalty for the same offence may be imposed simultaneously on both the company and the general director or other authorised officer of the company. Moreover, if the same offence is simultaneously committed against a number of employees, the total amount of administrative fine imposed on the official or the entity for such offences may in some cases be calculated taking into account the total number of employees affected by the relevant offence.

Employment history recording

As of 1 January 2020, all employers must submit the information on each employee’s employment to the Russian Pension Fund in electronic format. In relation to employees’ labour books (“*trudovaya knizhka*”) that have been obligatory before 2020, employers will only have to continue maintaining them if employees request this. Starting from 1 January 2021, employers will no longer be required to establish and maintain labour books in paper format for employees entering their first employment.

Specifics of hiring foreign nationals

If the employee is a foreign national, he/she may commence employment in Russia only once the steps described in the *Specifics of employing foreign nationals* section below have been completed.

In essence, employment law applies to foreign nationals to the fullest extent provided for in the Labour Code. Therefore, the employer is obliged to enter into an employment agreement with any foreign national and follow all rules and procedures which flow from their employment relationship.

Managing employment relationships

Internal policies

All employers in Russia (except for those that are qualified as “microenterprises”) must adopt a set of mandatory internal policies that include Internal Labour Regulations, a Labour Safety Policy, a Personal Data Protection Policy, a Remuneration Policy and an Anti-corruption Policy. These policies must be in Russian or at least in a bilingual format, approved by the order of an authorised representative of the employer. The policies must be brought to the notice of, and signed by, employees.

The same requirements apply to any global policies that the employer would like to be binding upon the employees in Russia.

Health and safety at work

Workplaces of all employees in Russia must be assessed from a work safety perspective. The workplace assessment is not required for homeworkers, teleworkers and employees working for individuals who are not registered individual entrepreneurs.

The main purpose of the work safety assessment is to provide employees with relevant guarantees and compensation, and to set additional pension and social insurance rates. These rates depend on workplace hazards, which are rated as optimal, acceptable, harmful or dangerous.

The provision of the workplace assessment is a duty of the employer. It must be held at least once every five years unless an unscheduled workplace assessment is required under law.

Sick leave

When an employee is on sick leave, his/her employer is required to pay him/her a temporary disability allowance for the period of sickness. The employee’s entitlement to the allowance is dependent on the submission of a medical certificate in the required form. The allowance is calculated on the basis of the average monthly salary over a period of two years and is capped at a specified amount.

The first three calendar days of an employee’s temporary disability period are paid by the employer out of its own funds. Any additional days are then funded at the expense of the Social Security Fund of the Russian Federation.

The same rules may apply to foreign nationals, provided that they meet certain criteria in relation to their migration status.

Maternity and child care leaves

An employee who gives birth is entitled to 70 calendar days’ maternity leave prior to and 70 calendar days’ leave after the child’s birth. Longer maternity leave may be granted in case of a multiple or abnormal pregnancy. This right arises upon the presentation of a medical certificate, which may be issued starting from the 30th week of pregnancy. This provides for a period of entitlement equal to 140 calendar days that can be used by the employee summarily (i.e. irrespective of the actual number of days used before the child’s birth).

Child care leave may last up to three years and can be used by the mother or the child’s relatives at any time during this period.

The employer is responsible for paying various maternity related allowances provided for by law and then sets off the relevant amount against payroll contributions.

In general, pregnant women and women with children under the age of three years are entitled to an extensive number of benefits and privileges under Russian employment law. In particular, such women may not be dismissed on the grounds of staff redundancy, neither may men with at least three children one of whom is under the age of three years provided that the mother of the children is not employed. Moreover, pregnant women may not be compelled to work a night shift, overtime, during days of rest or holidays and may not be sent on

business trips. Women with children under the age of three years may only be engaged in the above types of work upon their written consent and provided that their state of health allows them to perform these types of work, as confirmed by a medical certificate.

Trade unions

A trade union aims to represent employees and protect their social and labour rights and may be established in any company by at least three employees.

In the situations specified by the Labour Code (such as, for example, staff redundancy or termination of an employment agreement with a trade union member) or in collective agreements (if any), the trade union's motivated opinion is required. Should this occur, the employer must provide the trade union with draft documents explaining the relevant situation. The trade union has to reply within five working days, failing which the employer is free to ignore the union's opinion. If the opinion was duly submitted, but the employer decides to act contrary to it, the trade union has the right to appeal against the employer's decision to the Labour Inspectorate or a competent court.

Trade union leaders enjoy additional protection in certain cases where their employment is terminated at the instigation of their employer on certain grounds. They may not be dismissed without the consent of the upper-level

trade union in cases of mass redundancy, repeated breaches of their work obligations, or where their dismissal was based on poor performance evaluation results.

Disciplinary sanctions

Non-compliance with work discipline (i.e. the non-fulfilment or inadequate fulfilment by an employee of his/her duties) may result in the following disciplinary sanctions being applied: a warning, an official reprimand or dismissal on corresponding grounds established by law.

Disciplinary sanctions may be imposed no later than one month after the time the employer had, or should have had, knowledge of the breach and, in any event, no later than six months after the breach was committed.

The Labour Code regulates the procedure for imposing disciplinary sanctions. Failure to comply with it renders the sanction invalid.

Terminating an employment agreement

Cases and grounds for termination

An employment agreement may be terminated (the list is not exhaustive):

- at any time by the mutual agreement of the parties;
- unilaterally by an employee providing two weeks' written notice or at the initiative of the employer (as discussed below);
- because of circumstances beyond the reasonable control of the parties;

- when the term of the employment agreement expires;
- if an employee refuses to continue working because of a change in the ownership of the company (employer) or its reorganisation (this only applies in relation to certain top executive positions); or
- if an employee refuses to continue working because he/she (together with the employer) is relocated.

The employer may terminate the employment agreement at its initiative only on the limited number of grounds expressly set out in the Labour Code, which include, among others:

- When there is **staff redundancy** or the employer is being **liquidated**. The employer must notify each employee in writing at least two months in advance. If there is staff redundancy, the employer must offer employees all available vacancies which are equivalent to or below their current qualifications.
- When an employee is **unsuitable** for an employment position. Unsuitability must be confirmed by an attestation committee review.
- When an employee **systematically fails to fulfil** his/her employment **duties without reason** or commits a **single gross dereliction** of his/her duties.
- When an employee is found to have presented **false documents** during the hiring process.

In respect of specific categories of employees (e.g. the general director,

teleworkers), additional termination grounds may be provided for in the employment agreement.

The Labour Code requires that severance pay be made under certain circumstances.

Court practice with regard to dismissals varies substantially, and may differ from region to region. However, the general tendency is to protect the interests of employees, thus placing a greater onus on the employer.

Specifics of employing foreign nationals

Visas for foreign employees

Foreign nationals must apply for a visa. Citizens from the following countries of the Commonwealth of Independent States are exempt from Russian visa requirements: Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Ukraine and Uzbekistan.

Types of visas

There are five categories of visas: ordinary, official, transit, diplomatic and temporary residence. There are seven subcategories of an ordinary visa: business, tourist, work, student, private, asylum and humanitarian. The most important types of visa for legal entities are considered below.

Business visas

Business visas are intended for foreign nationals who wish to conduct short-term and temporary business activities

in Russia. Examples of these activities include business trips, negotiations, market studies and preparations to set up a company or any other type of establishment in Russia. Foreign nationals with multi-entry business visas are permitted to stay in Russia for up to 90 calendar days within a period of 180 calendar days.

Five-year business visas can be applied for in respect of employees or representatives of (i) large foreign companies investing in Russia which satisfy certain criteria established by the Russian Government; or (ii) companies taking part in Government projects such as Skolkovo or the International Financial Centre.

Foreign nationals who obtain Russian business visas are not allowed to undertake any type of work activities in Russia. This requires a work visa.

Work visas

Work visas are required for foreign nationals who intend to conduct professional activities in Russia.

A foreign national who has been issued an official invitation from an employer must first obtain a single-entry visa. The visa is valid for up to three months and may be exchanged for a one-year multi-entry work visa once the individual is in Russia, although this is not applicable to highly qualified specialists (please see the *Highly qualified specialists* section below). The family members of a work-visa holder may obtain visas of the same category

marked “accompanying person”. This visa allows family members to stay in Russia, but does not entitle them to work in Russia. It expires on the same date as the principal holder’s visa.

Work visas are issued only after the employer has received general authorisation to recruit foreign nationals and a quota of foreign persons they may employ. Each foreign employee must also be granted a work permit (please see the *Individual work permits* section below).

The Main Department for Immigration Issues of the Ministry of Internal Affairs of the Russian Federation (the “**Immigration Department**”) registers the employer as an inviting party for foreign nationals when the latter applies for a visa invitation for the first time.

The process of obtaining a work visa usually takes from 12 to 14 weeks.

Procedures relevant to an employer

An employer who recruits foreign employees to work in Russia has to comply with the following procedures.

Quotas

All legal entities wishing to employ foreign nationals must apply each year for a quota of foreign employees whom they may employ. The deadline for filing the quota application is established separately in each region of Russia. Certain professions and some categories of foreign employees (e.g. highly qualified specialists, foreign nationals

who are exempt from the requirement to hold a work permit) are quota-exempt.

The quota allocated to each legal entity depends on the general quota set each year for all foreign employees. This quota differs between regions, different categories of employees, as well as different professions, countries of origin and other economic and social criteria.

General authorisation for the recruitment of foreign nationals

The general rule is that any employer intending to recruit one or more foreign nationals must obtain a prior general authorisation from the Immigration Department to recruit foreign employees within its allocated quota. By way of exception, no such authorisation is required for highly qualified specialists and for foreigners from CIS¹ countries.

In its application for this authorisation, the employer must justify the use of foreign employees.

Individual work permits

General remarks

Once the general authorisation for the employment of foreign employees has been obtained, the employer must apply for a work permit for each employee.

A work permit is required for any foreign national who wishes to perform any “work activity” in Russia, including temporary work.

However, the following categories of foreign nationals are exempt from the

- work permit requirement:
- citizens of countries which are members of Eurasian Economic Union (the “**EEU**”) (currently Armenia, Belarus, Kazakhstan and Kyrgyzstan have joined the Union with Russia);
 - those holding a permanent residence permit; and
 - those holding a temporary residence permit, which allows them to work only in the region of Russia where they reside.

These categories of permit-exempt foreign nationals are not taken into account in their employers’ quotas and general authorisations to recruit foreign employees.

Employers are obliged to notify the Immigration Department on conclusion and termination of employment and civil law contracts with all categories of foreign nationals within three working days following the date of conclusion or termination of the contract.

Language command requirements

Applications for work permits for non-visa foreigners need to include a dedicated certificate proving their command of the Russian language, Russian history and fundamentals of Russian law (the “**Russian Language and Civilisation**”), unless they hold

¹ The member states of the Commonwealth of Independent States are Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan and Uzbekistan.

a relevant Soviet or Russian certificate of education.

Distinct rules apply to foreigners subject to a visa regime. They are given more time to prove they meet the Russian Language and Civilisation requirements. Proof must be submitted to the authorities within 30 calendar days from the issuance of the relevant permit (rather than upon application). If they fail to do so, their permits will be cancelled.

Certain categories of foreigners are exempt from the Russian Language and Civilisation requirements, such as highly qualified specialists and their relatives, and full-time foreign students with accredited educational institutions in Russia.

Personal accreditation of foreign employees of representative offices and branches

If the employer is a representative office or branch of a foreign company in Russia, it must apply for approval for the relevant number of foreign employees from the Chamber of Commerce and Industry of the Russian Federation as part of the accreditation process for the representative office or branch. Within that approved number, the employer must apply to the Chamber of Commerce and Industry for a personal accreditation card for each foreign employee.

Personal accreditation does not relieve the employer from having to obtain a general authorisation for the recruitment of foreign nationals, a work

permit and a work visa for its foreign employees.

Notification

There is a notification procedure which foreign nationals and their hosting parties must follow. This procedure also applies to highly qualified specialists.

It is based on the following principles:

- The Immigration Department must be notified of arrivals and of any travel within Russia.
- Foreign nationals can be registered at the address of the organisation where they carry out employment (or other activities not prohibited by Russian law) in the following cases only: (i) when they actually live at the address of the relevant organisation or (ii) when they live at a place of residence provided by an organisation which does not have a permanent address (e.g. a makeshift barrack). As most foreign employees and their families live in rented accommodation, their landlords are responsible for registering them.
- A highly qualified specialist and the members of his/her family are allowed a period of 90 calendar days from the date of entry into Russia, during which they are not required to register with the migration authorities. Once the foreign specialist has been in Russia for 90 calendar days, he/she must be registered at his/her place of residence.
- Armenian, Belarusian, Kazakh and Kyrgyz employees and the members

of their family have to register within 30 calendar days.

- For all other foreign nationals, the registration procedure with the Immigration Department must be completed within seven working days.
- Foreign nationals staying in Russia or travelling to another Russian region for less than seven working days, who are not staying in a hotel or in “a hotel-like residence”, are exempt from the notification procedure.
- Heads of State, heads of diplomatic missions, members of parliamentary or governmental delegations, heads of international organisations (and family members of these persons) are exempt from the notification procedure. Ship, train or aircraft crew members are exempt from the procedure under certain conditions.

Business trips within Russia

A foreign employee is permitted to go on business trips outside the Russian region(s) in which his/her work permit is valid only if he/she occupies a position which is included in the list of occupations approved by the Ministry of Health and Social Development.

In addition, the duration of foreign employees' business trips is regulated as follows:

- a total of ten calendar days during the validity of a general work permit; and
- 30 consecutive days during the validity of a highly qualified specialist work permit.

Different rules apply to foreign nationals who hold temporary or permanent residence permits.

The duration of business trips of highly qualified specialists having a travelling character of work regime fixed in their employment agreements is not limited.

Foreign employees holding “*patenty*” for work in Russia (this is a special type of authorisation for work issued to nationals of CIS countries who are not eligible or not willing to apply for a highly qualified specialist work permit) are allowed to work only in the Russian region in which their patent for work is valid. They are not permitted to go on business trips outside of such region.

Highly qualified specialists

Highly qualified specialists are foreign employees with professional skills, knowledge and the proper qualifications in a specific area to which a specific regime applies.

The monthly remuneration paid to a highly qualified specialist must be at least RUB 167,000 gross (EUR 2,386), unless a lower amount is set by law or in international agreements for certain nationals.

The highly qualified specialist regime is available to Russian commercial legal entities as well as to Russian-based duly accredited branches and representative offices of foreign legal entities.

When the above criteria are met, a simplified procedure applies for obtaining a highly qualified specialist work permit and work visa. Accordingly, a work permit may be obtained within 14 working days and the employer is exempt from fulfilling a significant number of formalities (obtaining a quota, general authorisation to recruit foreign employees, etc.).

In addition, opting for a highly qualified specialist regime provides employers and highly qualified specialists with increased flexibility, such as:

- A work permit is valid for up to three years, whereas an ordinary one is valid for only one year.
- A work permit may be valid for multiple Russian regions rather than just the region where the employer is based.
- There are fewer restrictions on business trips (as mentioned above).

Bilateral and multilateral international agreements

There are several international agreements regulating foreign workforce issues. They affect in particular French, South Korean, Armenian, Belarusian, Kazakh and Kyrgyz citizens.

Arrangements applying to French employees in Russia

On 1 March 2011, the Agreement “On the Temporary Employment of Citizens of One Country on the Territory of the Other”, as signed on 27 November 2009 between the Russian Federation and France, came into force.

Special filing procedures and review processes for obtaining authorising documents for employment have been established, with the goal of simplifying the temporary employment of the citizens of the two signatory countries. In particular, documents allowing French citizens to enter and work in the Russian Federation have to be processed within one month.

Arrangements applying to Korean employees in Russia

An Agreement has been in force since 1 January 2012 between the Governments of the Russian Federation and the Republic of Korea (South Korea) on the temporary work activity of their respective citizens.

This Agreement simplifies the rules and procedures applicable to the stay and employment of (i) Korean employees of representative offices of legal entities in Russia; (ii) Korean employees working at or for Russian organisations belonging to a Korean group of companies; (iii) Korean top executives managing Russian enterprises; and (iv) some family members.

In particular, quotas limiting work activities do not apply to these persons.

Arrangements applying to Armenian, Belarusian, Kazakh and Kyrgyz employees in Russia

In accordance with the Agreement on the EEU signed in Astana on 29 May 2014, simplified rules of employment of foreign nationals apply to citizens

of countries which are EEU member states. As commented above, currently, Armenia, Belarus, Kazakhstan and Kyrgyzstan have joined the Union with Russia.

The Agreement introduces reciprocal preferences, thereby simplifying significantly the conditions of stay and employment of the countries’ respective citizens.

Quota, general recruitment authorisation and work permit requirements do not apply to EEU employees in Russia. These migrant employees and family members are allowed to stay in Russia for the duration of a migrant employee’s employment agreement. The timeframe for notification of entering Russia is 30 calendar days from the entry date (rather than seven working days).

Sanctions for violating migration legislation

If an employer fails to comply fully or in part with the relevant migration procedures, it risks a fine (calculated per breach) of up to RUB 800,000 (EUR 11,440) and/or the suspension of its activities for up to 90 calendar days. The employer’s officials may be liable to fines of up to RUB 50,000 (EUR 715). A foreign employee may also be fined up to RUB 5,000 (EUR 71), and may be deported from and banned from entering Russia. An entry ban can also be imposed on a foreign national who has been held administratively liable two or more times, including for violations of legislation other than in the

field of migration (such as, for instance, road traffic regulations). Foreign nationals are therefore strongly advised to be as compliant as possible in view of the risk of an entry ban.

Stricter sanctions apply to the violation of migration law requirements in Moscow, Saint Petersburg, the Moscow Region and the Leningrad Region, namely: individuals will pay fines of RUB 5,000 - 7,000 (EUR 71 - 100) and be deported from Russia, officials – RUB 50,000 - 75,000 (EUR 715 - 1,071) and companies – RUB 800,000 - 1m (EUR 11,440 - 14,300) and/or have their operations suspended for 14 to 90 calendar days.

» In accordance with current law-enforcement and court practice, both the company and the company's general director or other authorised officer may be held liable for the same violation of labour laws, work safety and/or migration law requirements.



Personal data protection

General approach

Legal and regulatory framework

Federal Law No. 152-FZ "On Personal Data" (the "**Data Protection Law**") was adopted in July 2006. A number of its provisions are based on the 1981 Strasbourg Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data (the "**Strasbourg Convention**") that Russia signed on 7 November 2001.

The Data Protection Law provides a framework that is complemented by a number of regulations of the Russian Government and governmental authorities as well as certain provisions of Russian labour and administrative law.

Key developments

In 2015, the Data Protection Law was amended with a personal data localisation requirement, according to which personal data of Russian citizens must be stored on servers physically located in Russia. In 2019, significant fines for violation of this requirement were introduced in addition to the previous sanctions which include blocking access to the infringer's website.

In 2017, administrative fines for violation of personal data law requirements were substantially increased.

In 2018, Russia signed an Amending Protocol updating the Council of Europe Convention No. 108 for the Protection of Individuals with regard to Automatic Processing of Personal Data. The national data protection law is expected to be amended in order to comply with this Protocol. For example, an obligation on data controllers to notify the data protection authority and data subjects of any personal data breach, as well as the concept of genetic data as a new category of sensitive personal data, should be introduced in Russian law. At this stage, the law ratifying the Amending Protocol has not yet been adopted.

Supervisory authority

The authority in charge of personal data protection in Russia is the Federal Service for Supervision of Communications, Information Technology and Mass Media ("**Roskomnadzor**").

Scope of the Data Protection Law

The Data Protection Law defines, in particular, personal data and data processing, regulates the rights of data subjects and the obligations of data controllers, consent rules, data localisation and cross-border data transfer.

Personal data

The Data Protection Law does not contain an exhaustive list of data that is deemed to be “personal data”. Thus, what constitutes personal data must be assessed on a case-by-case basis. Personal data is defined as any information referring directly or indirectly to an identified or identifiable individual (the “data subject”).

The Data Protection Law also sets forth special categories of personal data. These cover information referring to a person’s racial or ethnic origin, political opinions, religious or philosophical beliefs, personal health, sex life and criminal record. In addition, the processing of biometric data is regulated by the Data Protection Law.

Data processing operations

The Data Protection Law applies to all personal data processing operations performed within Russia. However, in recent years Roskomnadzor successfully blocked several websites that contained personal data of Russian citizens and have been hosted or managed from abroad.

Personal data operations under the Data Protection Law include any processing, such as data collection, storage, recording, deletion, transfer.

The Data Protection Law does not apply to personal data processing performed by individuals for their private needs.

Rights of the data subjects

Under the Data Protection Law, a data subject has the right to:

- request details of the processing of his/her personal data by a data controller (what data is being processed and why, etc.);
- revoke his/her consent to the data processing at any time;
- request, in certain cases, the rectification, blocking or deletion of his/her personal data; and/or
- be compensated for damages, including for moral harm.

Obtaining consent from the data subjects

Personal data may only be processed (i) based on the prior, voluntary, express and informed consent of the individual (data subject); or (ii) if the law expressly permits processing without the data subject’s consent.

Consent can be given in any form: orally, in writing, electronically or by implication. The data controller must ensure that it can prove that consent was duly obtained. In certain cases, the law requires written consent as described below.

Qualified consent

Consent must be obtained in written form (“**Qualified Consent**”) when:

- special categories of personal data and/or biometric personal data are processed;
- personal data is transferred to countries which do not ensure an adequate level of protection of

- personal data (“**Unsafe Countries**”);
- decisions are taken automatically and such a decision could influence the rights and freedoms of a data subject; and
- employees’ personal data is transferred to a third party, including companies of the same group.

Qualified Consent must contain the following elements:

- name, address and passport details of the data subject;
- name and address of the personal data controller;
- purpose of the personal data processing;
- list of the personal data to be processed for which consent is given;
- list of the operations to be performed with the personal data and a general description of the methods to be used for personal data processing;
- term during which the personal data will be processed and how consent can be withdrawn; and
- data subject’s signature.

Cross-border transfer of personal data

The Data Protection Law distinguishes two types of cross-border data transfer:

- the transfer of data to countries with adequate protection of personal data (“**Safe Countries**”); and
- the transfer of data to Unsafe Countries.

Safe Countries comprise signatories to the Strasbourg Convention and countries

that are included by Roskomnadzor in the Safe Countries List. Roskomnadzor occasionally amends this list, which now consists of 22 countries.

The cross-border transfer of personal data to Safe Countries may be performed in accordance with the requirements for internal data transfer. The cross-border transfer to Unsafe Countries requires Qualified Consent to be obtained from the data subject, except in cases expressly provided by the law.

Data controllers and data processors

The Data Protection Law defines the data controller as an entity (either a state agency, municipal authority or a legal entity) or individual who organises the processing of and/or processes personal data. It also determines the purposes and scope of processing, the content of personal data to be processed and actions performed with the data.

Main obligations for data controllers

The main obligations of the personal data controllers are to:

- notify Roskomnadzor of their intention to process personal data, except when an exemption applies;
- ensure personal data security;
- adopt a personal data processing policy which includes the list of data, the purposes of data processing, etc.;
- appoint a data protection officer responsible for the organisation of data processing within the company; periodically perform internal audits

and assessments of the effectiveness of measures applied to protect personal data;

- retain control over such measures and the level of protection of personal data (in particular in cases where data processing is outsourced); and
- ensure that the recording, systemisation, accumulation, storage, clarification (updating, modification) and retrieval of Russian citizens' personal data is conducted in databases located within Russia.

Exceptions to the requirement to notify Roskomnadzor of the intention to process personal data

Notification is not required, in particular, to process (i) personal data of employees, when such data is processed by their employer for the purposes of employment relations; (ii) personal data received by the data controller to conclude and perform an agreement with the respective data subject; (iii) data made public by the data subject.

Technical requirements

According to the law, personal data must be protected against unauthorised access, alteration, transfer, disclosure by transfer or deletion as well as damage and accidental destruction. In order to ensure the security of personal data, the data controller must, in particular:

- use technical devices certified by the competent Russian authorities and keep a record of the devices on which the personal data is stored;
- determine the level of damage

which may be caused in the event of unauthorised processing of personal data; and

- establish rules relating to access to personal data.

The Data Protection Law does not provide further details on the technical and organisational measures mentioned above, although some detailed requirements are provided in the relevant regulatory orders.

Localisation requirements

Data controllers who collect personal data of Russian citizens must ensure that the recording, systemisation, accumulation, storage, clarification (updating, modification) and retrieval of Russian citizens' personal data are conducted only in databases located within Russia. There are a limited number of exceptions to this requirement, which usually do not apply to business.

When notifying Roskomnadzor of the commencement of processing of personal data, data controllers are required to state the location of the database containing Russian citizens' personal data.

Outsourcing

Data controllers may outsource the processing of personal data. To do so they must enter into an agreement with a data processing service provider (a "Technical Processor"). The agreement must contain certain substantial conditions as set out by the Data Protection Law. Data controllers

nevertheless remain responsible to data subjects for the fulfilment of their obligations. The Technical Processor must ensure the confidentiality and protection of the personal data.

Liability
Administrative fines and other sanctions

If a data controller has violated the requirements of the Data Protection Law, Roskomnadzor and/or the relevant court may:

- require the data controller to rectify the violation(s);
- issue a warning to the data controller; and/or
- impose fines.

The following fines may be imposed on data controllers:

- for individuals: RUB 700 - 5,000 (EUR 10 - 71);
- for company officials: RUB 3,000 - 20,000 (EUR 43 - 286);
- for legal entities: RUB 15,000 - 75,000 (EUR 214 - 1,071).

 RUB 70 = EUR 1 *notional exchange rate used for convenience

The most frequent violations include:

- failure to file a notification of the commencement of processing of personal data with Roskomnadzor;
- inconsistency between the details set out in the notification and the actual processing activities;
- failure to obtain the Qualified Consent of a data subject and to inform a data subject on the processing of his/her personal data; and

- processing of personal data without proper legal grounds and failure to provide unrestricted access to its personal data processing policy (e.g. posting on its website).

The Russian Code on Administrative Offences was recently amended to introduce a separate sanction for breach of personal data localisation requirements. In addition to the blocking of websites, the following fines may be imposed:

- on individuals: RUB 30,000 - 50,000 (EUR 429 - 715);
- on company officials: RUB 100,000 - 200,000 (EUR 1,430 - 2,860);
- on legal entities: RUB 1m - 6m (EUR 14,300 - 85,800).

Repeat violations of the personal data localisation rules may result in higher fines of up to RUB 18m (EUR 257,400) for legal entities.

Judicial remedies

Data subjects can file a court action against a data controller to seek compensation for damages caused by the illegal treatment of personal data.

Criminal law issues

In serious cases, unlawful data processing may also be deemed as illegal collection and distribution of information on the private life of a person. The Russian Criminal Code provides that such violations are punishable with a fine, compulsory works or imprisonment.

» The most significant issue over the past years remains compliance with the data localisation requirements. Control by the authorities does not relent and still results in fines. So, data controllers have less room for flexibility.



Right to be forgotten

Russian Internet users enjoy the right to demand the removal of online links to information about them.

Within ten days after the receipt of a relevant request from an individual, a provider must remove relevant link(s) or give reasons if it refuses to do so. This refusal may be appealed by the individual in court.

Intellectual property

General approach

Over the years, Russia has demonstrated its willingness to reinforce its efforts in combating the infringements of intellectual property rights.

Russia has been a member of the World Trade Organisation since 2012. In the run-up to WTO accession, Russia adopted new legislation matching international standards for the protection of intellectual property rights by, in particular, increasing sanctions for, and improving legal mechanisms to combat infringements of intellectual property rights. The resulting legal framework in the field of intellectual property is generally in line with international standards, allowing right owners to adequately protect their intellectual property rights.

Examples of Russia's commitment to advancing the fight against copyright infringements include the adoption of:

- a law that connected administrative fines for the production of fake goods with the number of fake goods produced in summer 2013;
- the so-called "Anti-piracy Laws"¹ which deal with the procedure for blocking almost all types of copyright infringing content on the Internet and mirror websites; and
- a set of amendments to the Russian

Civil Code (the "**Civil Code**") in spring 2014 expressly providing for:

- the presumption of guilt of intellectual property rights infringers; as well as
- the legal possibility of contacting Internet providers with a request to stop infringement of intellectual property rights on the Internet.

In addition, the online industry in Russia took a step towards self-regulation in the sphere of anti-piracy. Accordingly, Russian associations for the protection of rights of owners and licensees, large Russian media holdings and TV companies, as well as Russian search engines and large Russian platforms that host video content, have signed a memorandum on cooperation for the protection of exclusive rights over digital technologies. This memorandum is aimed at more efficiently combating illegal content online.

International standards

Russia is a party to a number of the most important international treaties and conventions covering different intellectual property aspects, including:

- the Convention establishing the

¹ Federal Law No. 187-FZ dated 2 July 2013, Federal Law No. 363-FZ dated 24 November 2014 and Federal Law No. 156-FZ dated 1 July 2017.

World Intellectual Property Organisation;

- the Universal Copyright Convention;
- the Berne Convention for the Protection of Literary and Artistic Works;
- the Paris Convention for the Protection of Industrial Property;
- the Madrid Agreement on the International Registration of Marks and the Madrid Protocol;
- the Singapore Treaty on the Law of Trademarks;
- the Nice Agreement on the International Classification of Goods and Services for the Purposes of Registration of Trademarks;
- the Patent Cooperation Treaty (PCT);
- the Eurasian Patent Convention;
- the Locarno Agreement Establishing an International Classification for Industrial Designs;
- the Geneva Convention for the Protection of Producers of Phonograms against Unauthorised Duplication of their Phonograms;
- the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS); and
- the Hague Agreement Concerning the International Registration of Industrial Designs.

General legal framework

Civil Code

The need to ensure consistency in the legal regulation of intellectual property has led to the adoption of Part IV of the Civil Code. This codifies the existing general legal rules concerning intellectual property rights whilst

introducing some new provisions and principles.

Part IV of the Civil Code includes an exhaustive list of intellectual property rights and the various legal methods for protecting these rights. It also sets out some general requirements concerning their use and their enforcement.

Regulatory orders

In addition to Part IV of the Civil Code, certain intellectual property issues are regulated by orders of the Federal Service for Intellectual Property (“Rospatent”).

Rospatent is subordinated to the Ministry of Economic Development and is responsible for the registration of intellectual property rights to trademarks, patents, software, databases, as well as for the registration of, alienation of, and encumbrances over these registered rights.

Specialised court

The Russian Intellectual Property Court (the “IP Court”) has been operating since 2013. As expected, this has led to an increase in professionalism and a sound legal approach with regard to judgments in this field, not only from the newly established court but also across the Russian court system as a whole².

² Please see the IP Court section on page 132.

Contractual aspects of intellectual property rights

Licence agreement

General

A licence agreement grants the right to use intellectual property rights within the limits set out in the agreement.

Under the Civil Code, licence agreements must set out the following information:

- the licensed object;
- the duration of the licence;
- the territories for which the licence is granted;
- the manner in which the licensed object may be used; and
- the amount of remuneration (i.e. the royalty payments) or its method of assessment.

The licence may be granted on an exclusive or on a non-exclusive basis. By granting an exclusive licence, the licensor is not only unable to issue subsequent licences to others, but is also prohibited from itself using the rights transferred under such licence, unless otherwise agreed by the parties. If the licensee is entitled to issue sublicences, this must be expressly provided for in the agreement.

Licences are deemed to be granted for consideration, even if the licence agreement is silent on remuneration. The agreement may fix the amount of remuneration (royalty payments), or set out a method to determine it. Remuneration may take the form of a lump-sum fixed in advance and delivered as a single payment, periodical royalties, or as a percentage of revenues.

Commercial entities are prohibited from entering into exclusive licence agreements worldwide and for the whole term of the respective intellectual property protection on a free-of-charge basis.

Shrink-wrap licences

Shrink-wrap licences for software and databases are where the conditions of the licence are provided for on the plastic wrapping of the CD or in electronic form, and the first use of the software or database by the consumer means they agree to adhere to the conditions of the licence. The Civil Code permits the use of shrink-wrap licences for software and databases which may be granted to each user.

Open licences

The legal concept of an open licence to use works of science, literature or art exists in Russian law. In essence, this type of licence is deemed to be a contract of adhesion. Therefore, the law requires the terms and conditions to be freely accessible to anyone who wishes to review them.

Licence conditions must contain the scope of the use of the work. Unless otherwise stated in the licence conditions, licences will be granted free-of-charge and be valid throughout the world for five years (if the open licence is for computer programmes and databases, this will be for the duration of the exclusive rights).

Assignment of exclusive rights

According to the Civil Code, this contract involves transferring the full and exclusive rights and title to an object of intellectual property rights for the entire period during which these rights are protected. Notably, free-of-charge assignment agreements between commercial entities are expressly prohibited (unless otherwise regulated by the Civil Code).

State registration of contracts

If a trademark, software, database, invention, utility model or design is registered with Rospatent, then any licence, assignment contracts or pledge contracts (as expressly provided for by the Civil Code) also require registration with Rospatent in order for the contract to be valid for third parties.

Rights over the results of intellectual activity
Copyright and related rights
Copyright

Copyright covers scientific, literary or artistic work that is the product of creative activity regardless of the value, type or mode of expression of the work. Copyright protects both disclosed and undisclosed works. Copyright protection arises when a work is created. There are no registration requirements.

Chapter 70 of the Civil Code gives an author certain rights over his/her work. It sets out exclusive property rights over the work, as well as moral rights for the author of the work.

These exclusive rights include (among other things) the:

- right of reproduction;
- right of distribution;
- right of demonstration to the public;
- right to import or export originals; and
- right to provide access to the work by any means of telecommunication (including the Internet).

Moral rights include in particular the:

- right of authorship;
- right to the name;
- right to preserve the integrity of the work; and
- right of publication.

The exclusive rights to the works are protected for the lifetime of the author plus 70 years.

Infringement of copyright may lead to civil, criminal and/or administrative liability.

Neighbouring rights

Neighbouring rights cover the creation and use of performances, phonograms, broadcasting programmes, cable distribution organisations, and databases.

The owner of neighbouring rights may be the performer of phonograms, the creator of databases or the broadcaster of media.

Under the Civil Code, performers enjoy both exclusive property rights and moral rights, whilst radio and television

broadcasters only enjoy exclusive property rights.

The holding and the exercise of neighbouring rights is not subject to any mandatory registration formalities.

The rights enjoyed by owners of neighbouring rights may be granted by virtue of a licence agreement, or a contract for the exclusive assignment of rights.

Online audio-visual platforms

Regulations governing online platforms used for the creation and distribution of audio-visual works came into force on 1 July 2017. The regulations cover the following platforms, in particular:

- websites;
- information systems; and
- computer programmes.

The regulations will, however, only apply to platforms:

- that provide access to audio-visual works for a fee or on the condition that the viewers watch advertisements; and
- having a daily audience of at least 100,000 Russian-based users.

The owners of audio-visual platforms must comply with a number of obligations. These include, for example, a prohibition on the dissemination of certain information, specific requirements on the dissemination of information to the general public and the ensuring that its content is subject to age-based restrictions, where appropriate.

The liability of legal entities for violations ranges from RUB 300,000 (EUR 4,290) to RUB 3m (EUR 42,900). Violations can also lead to the blocking of the audio-visual platform by order of the court.

₹ RUB 70 = EUR 1 *notional exchange rate used for convenience

The Russian Federal Service for Supervision in the Sphere of Telecom, Information Technologies and Mass Communications (i.e. “Roskomnadzor”) maintains a register³ of such audio-visual platforms.



Moreover, such platforms can only be owned by Russian legal entities or Russian citizens that are not also citizens of other countries. Foreigners are permitted to own such Russian legal entities but there are some limitations on specific foreign operators.

Patents

National registration

Patent protection covers:

- **inventions**, which are a technical solution in any field related to a product or a process;
- **utility models**, which are the devices that are the result of intellectual activity in the scientific and technical spheres; and

³ <https://rkn.gov.ru/opendata/7705846236-AudiovisualService/>

- **industrial designs**, which are the result of intellectual activity in relation to the appearance of the product.

Chapter 72 of the Civil Code regulates the protection of inventions, utility models and industrial designs.

Patent protection is subject to conditions, which depend on the type of object being protected.

An invention can only be protected if it:	is new; has an inventive step; and is capable of industrial application
A utility model can only be protected if it is:	new; and capable of industrial application
An industrial design can be protected only if it is:	new; and original

The concepts of dependent invention, dependent utility model and dependent industrial designs are defined in the Civil Code. To use them, it will be necessary to be authorised by the patent holder of the inventions, utility models or industrial designs. Without such authorisation, the dependent objects of intellectual property cannot be used. Unlike copyright, which protects the author’s work from the day of its creation, a patent is only protected after being registered with Rospatent. The right to obtain a patent belongs to the inventor, his/her employer (in case of an employee’s invention) or to their

assignee(s). The patent application is filed with Rospatent for examination. Rospatent will grant the patent if the relevant criteria are met.

- The maximum duration for patent protection is as follows:
- 20 years from the filing date of a patent application for an invention, with the possibility of up to a five-year patent term extension for pharmaceutical products, pesticides and agrochemicals;
 - ten years from the filing date of a utility model application; and
 - five years from the filing date of an industrial design application, with the possibility of up to a five-year term extension, which may be renewed so that the entire period of life of a design patent may be up to 25 years.

According to the Civil Code, inventions and, as of June 2019 industrial designs, are also subject to temporary protection during the registration process. Once the relevant patent is granted, the owner may demand payment of remuneration for the use of the invention/industrial design during the registration term.

The patent licence and/or any assignment agreement need to be registered with Rospatent. It is also possible to obtain a compulsory licence, following the decision of a court. Rospatent also registers open patent licences, which may be chosen by the owner of the patent.

Industrial design applicants no longer need to file a list of essential features of the design by registration, which had traditionally been serving as the basis for determining the scope of protection of the design. This means that designs are protected within the scope of the image of the design and its description. This change has narrowed the scope of protection of industrial designs.

International and regional registration

In addition to national registration, there are also two levels at which inventions can be protected, namely: at international and regional levels.

At international level, an invention can be protected by the International Patent System. By filing one international application under the Patent Cooperation Treaty (PCT), applicants can protect an invention in more than 153 PCT contracting states.

Russia has been a party to the Hague Agreement Concerning the International Registration of Industrial Designs since 28 February 2018. This enables the protection of industrial designs in Russia (as well as in many other countries) through a new procedure that is faster and cheaper than filing an international application for data protection.

Alternatively, an invention can be protected at regional level on the basis of a single Eurasian patent valid within the territory of the nine member states of the Eurasian Patent Convention (EAPC).

On 9 September 2019, the member states of the Eurasian Economic Union adopted the Protocol on the Protection of Industrial Designs to the EAPC which entitles applicants to receive a single Eurasian patent on industrial designs by filing a single application. The Protocol has not yet been implemented in Russian law, but is likely to come in force in 2020. If so, this will make the regional patent registration procedure much more convenient.

Trade secrets and know-how

IP-related information and professional activity methods which have actual (or potential) commercial value can be defined as a trade secret or know-how as long as the necessary criteria are met. In particular, the information must be unknown to third parties because there is no free access to it. Further, the owner of the trade secret must take active measures to protect the secret and ensure that there is no free access to it (in particular, by implementing the so-called “trade secrecy regime”).

The Law on Trade Secrets⁴ defines the information that constitutes a trade secret and lists the measures that the right owner should take in order to ensure the protection of know-how. The law also provides for civil, administrative and criminal liability for a breach of trade secret rights.

⁴ Federal Law No. 98-FZ “On Trade Secrets” dated 29 July 2004.

Employees' work and employees' inventions

The Civil Code regulates employees' work. This includes copyrighted works and patented objects that are created by employees as part of their employment duties or the tasks instructed by the employer.

As a general rule, exclusive rights to the results of an employee's intellectual activities belong to the employer.

However, if the employer fails to use, license or assign its employees' work within a prescribed period, or the employer fails to notify the employee that it has decided to keep the work secret, the exclusive rights to the work (or invention) will be transferred to its author, i.e. the employee. This does not apply to know-how.

If the employer has started to use the work, assigned the rights to it, or has decided to keep it secret, the employee is entitled to be remunerated as agreed by the parties. If the parties fail to agree on the amount, then a competent court may determine the remuneration. Specific rules⁵ regulate the amount of remuneration of employee inventors of patentable inventions, industrial designs and/or utility models ("IP Objects"). They set minimum amounts for three different types of compensation, namely for: (i) the creation of a patentable IP Object; (ii) use of an IP Object by the employer; and (iii) the licensing or assignment of an IP Object by the employer.

The right to remuneration from the employer is not inheritable. However, the rights from the agreement concluded between the employee and the employer, as well as any outstanding remuneration which the employer has not paid, are transferred to the employee's heirs.

Company names, trade names, trademarks and appellations of origin

Chapter 76 of the Civil Code provides for the protection of means of individualisation, i.e. the protection of those intellectual property rights that are used to distinguish and identify companies or the goods or services they offer.

Company names

The company name is indicated in the corporate documents of the company, and it is reflected in the Unified State Register of Legal Entities. The company name is protected in Russia upon the company's registration with the tax authorities.

The exclusive right of a company over its company name may not be transferred or licensed to third parties. This exclusive right allows the owner of the company name to use the name freely, in particular, (i) on signs; (ii) on letterheads; (iii) on official documents; (iv) in advertising; (v) on products; (vi) on packaging; and (vii) on the Internet.

⁵ Russian Government Decree No. 512 dated 4 June 2014.

Additionally, the company name may be protected as a trademark or as a commercial name (a trade name).

Trade names/commercial names

Legal entities may use trade names separately from their company name. Unlike the company name, the trade name is not necessarily mentioned in corporate documents or in the Unified State Register of Legal Entities. The trade name may be used to distinguish different enterprises of a legal entity. A legal entity can have only one trade name. A legal entity may not use a trade name which would create confusion with a third party's company name or trademark or which would mislead consumers. The right to use a trade name to individualise a Russian company is valid throughout Russia.

This exclusive right ceases to exist if the owner does not use the trade name for one year. The right to use a trade name is protected independently, regardless of the company name or trademarks. It may be transferred by a franchise agreement or by a contract for the lease of an enterprise.

Trademarks/service marks

A trademark is a designation which is used to distinguish the goods or services of companies. A trademark can be a word, a figure or a three-dimensional designation, or a combination of all of these elements. The Civil Code provides a list of words and designations that may not be used as trademarks.

To be protected in Russia, the trademark needs to be registered with Rospatent in the Register of Trademarks. Alternatively, it may be protected in Russia under the Madrid System of the International Registration of Marks.

The duration of trademark protection is ten years, which is calculated from the date of filing of the application with Rospatent. There is an option to renew this ten-year protection period, subject to the necessary petition and payment being made.

As a general rule, the exclusive rights to a trademark are transferable to third parties, unless this assignment would be misleading for consumers. The exclusive right to use a trademark may also be licensed to allow a third party to use that trademark within the framework of the licence and in accordance with the quality requirements set out by the licensor.

Trademark protection may be terminated early if the trademark is not sufficiently used during any three consecutive years after the date of registration. Any interested person may file an application for non-use invalidation with the Chamber of Patent Disputes under Rospatent.

Information on applications for the registration of a trademark is to be published in the official gazette of Rospatent, as well as in Rospatent's online database⁶.

⁶ www1.fips.ru/registers-web/action?acName=clickRegister®Name=RUTMAP



Any person may object to a particular trademark as soon as this information has been officially published.

Appellations of origin of goods

The appellation of origin of goods is the name of the place where the goods come from. It may designate a country name, a city or any geographical area referring to the place of origin of the product.

An appellation of origin registered with Rospatent is protected throughout Russia. Any producer (or group of producers) acting within the geographical area designated by the appellation of origin may enjoy the right to use that name provided it has first obtained a certificate from Rospatent and, if the appellation of origin has not yet been registered, to register it.

The system of official publication of trademark registration applications and right to object described above applies to appellations of origin.

Geographical indications

From 27 July 2020, geographical indications will be protected in Russia and it will be possible to register them with Rospatent. The corresponding amendments to the Civil Code were signed on 26 July 2019.

The geographical indication is a new form of intellectual property which will co-exist with appellations of origin of goods.

The geographical indication is a designation used on products that have a specific geographical origin and possess special qualities or a reputation that are due to that origin. At least one stage of the product manufacturing process must be conducted on the territory specified in the geographical indication.

Intellectual property rights infringements

Situation in Russia

Background

Counterfeiting and piracy are difficult to quantify in general, and this is especially true in Russia. They affect all areas of the Russian economy, including: consumer products, automotive, pharmaceuticals, etc. Counterfeit and pirated products are mainly distributed through "open-air" markets and online shops, although they may often be found in reputable department stores.

Recognising the magnitude of the problem and its potential impact on consumers' health and well-being (especially with regard to pharmaceuticals), Russia has demonstrated a willingness to fight counterfeiting and to ensure the compliance of its laws and enforcement mechanisms with international standards.

Protection through customs

When counterfeit or pirated goods are imported to Russia, Russian customs officers can assist right owners in stopping the infringement of their intellectual property rights provided the right owners applied to have the relevant rights entered into a special Customs Intellectual Property Register. Customs officials can also in some cases take action on their own initiative by virtue of their status. The powers of customs officials are limited to copyrights and trademark rights (they do not cover inventions, utility models or designs). The maximum protection period for registered rights is two years, renewable at the request of the right owner.

Issue of parallel imports

Parallel importation is considered as a trademark infringement in Russia, although recent trends in the court practice and relevant legislative initiatives are controversial in this respect.

Since the spring of 2015, the Russian authorities have been pushing for parallel imports to be allowed, at least in relation to certain types of goods (such as pharmaceuticals, medical devices, automotive parts, cosmetics, perfumes, alcoholic beverages (except beer) and hygiene products).

In 2017, the Eurasian Intergovernmental Council was provisionally authorised by the Eurasian Economic Council to allow parallel imports of certain goods. The authorisation is, however, subject to the unanimous agreement of all the

members of the Eurasian Economic Union and to date, no such agreement has been reached.

In 2018, the Russian Constitutional Court decided that parallel importation may be allowed if the trademark owner follows unfair practices such as price regulation or restriction of competition.

Such an approach was also set forth in Resolution No. 10 "On Applying Part Four of the Russian Civil Code" issued in April 2019 by the Plenum of the Russian Supreme Court.

Liability

Russian legislation provides for civil, administrative and criminal liability for the infringement of intellectual property rights. The sanctions depend on the amount of the counterfeit goods involved and on whether the individuals or legal entities involved are repeat offenders.

Civil penalties

The civil law route entitles the trademark owner to file a claim in court for the:

- termination of the infringement;
- seizure/destruction of the counterfeit goods (or removal of counterfeit signs or labels); and
- payment of compensatory damages or statutory liquidated damages (in an amount of RUB 10,000 - 5m (i.e. from EUR 143 - 71,500), or double the value of the infringing goods or of the right to use the infringed trademark under regular market conditions).

The Anti-piracy Law provides copyright and neighbouring rights owners with an efficient tool of copyright enforcement – web blocking injunctions. This law covers all copyrighted works and objects of neighbouring rights, except photographic works.

Sanctions under the Russian Code on Administrative Offences

The trademark infringer is administratively liable if the damage caused by the infringement is less than RUB 250,000 (EUR 3,575). Different sanctions apply to different infringements.

For example, the levels of the applicable fines for the production of fake products depend upon the scope of the infringement, which will be based on the value of the counterfeit goods seized.

The most serious sanctions apply to legal entities that produce or sell counterfeit goods. The fine that may be imposed in this case would be five times the value of the counterfeit goods seized, and in any event not less than RUB 100,000 (EUR 1,430). The counterfeit goods will also be confiscated.

Sanctions under the Russian Criminal Code

If the damage caused by the infringement reaches or exceeds RUB 250,000 (EUR 3,575) or if the offender repeats the offence, he/she may be held criminally liable.

The unlawful use, disclosure or appropriation of an invention or patent that has caused significant damage to the author will result in a fine of up to RUB 200,000 (EUR 2,860) or equal to the offender’s income for 18 months, or imprisonment for up to two years.

Similar sanctions apply to infringement of copyright and to the sale of counterfeit goods.

When the offender is a legal entity, criminal sanctions will be applied against the entity’s officials, as legal entities cannot be held criminally liable under Russian law.

IP Court

The IP Court is part of the Russian commercial (“*arbitrazh*”) court system. It is located in Moscow.

The IP Court reviews:

- as a court of first instance – challenges of regulatory and legal acts of Rospatent;
- as a court of first instance – claims for the invalidation of the registration of intellectual property rights for non-use and disputes over the ownership of intellectual property rights; and
- as a court of third instance (i.e. a second appeal or a cassation) – cases concerning the infringement of intellectual property rights between legal entities and/or individual entrepreneurs.

The cassation rulings of the IP Court can be further appealed to the Supreme Court of Russia. Other rulings are appealed against at the IP Court.

Intellectual property disputes (including those associated with intellectual property prosecution issues) in Russia are reviewed by judges specialising in this area of law. Accordingly, intellectual property owners can expect a professional review of their IP-related claims in Russia and a sound legal approach in the judgments adopted as a result.

Procedural aspects

Pre-trial disputes settlement

In June 2016, a mandatory pre-trial procedure for resolving most commercial disputes was introduced through the adoption of amendments to the Russian Commercial Procedure Code.

Many court disputes have, since 11 July 2017, been excluded from the scope of the mandatory pre-trial disputes settlement procedure. Certain types of IP disputes were not initially excluded from the procedure, but special regulatory arrangements were later adopted to address such cases.

In respect of claims for damages or compensation for exclusive rights infringements, the compulsory requirement to send a pre-trial demand letter has been preserved in cases when the parties to the dispute are legal entities or individual entrepreneurs.

Despite the fact that sending a pre-trial demand is compulsory, filing a statement of claim is possible in the event of:

- a total or partial denial of the claims; or
- no response to the demand letter within a period of 30 days from the date of sending such letter.

Moreover, in cases where an interested party intends to terminate the trademark of another party for non-use, it must follow a special pre-trial settlement procedure. Under this procedure, the interested party must send a proposal to the trademark owner to:

- apply for a waiver of the trademark rights; or
- enter into a contract for the alienation of such rights.

If no action is taken within two months following the date of the proposal, the interested party has a right to start legal proceedings. The time limit set for launching such legal proceedings is 30 days from the end of the two-month period.

The pre-trial procedure requirement is not applicable if so-called “intangible demands for the protection of exclusive rights” are made. These cover, for example, claims for the seizure and destruction of counterfeit goods, and claims to suppress actions violating the rights of the right owner or threatening the violation of such rights.

» Parallel importation is considered as a trademark infringement in Russia, although recent trends in the court practice and relevant legislative initiatives are controversial in this respect. In particular, the courts have defined situations when parallel importation is allowed.



Recent court practice

In its Resolution No. 10 “On Applying Part Four of the Russian Civil Code” issued in April 2019, the Plenum of the Russian Supreme Court clarified the procedure for applying the Russian intellectual property legislation in court disputes.

Clarifications are traditionally based on specific court cases and relate to different issues, for example, jurisdiction

over disputes on the means of individualisation and evidence in intellectual property cases.

Although the Resolution does not carry the status of a statutory regulation, its provisions are often crucial for the courts when taking a decision on a particular issue, and the courts are already relying on the Resolution when resolving disputes.

Advertising issues

General approach

General legal and regulatory framework

Advertising issues are primarily governed by Federal Law No. 38-FZ “On Advertising” dated 13 March 2006 (the “**Advertising Law**”), while liability for violations of advertising regulations is mainly established by the Russian Code on Administrative Offences.

The Federal Anti-monopoly Service (the “**FAS**”), a Russian executive authority, controls and enforces compliance with advertising legislation.

Trends

Self-regulation in Russia

The FAS and the advertising industry are currently working on a bill on self-regulation of the advertising industry, whereby certain types of cases on non-compliance with the Advertising Law would be determined by a self-regulatory body rather than the FAS. The bill is expected to be submitted to the Government this summer.

Digital advertising

Digital advertising is showing incredible growth on the Russian market. It follows that court practice in this area is also developing – there have already been several cases on advertising published by bloggers (so-called “native advertising”) and on social media.

and on social media.

The Russian Supreme Court has also confirmed that using a competitor’s trademarks as a key word in “search advertising” (i.e. when an advertiser pays to have an advertisement of its product appear in the results listing when a person uses a particular phrase or word such as a competitor’s trademark to search the Internet) may qualify as unfair competition. The FAS has clarified, however, that the claimant will have the burden of proof in such cases.

Recommendations on advertising of OTC medicines

In November 2018, the Recommendations on Advertising of OTC (over-the-counter) Medicines were approved by the FAS and the pharmaceutical industry.

The Recommendations clarify that the Advertising Law imposes special requirements on pharmaceutical advertising and provides for examples of wordings and techniques that may be used in promotion materials.

Most pharmaceutical companies have adopted the Recommendations and use them in everyday activities. As a result, there has been a decrease in the number of cases on pharmaceutical advertising initiated by the FAS.

Scope of application of the Advertising Law

The Advertising Law:

- defines advertising and advertising participants;
- lists general requirements for advertising;
- imposes restrictions on advertising of specific goods¹ and specific types of advertising;
- regulates outdoor advertising and establishes the local authorities' powers in this regard; and
- empowers the FAS to oversee the application of the Advertising Law.

The Advertising Law applies to any information in any form when it is directed at an indefinite range of persons and aimed at promoting an advertised item.

Violations of the Advertising Law

General requirements

Advertising must be fair and accurate. Misleading and unfair advertising is not allowed.

Misleading advertising

Advertising will be deemed misleading by the FAS if it contains certain untrue statements on advertised products, including with regard to:

- a comparison of their advantages over those of competitors;
- their characteristics, including their nature, composition, method and date of manufacture, purpose and consumer features;
- their price and other conditions of purchase;

- official or public recognition of those products, including reference to any medals, prizes, diplomas or other awards;
- their endorsement by individuals or legal entities;
- the results of research and testing; or
- additional rights or advantages purchasers would obtain if they buy the advertised product.

Comparisons with competitors

Comparisons with competitors are generally allowed provided they are not unfair or misleading.

The advertiser is equally liable for the accuracy of information relating to its goods as well as goods of its competitors which are referenced in the advertisement.

Comparisons based on disparate criteria or incomplete comparisons of goods are prohibited, as this distorts the overall impression given by the advertised goods.

Moreover, advertising must not defame the honour, dignity or business reputation of a competitor.

If expressions such as "No. 1", "best", "first" are used, the criterion used for the comparison must be stated, and supporting documents (e.g. market research studies, surveys) must be referred to.

¹ Below the use of the word "goods" includes "services and works".

Lack of essential information

Advertising must not omit any essential information on advertised goods (including conditions for their purchase or use) if this would mislead consumers.

The general approach is that all essential information should be described in the key message of the advertisement; however, disclaimers and footnotes are permissible. A disclaimer must be of sufficient size to be clearly readable by consumers, and the print must have a reasonable degree of contrast between the background and the printed text.

Ethical aspects

Advertising must not be offensive (with regard to gender, nationality, race, social category, age, language, cultural properties, etc.). Using swear words or obscene and abusive images is also prohibited.

Consent

Advertisers must not send spam emails, SMS and other digital advertising messages to consumers without their consent.

Language

It is forbidden to use words or expressions in a language other than Russian without a translation or transliteration in the advertisement, if this may lead to the meaning of the information in the advertisement being distorted. The only exception is for the use of trademarks and foreign companies' names.

Surrogate advertising

Surrogate advertising is prohibited. This is a form of advertising used to promote goods which cannot be advertised by law under the guise of other goods.

Unfair competition

Any advertising which represents unfair competition under the Competition Law² is recognised as unfair.

Use of the image of a doctor

It is forbidden to use images of doctors and pharmacists in advertising. The exception is advertising which is (i) distributed only among doctors and pharmacists; (ii) distributed in venues of medical or pharmaceutical exhibitions, seminars, conferences and other similar events; or (iii) placed in print publications intended for doctors and pharmacists.

Special provisions

Prohibited goods in Russia

The following must not be advertised:

- goods that it is forbidden to manufacture or sell;
- narcotics and psychotropic substances (including the plants and parts used in the development of such substances);
- explosive compounds and materials, except for pyrotechnic products;
- body organs or human tissue as an object for sale or purchase;
- unregistered goods that are subject to state registration;

² Please see the Anti-monopoly issues chapter on page 41.

- goods that have not obtained any mandatory certification or confirmation of compliance with technical regulations;
- goods that have not obtained any necessary licence or other special permission for their manufacture or sale;
- tobacco, tobacco products and smoking accessories, including pipes, hookahs, cigarette paper and lighters;
- medical services for abortions; and
- drafting services for graduation theses or other qualification works required to pass educational exams.

Protection of minors

Advertising must not:

- discredit parents and teachers;
- undermine confidence in minors;
- incite minors to persuade parents or other persons to purchase the advertised goods;
- create a false impression that the advertised goods are available to a family with any level of income;
- create the impression among minors that having the advertised goods would accord them a preferable position in relation to their peers;
- induce an inferiority complex in minors who do not have the advertised goods;
- portray minors in dangerous situations, including cases that may prompt them to commit acts that pose a threat to their life or health;
- underestimate the level of skills necessary to use the advertised goods; or

- give rise to an inferiority complex in minors associated with their physical appearance.

Advertising of certain goods (e.g. alcohol, medicines, gambling) must not be addressed to minors.

Distance selling of goods

Advertisements of goods sold remotely must contain information in relation to the seller, including its name, registration number and registered address.

Promotional competitions

Advertising of any promotional competition must include:

- the date(s) of the competition; and
- information on the competition's organiser, its rules, the number of prizes or winnings, its location, its timing and how any prize can be obtained.

Sponsorship advertising

Sponsorship advertising must disclose the name of the sponsor.

Sponsorship in television programmes must not exceed 20% of broadcasting time per hour and 15% of broadcasting time per day.

Alcohol

Advertisements of alcoholic beverages must not:

- contain a statement that consuming alcoholic beverages is important to achieve public recognition, professional, athletic or personal success, or to help improve physical

- or emotional state;
- criticise abstention from alcohol;
- state that alcohol is safe or helpful for health;
- represent alcohol as a way to satisfy thirst;
- address minors; or
- use images of humans or animals, including animated ones.

Advertisements of alcohol must not be published:

- in the press (with an exception for beer and beer-based beverages and Russian-produced wine, which can be advertised in the press except on the first or last pages, or on covers);
- in print media, audio and video broadcasts or recordings intended for minors;
- on television or radio (except for (i) sport events broadcasting under specific conditions; and (ii) Russian-produced wine);
- on transport vehicles;
- in or near educational, medical or certain other institutions including libraries, theatres and concert halls; or
- online.

Promotional campaigns related to alcohol may only be held in certain authorised places (e.g. in shops where alcohol is sold).

Permitted alcohol advertising must be accompanied by a warning about the dangers of excessive consumption. Such a warning must take at least 10% of the advertising space.

Medicines and medical services

Advertisements of medicines and medical services³ must not:

- address minors;
- refer to specific cases of persons being cured, or the improvement of health, as a result of the use of the advertised medicines;
- contain an expression of gratitude by individuals pertaining to use of the advertised medicines;
- give the impression that the advertised medicines have advantages by referring to the fact that research which is compulsory for the state registration of the advertised medicines has been completed (e.g. clinical trials, bioequivalence study);
- contain statements or assumptions that certain diseases or health disorders exist;
- create an impression that healthy persons need to use the advertised medicines;
- create an impression that it is unnecessary to visit a doctor;
- guarantee that the advertised medicines have a positive effect, are safe, effective and have no side effects;
- present the advertised medicines as biologically active dietary supplements and food supplements or other non-medicinal products; or
- contain statements that the safety or effectiveness of the advertised medicines is guaranteed because it is natural.

³ Below the use of the word "medicine" includes "medical services".



Advertisements of medicines and medical services must also contain the following disclaimer: *"There are contraindications. Please read the instruction or consult a specialist"*.

There are also requirements for the size and duration of any disclaimers used in the advertisements of medicines and medical services:

- Disclaimers used in radio programmes must be at least three seconds.
- Disclaimers used in TV shows, films or online videos must be at least five seconds and comprise at least 7% of the frame area.
- Disclaimers used in any other distribution methods, including online, must comprise at least 5% of the advertising space.

In 2018, the FAS approved the Recommendations on Advertising of OTC Medicines. In particular:

- It contains an exhaustive list of words and expressions that are acceptable or unacceptable in pharmaceutical advertising.
- In deciding whether an advertisement guarantees the effectiveness of the medicine, the entire content should be considered (e.g. in video advertising, the text and the visual imagery should be analysed).
- The use of words such as "quickly" or "fast action" to characterise the therapeutic effect of a medicine is prohibited.

Biologically active dietary supplements and food supplements

Advertisements of biologically active dietary supplements and food supplements must not:

- give the impression that the advertised goods are medicines and have medicinal features;
- contain references to specific cases of persons being cured or the improvement of health;
- contain an expression of gratitude by individuals;
- suggest that such supplements are a substitute for a healthy diet;
- give the impression that using these goods is beneficial by referring to the fact that research which is compulsory for the state registration of the advertised supplements has been completed, or by using the results of another research as a direct recommendation to consume supplements.



Advertisements of such supplements must also contain the following disclaimer: *"A food supplement is not a medicine"*.

There are also requirements for the size and duration of any disclaimers used in the advertisements of supplements:

- Disclaimers used in radio programmes must be at least three seconds.
- Disclaimers used in TV shows and films must be at least five seconds and comprise at least 7% of the frame area.
- Disclaimers used in other distribution methods must comprise at least 10% of the advertising space.

Gambling

Gambling advertisements must not:

- address minors;
- make an impression that gambling is a way of generating earnings or other income;
- contain statements that overestimate the chance of winning or underestimate the risk of losing;
- have any reference to winners that did not receive an award;
- contain statements that gambling is important to achieve public recognition, professional, athletic or personal success;
- criticise non-participation in gambling;
- give the impression of guaranteed wins; or
- use images of humans or animals.

Gambling advertisements must state:

- the prize drawing timeframes; and
- information on the organiser, as well as on the rules, prizes, location and how prizes are obtained.

Gambling advertisements may only be distributed in particular sources (e.g. in the media and on websites specialising in sports).

Financial services and products

Advertisements of banking, insurance and other financial services and financial products must contain the name of the company or individual providing such services or products.

An advertisement must not:

- contain any guarantees or promises

of future profitability;

- omit conditions for the provision of the relevant services which would affect the amount of income received, or the expenses incurred, by those using the services.

Advertisements related to the provision of a loan must disclose all conditions pertaining to the use and repayment of the loan so that the total cost of the loan is determinable.

The Advertising Law sets forth specific provisions on the disclosure of information in advertisements related to securities, real estate investments and other financial services.

Liability

Individuals and legal entities may be subject to administrative liability for non-compliance with advertising legislation (please see the table on the next page).

» Digital advertising is showing incredible growth on the Russian market. It follows that court practice in this area is also developing – there have already been several cases on advertising published by bloggers (so-called “native advertising”) and on social media.



Potential liability	Legal entities	Company officials	Individuals
General fines	RUB 100,000 - 500,000 (EUR 1,430 - 7,143 ⁴)	RUB 4,000 - 20,000 (EUR 57 - 286)	RUB 2,000 - 2,500 (EUR 30 - 36)
Fines in case of breaches of special standards for broadcast advertising	RUB 200,000 - 500,000 (EUR 2,857 - 7,143)	RUB 10,000 - 20,000 (EUR 143 - 286)	–
Fines for breaching limits of advertising text in printed media	RUB 40,000 - 100,000 (EUR 571 - 1,430)	RUB 4,000 - 7,000 (EUR 57 - 100)	–
Fines for breaching special standards on the advertising of medicines, medical devices, medical services, biologically active dietary supplements and food supplements	RUB 200,000 - 500,000 (EUR 2,857 - 7,143)	RUB 10,000 - 20,000 (EUR 143 - 286)	RUB 2,000 - 2,500 (EUR 30 - 36)
Fines for breaching special standards on the disclosure of information in financial advertising	RUB 300,000 - 800,000 (EUR 4,286 - 11,430)	RUB 20,000 - 50,000 (EUR 286 - 715)	–

⁴ At the notional exchange rate of RUB 70 = EUR 1, as used for convenience throughout this guide.

Anti-corruption and compliance

General approach

Over the past decade, a number of anti-corruption measures have been introduced at the legislative and executive levels in Russia. However, the issue cannot be resolved all at once. And the level of corruption in Russia is widely assumed to be relatively high according to international studies and ratings.

Recent developments and trends

The President's National Anti-corruption Plan for the period 2018-2020 aims, as previous plans, to improve the legislation and enforcement practice in the following areas:

- prevention and disclosure of conflicts of interest;
- control over state officials' expenses and forfeiture of non-confirmed incomes to the state;
- counteraction of corruption in the public procurement sector; and
- international collaboration on revealing, arresting and returning assets gained as a result of corruption.

Many efforts in the past two years were directed at counteracting corruption both at the level of the civil service and that of private companies.

A number of initiatives were aimed at increasing transparency in the civil

service and generally deterring civil servants from committing corruption offences. For instance:

- In 2019, the General Prosecutor's Office was granted the right to request information on the foreign bank accounts of civil servants through the Central Bank of Russia.
- A register of civil servants dismissed for corruption offences has been available online at

 <https://gosszluzhba.gov.ru/reestr>

since 2018.

The Ministry of Labour and Social Protection has developed new recommendations regarding anti-corruption measures to be adopted by companies.



Please see the *Compliance requirements for companies* section below.

However, many organisations still fail to implement anti-corruption measures in spite of the fact that there has been a legal requirement to do so since 1 January 2013. This is largely because no specific sanctions for the relevant violations are in place.

A legal entity will now be liable when bribery offences have been committed

not only for its benefit, but also for that of any related legal entities. The maximum fine for such offences was increased to 100 times the amount of the bribe (on top of the seizure of the amount paid as a bribe).

At the same time, some of the initiatives widely discussed in 2018 were put on hold or declined in 2019. For example, a bill protecting whistle-blowers was rejected by the State Duma, and a bill introducing restrictions on the types of gifts that civil servants may receive was postponed for an indefinite period.

Court practice in the sphere of anti-corruption has also been developed:

- At the end of 2019, the Supreme Court of the Russian Federation amended its resolutions of the Plenum on bribery cases and abuse of powers.
- Rulings of lower courts on corruption cases were regularly reviewed by the Supreme Court and summarised in court practice reviews.
- In 2019, the Constitutional Court of the Russian Federation established that non-confirmed incomes or property purchased using such incomes can also be seized from any relatives and even friends of a civil servant.

According to the General Prosecutor's Office, the number of corruption crimes revealed by investigating authorities for the first nine months of 2019 increased in comparison with 2018 (26,114 in 2019 against 25,004 in 2018)¹.



Similarly, the number of offences committed by legal entities has doubled over the past five years².



As in the previous year, 2019 saw several landmark anti-corruption cases and investigations against high-ranking officials, including the governors of several regions and federal agency officials.

Legal framework Relevant legislation

Prior to 2008, there was very little anti-corruption legislation in Russia. However, in 2008, the first National Anti-corruption Plan was announced. As part of that Plan, Federal Law No. 273-FZ "On Fighting Corruption" was enacted on 25 December 2008 (the "**Anti-corruption Law**") (as amended and supplemented). This law remains the principal legislative act on bribery in Russia. However, the relevant legislation is by no means consolidated and relevant provisions are found in a number of legal acts.

¹ <https://www.kommersant.ru/doc/4186717>

² <https://www.interfax.ru/interview/687205>

Russian law in this area is also affected by international treaties.

The current legislation on corruption now includes:

- International legislation:
 - United Nations Convention against Corruption dated 2003 (ratified by Russia in 2006);
 - Criminal Law Convention on Corruption No. 173 by the Council of Europe (ratified by Russia in 2007); and
 - OECD Convention on Combating the Bribery of Foreign Public Officials in International Business Transactions dated 1997 (ratified by Russia in 2012).
- Federal legislation directly addressing corruption:
 - the Anti-corruption Law;
 - Federal Law No. 230-FZ "On Monitoring the Correlation of Expenses by State Officials with their Incomes" dated 3 December 2012;
 - Federal Law No. 79-FZ "On the Prohibition for Certain Categories of Individuals to Open and Have Accounts, Keep Moneys and Assets in Foreign Bank Accounts outside the Russian Federation, Own and/or Use Foreign Financial Instruments" dated 7 May 2013;
 - Federal Law No. 172-FZ "On Anti-corruption Examination of Regulative Acts" dated 17 July 2009;
 - Law No. 2202-1 "On Public Prosecution" dated 17 January 1992;
 - Federal Law No. 79-FZ "On Public Civil Service" dated 27 July 2004 (the "**Public Civil Service Law**");
 - Federal Law No. 262-FZ "On Access to Information on Court Activities in the Russian Federation" dated 22 December 2008;
 - the Criminal Code of the Russian Federation dated 13 June 1996 (the "**Criminal Code**"); and
 - the Code on Administrative Offences of the Russian Federation dated 31 December 2001 (the "**Code on Administrative Offences**").
- Federal legislation indirectly addressing corruption, such as:
 - Federal Law No. 3-FZ "On Police" dated 7 February 2011;
 - tax law; and
 - Federal Law No. 44-FZ "On the Contractual System in the Sphere of the Procurement of Goods, Works or Services for State and Municipal Needs" dated 5 April 2013 (the "**Public Procurement Law**").
- Decrees of the President, the Federal Government and other executive executive bodies, specifically:
 - establishing the National



Please see the *Disclosure rules* section below.



Please see the *Example of sector-specific anti-corruption measures* section below.

Anti-corruption Plan (includes a list of steps and measures to be taken with a view to fighting corruption); and

- regulating the anti-corruption examination of the acts of governmental bodies.

However, the legislation is still quite fragmentary and sometimes confusing.

In addition to Russian law, laws of other states may be applicable to situations in Russia. The United States Foreign Corrupt Practices Act of 1977, the United Kingdom Bribery Act of 2010 and the French Sapin II Law of 2016 have a wide extraterritorial reach.

State agencies

Apart from the general law enforcement authorities (the police, public prosecution, etc.), several state agencies are responsible for enforcing federal anti-corruption measures, such as the President's Council on Counteracting Corruption (as a supervising body) and the Ministry of Justice (responsible in particular for the anti-corruption screening of draft legal acts).

The General Prosecutor's Office has a range of authorities to counteract corruption, including:

- initiating administrative proceedings and carrying out administrative investigations;
- participating in court proceedings on corruption crimes;
- coordinating investigation authorities in anti-corruption matters; and

- monitoring enforcement of anti-corruption legislation.

Special parliamentary committees have also been established to monitor the income and assets of the members of parliament.

Compliance requirements for companies

Russian companies, representative offices and branches of foreign companies must develop and implement internal measures aimed at preventing bribery. These include, amongst others, appointing compliance officers, adopting internal codes of ethics and policies for all employees, cooperating with law enforcement authorities.

To help companies implement effective anti-corruption measures, the Ministry of Labour and Social Protection has developed new recommendations on combating corruption in organisations.

These recommendations include adopting measures aimed at minimising corruption risks for companies and, in particular, those related to:

- developing anti-corruption policies and standards;
- settling conflicts of interest;
- interacting with employees;
- building an effective system for obtaining information on corruption offences; and
- interacting with law enforcement agencies.

To date, no sanctions are provided for failure to take anti-corruption compliance measures. However, the General Prosecutor's Office may file a claim to demand the implementation of anti-corruption measures. Moreover, in the event of checks by the authorities (police, public prosecutor, etc.), an order to remedy the failure can be issued against the delinquent company. In turn, failure to implement this kind of order carries administrative sanctions, namely fines and/or the disqualification of the company's general director from holding office for up to three years.

Concept of corruption in Russian law

The Anti-corruption Law defines corruption as:

- the abuse of an official rank or powers;
- giving or receiving a bribe;
- commercial bribery;
- other illegal use of official rank by an individual contrary to the lawful interests of the state and society for the purpose of any form of material benefit for oneself or others; or
- the illegal provision of a material benefit to a public official by another individual on their own behalf, or on behalf of or pursuant to the interests of a legal entity.

Material benefit includes money, valuables, other property or pecuniary services, benefits of a "property character" (*"immushestvenniy kharakter"*, e.g. travel offers), and other property rights.

Bribery is subject to the Criminal Code and consists of two interdependent elements: (i) the giving of a bribe; and (ii) the taking of a bribe. They are committed simultaneously and result in two separate crimes. According to the Anti-corruption Law, a bribe involving money and other assets may be a property-related benefit, service or a favour, and must have a monetary value (renovation, building a house, etc.). Property-related services may include the transfer of property at an undervalue, a reduction of lease payments or loan interest rates.

If these benefits are provided to family members or friends of the official, with the official's approval or consent, and the official has used his/her official powers to the benefit of the briber, this also constitutes bribery.

Commercial bribery is the illegal transfer of material assets to a legal entity's manager in connection with his/her position as well as the unlawful rendering of property-related services, or the granting of other property rights to him/her for taking action (or refraining from action) in the interest of the giver.

Possible targets of bribery

Even though the Anti-corruption Law contains a commercial bribery element, public officials constitute the main target of the legislation.

Definition of public officials for the purpose of anti-corruption legislation

For the purpose of Russian legislation public officials include any official or functionary with managerial, regulatory, administrative or economic (financial) duties. Specifically, these officials hold state (i.e. federal or regional) or municipal offices established by law and discharge those functions entrusted by law, specific normative acts or on the basis of an order of a respective superior official.

Officials without executive authority may still commit breaches of the Anti-corruption Law when, in their official capacity: (i) they have the opportunity to prompt another official to act (or refrain from acting) and; (ii) they have been bribed for general patronage or connivance. Even if a briber is coerced into offering a bribe by a person presenting himself/herself as an official, the former may still be liable for a bribery offence.

In 2017, the list of persons obliged to take measures to prevent conflicts of interest was clarified. To date, it includes:

- civil servants at federal, regional or municipal level;
- officials of the Central Bank of Russia, state corporations, state funds and other organisations established under federal laws;
- employees of organisations established to accomplish tasks of federal agencies; and

- other persons set out by federal laws.

Prohibitive measures for public officials

Under the Public Civil Service Law, public officials are prohibited from:

- engaging in entrepreneurial activities;
- receiving from legal entities or individuals remuneration in cash or non-cash gifts (except for gifts with a value of up to RUB 3,000 (EUR 43) given during official events);



RUB 70 = EUR 1

*notional exchange rate used for convenience

- travelling abroad at the expense of legal entities or individuals;
- purchasing securities in certain cases stipulated in the federal legislation; and
- disclosing confidential or relevant information obtained during civil service in favour of legal entities or individuals after retirement.

The Public Civil Service Law also stipulates a mechanism for regulating conflicts of interest involving public officials.

Disclosure rules

Under Russian tax law, public officials and their close relatives (their spouses and minor children) must file compulsory income declarations and disclose expenses that exceed their declared income. The tax authorities and the Council on Counteracting Corruption are authorised to check the income and

expenses of officials and demand an explanation as to the origin of their assets³, if these assets do not correlate with the income level of the individual.

Public officials may be dismissed for loss of confidence by their “employer”. Their dismissal may result from a conflict of interest while in public service, or from a failure to disclose income or expenses which should have been disclosed. If it is discovered that an official is involved in entrepreneurial activities or affiliated with legal entities, he/she must be dismissed on these legal grounds.

Liability and penalties for corruption

Public officials

Apart from bribery, the Criminal Code holds public officials liable for crimes committed against the state and/or municipal authorities, such as:

- abuse of powers;
- exceeding rank and authority;
- illegal entrepreneurial activities; and
- forgery by an official.

If a public official is prosecuted for several crimes, the court will first consider each of them independently and then as a whole to determine the gravity of the offence and resulting sentence.

Under the Criminal Code, only individuals may be held liable for crimes specified in

³ Immovable property, motor vehicles, securities and/or participations in legal entities.

the Code (including bribery/commercial bribery); however, legal entities may be punished for corrupt activities under the Code on Administrative Offences. The liability of a legal entity does not exempt a culpable individual from liability, and vice versa.

Interestingly, a bill extending the criminal liability of legal entities has been under consideration by the State Duma since 2015, although it is not yet known when the respective law will be enacted.

Individuals

Individuals are subject to:

- liability to reimburse losses in full (under the Russian Civil Code);
- disciplinary actions resulting in the termination of employment (under the Russian Labour Code);
- up to ten years’ imprisonment for abuse of authority;
- up to eight years’ imprisonment for commercial bribery (for the bribe giver);
- up to 12 years’ imprisonment for abuse of authority in conjunction with commercial bribery;
- up to 15 years’ imprisonment for a public official who receives a bribe;
- up to 15 years’ imprisonment for bribe giving;
- disqualification of a bribed public official from holding public office for up to 15 years;
- up to seven years’ imprisonment for facilitating bribery in commercial and other organisations; and/or
- up to 12 years’ imprisonment for facilitating bribery of public officials.

» The measures taken in 2019 are mainly intended to reveal and prevent potential corruption offences.



In addition to or instead of the abovementioned sanctions, those giving or receiving bribes (including commercial bribes) may be fined ten to 100 times the amount of the bribe offered/received.

Legal entities

Legal entities may be prosecuted for:

- the illegal employment of a current or former public official, carrying a fine of up to RUB 500,000 (EUR 7,150); and
- the illegal payment of a bribe on their behalf or that of any related legal entity, carrying a fine ranging from RUB 1m (EUR 14,300) to 100 times the amount of the bribe plus seizure of the amount paid. Also, the entity's assets (including bank accounts and immovable property) up to a value equal to the potential fine may be frozen while the matter is being investigated. In that sense, the legal entity may be prohibited from selling or otherwise disposing of the property.

Example of sector-specific anti-corruption measures

The Public Procurement Law contains provisions which are designed to counter bribery by:

- requiring the holding of auctions or competitive tenders for the purchase of goods, works and services for federal, regional and municipal needs ("**Public Procurement**");
- regulating in detail the procedural aspects of Public Procurement (including requirements applying to tender participants);
- prohibiting tender rules that limit the number of participants; and
- requiring Public Procurement decisions to be adopted by more than one public official (i.e. shared responsibility in adopting these decisions).

Real estate and construction

General approach

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

- the Civil Code of the Russian Federation (the "**Civil Code**");
- the Land Code of the Russian Federation (the "**Land Code**");
- the Town Planning Code of the Russian Federation (the "**Town Planning Code**");
- the Forest Code of the Russian Federation;
- the Water Code of the Russian Federation;
- Federal Law No. 102-FZ "On Mortgage (Pledge of Immovable Property)" dated 16 July 1998 (the "**Law on Mortgage**"); and
- Federal Law No. 218-FZ "On State Registration of Immovable Property" dated 13 July 2015 (the "**Law on State Registration**").

Rights to real estate

Russian law provides for two basic types of rights to immovable property:

- the ownership right (freehold); and
- the right of lease (leasehold).

Public and private ownership rights

Real estate (including land plots) in the Russian Federation may be owned

publicly or privately. In relation to land, we would like to outline a number of local specificities.

Public land ownership

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

The delineation of state- and municipal-owned land plots is regulated in the Land Code and Federal Law No. 137-FZ "On the Entry into Force of the Land Code of the Russian Federation" dated 25 October 2001.

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

Private land ownership

Any legal entity or individual may own private land in the Russian Federation, subject to certain restrictions which regulate the legal status of the land plot.

Foreign nationals and legal entities enjoy the same rights to land plots as Russian individuals and legal entities. However, in respect of the ownership of land, foreign investors may not own:

- land in certain border territories or other territories specifically designated in the Land Code or federal laws (such as, for instance, land located within the boundaries of sea ports); or
- agricultural land. This rule also applies to Russian companies with a foreign participation of more than 50% in their charter capital; foreign investors (as widely defined above) may only lease agricultural land.

Other rights to or affecting land plots

Russian land legislation also provides for other types of land rights, such as (among others) the right of permanent perpetual use of the land plot and the right of inheritable use. However, the use of such rights has no practical application for foreign investors.

As in other countries, an easement (or servitude) may be established over a land plot which is owned by a third party. This grants the land user a variety of rights (including the right to build linear facilities such as cable lines and pole lines). The easement may be public or private and the distinction depends on the range of persons who benefit from it. If the easement is required for a particular individual or legal entity, then only a private easement may be established in respect of the relevant land; if the

general public enjoys the easement, then a public easement may be established.

Since 1 September 2018, the Land Code provides for a specific legal regime for public easements established in connection with the construction of linear objects (e.g. for the placement of **utility infrastructure facilities**, the storage of construction supplies, siting roads and railways into tunnels). This regime is aimed at protecting the interests of all those involved in the development of linear facilities.

Under Russian law, it is possible to enter into an easement agreement not only with the owner of the land, but also with its legal holder (a tenant, a land user enjoying the right of free use, etc.).

Real estate transactions
Sale and purchase transactions
Cadastral and state registration

A publicly- or privately-owned land plot may be bought and sold provided that (i) it has undergone all cadastral registration formalities; and (ii) the title to the land plot has undergone state registration (save for non-delineated public lands that municipal authorities, or, in the case of Moscow and Saint Petersburg, regional authorities, can dispose of without state registration).

There are some cases when the state registration of title to the land plot can be performed simultaneously with its cadastral registration (e.g. formation of a new land plot, provided certain conditions are met).

Both procedures require the submission of certain documents to the state registration authority (i.e. the Federal Service for State Registration, Cadastre and Cartography) or its regional/local departments (“*Rosreestr*”) (the “**Registrar**”). Documents can be submitted to the Registrar’s offices in any region of the Russian Federation regardless of the immovable property’s location.

Until fairly recently, there were two main information resources for cadastral registration and state registration of rights to immovable property, namely the State Cadastre of Immovable Property and the Unified State Register of Rights to Immovable Property and Transactions therewith. In practice this often resulted in the duplication and inconsistency of records made in these two independent systems. However, since 1 January 2017, these two systems were merged into a new information resource, i.e. the Unified State Register of Immovable Property (the “**State Register**”) maintained by the Registrar in electronic form.

The State Register contains information on both immovable property and the rights thereto. In particular, it includes:

- (i) a register of immovable property;
- (ii) a register of rights to, liens on and encumbrances over immovable property;
- (iii) a register of boundaries (e.g. the boundaries of the regions of the Russian Federation and municipalities, boundaries of use-restricted zones, territorial zones and other special

territories); and (iv) registration files, cadastral maps and document journals.

Rights to buildings and structures in Russia are not effective until they are registered in the State Register. Such state registration (as evidenced by an extract from the State Register) is the only confirmation of the existence of the ownership right. Only a court decision may overrule state registration.

Since 15 July 2016, ownership certificates, which used to be the main confirmation of state registration of the ownership right to immovable property, are no longer issued and fully replaced by extracts from the State Register.

Since 1 January 2017, cadastral extracts also no longer exist. Starting from this date, both state cadastral registration and state registration of rights to immovable property are evidenced by a sole extract from the State Register.

Buildings on land plots

The Land Code prohibits the transfer of land without the buildings and structures standing on it. Ownership rights to a building may only be transferred together with the rights (be it ownership or lease rights) to the land plot underlying this building. In exceptional cases, title to parts of a building may be transferred separately from the land if it is impossible to separate the respective part of the land plot, or if there is a restriction on the acquisition of this land plot.

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

Privatisation

If buildings, structures or industrial facilities are being privatised, the underlying land must also be privatised at the same time.

A building owner has pre-emptive rights to obtain ownership or lease rights to a publicly-owned land plot on which the owner’s building stands.

In case of ownership, the buyout price is determined by the authority owning the land. In any event, the price of such land plot must not exceed its cadastral value or any other price if so established by applicable law (except for cases when the land plot is to be sold through an auction).

Sale and purchase agreement
General

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

material to the transaction. The material contractual conditions must be recorded and reflected in the State Register.

If a sale and purchase agreement does not provide the material terms and conditions, it is deemed not to have been concluded. This means that (i) the purchaser does not acquire the ownership right to the land plot or real estate; and (ii) the land plot or real estate must be vacated and returned to its owner in its original state and the sale price returned to the purchaser. These consequences arise only if a court declares the sale and purchase agreement as not having been concluded.

Purchase of future property

Sale and purchase agreements in relation to future property are considered valid, but the buyer’s title to the property only arises after its commissioning and the subsequent registration of the seller’s title¹.

In most cases, investment contracts in Russia are recognised as sale and purchase agreements in relation to future property.

In practice, this means that, when a project is structured around an investment contract, the investor is denied ownership rights if the property is under construction or it is actually

¹ Ruling No. 54 of the Plenum of the Supreme Commercial Court of the Russian Federation dated 11 July 2011.

completed but the developer has not registered ownership. The reason for this is that legally the real estate does not exist until it is registered. Although according to the current court practice there is no risk that an investment agreement will be considered as not having been concluded, an investor can only compel the developer to transfer the property once the developer has registered its own initial ownership to the property. Thus the investor is not able to register its ownership immediately after commissioning. Until such registration, the only option provided to the investor is to terminate the agreement and/or claim losses. This solution is far from desirable for investors. There are options for investors which can be tailored for each project and require expert contract drafting. These can include securing obligations via pledges, penalties and/or independent (including bank) guarantees and, for substantial real estate finance projects, using corporate mechanisms to take control over the developer.

Allocation of land for construction

Where the main type of permitted use is construction, publicly-owned land may only be granted on lease, unless exceptions apply².

Registration of transfer of title

The transfer of ownership title to real estate must be registered in the State Register. The sale and purchase

² Please see the Acquisition of public land for construction section below on page 166.

agreement itself does not have to be registered but merely submitted and examined as part of the registration process.

When the applicant is a Russian legal entity, the Registrar is obliged to request its constituent documents directly from the competent authorities as a part of the interagency information exchange system and, therefore, it is not obligatory to submit constituent documents.

The Registrar must immediately notify the individual or entity holding rights over immovable property of the state registration application having been filed in respect of its property. As a general rule, after seven working days from the application date, the ownership title to the real estate can be state registered.

The ownership title to immovable property is deemed to legally exist on the date of state registration. However, rights to property which arose before Federal Law No. 122-FZ “On State Registration of Rights to Immovable Property and Transactions” came into force (in January 1998) are deemed valid even if they are not registered.

Any person acting in good faith may rely on any record made in the State Register. Where a person incurs losses as a result of illegal or incorrect data having been entered into the State Register due to a fault of the Registrar, that person is entitled to claim compensation from the federal budget.

If parties to a sale and purchase agreement choose to conclude it before a notary (they are not obliged to do so unless the transaction relates to shares in a co-owned property), the notary must check the validity of the transaction. Since 1 February 2019, the notary also deals with registration formalities with the Registrar unless the parties have agreed otherwise. In this case, the state registration of the real estate rights takes three working days (or one working day if the documents are submitted by the notary in electronic form) and the notary is responsible for the validity of the transaction.

It is possible to submit an application and the documents required for the state registration of rights in electronic form, through special e-services of the Registrar. As this development is still fairly recent, the practice of paper-based registration still continues to be widely used.

Any person may request general information about real estate (such as the owner or registered encumbrances) in the form of an extract from the State Register in paper or electronic format³.



However, information relating to the content of the documents based on which the title has been created, and the properties owned by a certain

individual or legal entity, may only be requested by the owner of the relevant property.

Although, since 4 August 2018, it is generally required to register most of the existing encumbrances⁴, certain types of encumbrances (protective zones of cable lines and gas transmission lines, sanitary protection zones, etc.) are still not always recorded in the State Register. For this reason, it is highly advisable to conduct onsite investigations and legal due diligence of the land plot and any properties located on it, and to review the documents kept by the Registrar (e.g. the extracts from the State Register).

Recent practice of state registration

The Law on State Registration (effective since 1 January 2017) provides for certain changes to the procedure of state registration of real estate. The main goal of these changes is to ensure better protection for state registration applicants, increase the liability of the Registrar and its officers and reduce the related investment risks.

However, despite some positive innovations, certain provisions of the Law on State Registration may adversely affect the real estate market players' activities. For example, the Registrar now has more grounds to deny the state registration of rights.

³ https://rosreestr.ru/wps/portal/p/cc_present/EGRN_1

⁴ Please see the Zones with restricted use section below on page 165.

Formally, the Law on State Registration provides for a single ground for such denial – failure to eliminate reasons preventing the state registration of rights within the period (being for up to three months in most cases) for which the Registrar has suspended the state registration. However, at the same time there are currently 65 grounds allowing the Registrar to suspend the state registration. Quite a number of these grounds are controversial, in particular because an applicant has no control over some of them. As a result of the state registration reform, the number of potential grounds to deny state registration has increased from 30 to 65.

**Leases
Land leases**

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

In practice, in the case of lease of public land, the land lease agreement will contain general provisions dictated by the landlord. As such provisions come from legal acts adopted by the relevant municipal or state body, there is little scope for negotiating any amendments. The conclusion of the lease will also generally presuppose a tender process (subject to certain exceptions).

A lease agreement in respect of a privately-owned land plot may include any provisions provided they do not contradict the mandatory requirements of Russian law.

Material conditions of the lease, such as the subject matter (i.e. the land plot itself) and amount of the rent, must be clearly determined in the lease agreement.

If a lease agreement does not meet the above requirements, it is deemed not to have been concluded. If this occurs, the land plot must be vacated and returned to its owner, and any rent already paid to the landlord must be returned to the tenant save for the amounts due from the tenant for actual use of the land plot.

Term

Russian legislation does not impose any general limit on the term of a lease of a privately-owned land plot.

The maximum lease period for a publicly-owned land plot is 49 years. In addition, certain limits exist on leases of specific types of land. For example, the maximum permitted term for a lease of agricultural land or forest land is also 49 years. The maximum permitted term for a lease of coastal land is 20 years.

The Land Code sets maximum terms for 21 types of leases in respect of publicly-owned land plots. For example, a lease agreement for a land plot required for the construction of buildings and structures may now be concluded for a term of three to ten years, a lease agreement of a land plot required for integrated urban development – for a term of three to five years. The maximum term of a lease agreement concluded for

the purposes of placing linear facilities (e.g. power transmission lines, pipelines, railways, etc.) is 49 years. A 49-year maximum term will also apply to lease agreements to be entered into with owners of buildings located on publicly-owned land plots and to other public land lease agreements unless a specific maximum lease period is expressly provided by the Land Code.

Therefore, the impact of the lease term should be assessed before any material investments are made.

Any lease agreement concluded for a term of one year or more is subject to registration in the State Register. In the absence of the state registration, the lease agreement is deemed binding upon its parties, but remains unenforceable against third parties (i.e. anyone except the tenant and the landlord). In such cases, the tenant forfeits its preferential right to renew the lease agreement. In the event of a sale, a new owner of the land plot may claim termination of such long term lease agreement which has not been duly registered.

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

Upon expiry of the lease, a tenant has a preferential right to conclude a lease of the same land plot for a new term by operation of law. However, the lease agreement may expressly exclude this preferential right.

If the tenant continues to use the land plot after the expiry of the lease term and the landlord does not object, the lease will be considered to be renewed on the same conditions for an indefinite term and may be terminated at any time by either party serving a termination notice three months in advance. Russian courts usually consider this provision of the Civil Code as a mandatory one. Therefore, courts are likely to strike down clauses providing for the automatic prolongation of a lease. In order to avoid this uncertainty, a lease should contain an undertaking by the parties to enter into a new lease for the same term and on the same conditions.

Assignment

It is generally permitted (subject to certain restrictions) to sublease, assign, mortgage or contribute lease rights to a land plot to the charter capital of a company. Unless otherwise provided for in the land lease agreement, sublease, assignment and mortgage agreements may be entered into without the landlord’s consent (but subject to a subsequent notification by the tenant). In any event, there are a number of circumstances when the tenant’s right to sublease or mortgage a land plot, or assign lease rights, may not be

waived or restricted (e.g. in case of lease of public land for more than five years).

Termination

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

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

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

Commercial leases of buildings, structures and premises

Commercial lease sector

The commercial lease market is generally dominated by the private sector of the economy, what results into the legal relationships being heavily influenced by commercial needs, the

return on investment and the level of yield.

The commercial lease sector (especially in Moscow, the Moscow Region, Saint Petersburg and other large Russian cities) is also affected by international practice in respect of rent and methods of rent calculation: so-called “net”, “double net” and “triple net” leases. A “triple net” lease (the most common type) is a lease where the tenant is obliged, in addition to the payment of the base rent, to compensate the landlord for all expenses associated with the leased property (including multitenant buildings) such as property taxes, insurance, utilities, and maintenance and operation costs. “Triple net” leases are usually used for long-term lease relations for large malls, business centres and warehouses due to their alleged positive impact on taxes, cash flow and other factors.

Structuring lease arrangements in respect of existing buildings, structures or premises

Long-term lease (the “LTL”)

An LTL is a lease agreement which lasts for one year and more. An LTL is considered as fully enforceable against third parties only upon state registration in the State Register. Either party to the LTL can apply to the Registrar and submit the LTL for registration. During the registration procedure, the Registrar will examine the validity of the LTL. Material conditions of any lease should, therefore, be clearly determined, including the subject matter of the LTL (i.e. building, premises or structure) and

the amount of rent or the rent calculation method.

An LTL can now be registered simultaneously with state cadastral registration of the leased premises based on their technical plans prepared by a duly qualified cadastral engineer.

The documents for the state registration of an LTL may now be submitted in electronic form.

Short-term lease (the “STL”)

An STL is a lease agreement executed for a period of less than one year (usually 11 months or 364 days). As the term of an STL is less than one year, it does not require state registration. It, therefore, only needs the signatures of the parties to be binding and effective.

Structuring lease arrangements in respect of buildings, structures or premises under construction

As in the past it was absolutely impossible to lease future property under Russian law, market players developed the following two- or three-tiered legal structure:

- Preliminary Lease Agreement (the “PLA”);
- STL; and/or
- LTL.

Although now it is legally possible to enter into a lease agreement for future property, market players still widely use this lease structure (or its variations) in their operations.

PLA

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

Before the owner’s title to a building and the building itself are registered in the State Register, no lease rights in respect of the building or premises within it arising out of an LTL can be registered. The PLA, in its turn, sets out the parties’ undertaking to enter into the principal lease agreement in future and contains various pre-lease obligations (such as the time period for construction, the tenant’s requirements to fit-out works in the building and/or premises).

In order to be legally valid, the PLA must clearly determine its subject matter, sufficiently describe the property to which it relates, and establish all the material terms and conditions of the principal lease agreement to be entered into (the “**Principal Agreement**”).

Parties to a PLA should determine a time period within which they are obliged to enter into the Principal Agreement. If no time period is specified, the parties must enter into the Principal Agreement within one year from the date of execution of the PLA. If the parties fail to enter into the Principal Agreement within this time period, the PLA will terminate. However,

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

Principal Agreement – STL and LTL

The STL and/or the LTL are executed after the initial state registration of the landlord’s ownership title to the building/premises in the State Register. The STL, if one is signed, remains in effect and is subject to renewal until the LTL is duly state registered and becomes effective.

Lease for future property

It is possible to lease out a future property, e.g. a building or facility under construction, or a building, facility or land plot an ownership title to which has not been registered yet.

Lease agreements for future property are considered valid, but the tenant’s lease rights to the property only arise after completion of the construction and the subsequent registration of the landlord’s title over it.

Lease agreements for future property are becoming more and more popular in practice. The market players use them as an alternative to the two- or three-tiered legal scheme (PLA, STL and/or LTL).

Real estate transactions and anti-monopoly control

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

However, pre-transaction anti-monopoly control will apply to the acquisition and lease of production assets such as industrial-purpose structures, facilities of communal infrastructure if:

- their assets book value exceeds 20% of the book value of the fixed production and intangible assets of the seller or the landlord; and
- certain worldwide asset value or revenue thresholds of the relevant groups of companies are exceeded⁵.

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

Mortgages

Creating a mortgage

Both ownership and lease rights to land and buildings may be mortgaged; there are no restrictions against this in either the Land Code or the Civil Code. Rights to buildings and parts of buildings may also be mortgaged.

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

A security interest over a land plot or other property is generally created

⁵ Please see the Anti-monopoly issues chapter on page 43.

by the parties entering into an express mortgage agreement. However, a mortgage may arise by operation of law (for example, a bank giving a loan to buy a property will become a mortgagee until the sale price is repaid in full).

A mortgage agreement must be drafted as a single contract and signed by both parties who may choose to do so before a notary. Any mortgage agreement except for a mortgage over the lease rights under non-registerable STLs must be further submitted to the Registrar. Mortgage agreements concluded before 1 July 2014 only come into effect upon registration in the State Register, failing which they are null and void. Mortgage agreements concluded from 1 July 2014 no longer need to be state registered. They therefore come into effect upon signing. However, mortgages as encumbrances over real estate still need to be state registered based on a mortgage agreement.

Since 1 February 2019, the parties to a notarised mortgage agreement have two registration options:

- follow the general rule and let the notary submit a notarised application; or
- expressly agree to the contrary in the mortgage agreement and submit a joint application and a set of necessary documents to the Registrar themselves.

The Law on State Registration sets out the time period within which the Registrar must complete the registration

formalities. For a mortgage of a land plot and non-residential property under a notarised agreement, the time period is three working days from the date of submission of the application to the Registrar (or one working day if the documents are submitted in electronic form) or five working days if the set of documents is submitted through a special multifunctional centre. For mortgages of land plots and non-residential property under a simple agreement, the time period is seven working days (if the application is made directly to the Registrar) or nine working days (if the application is made via a multifunctional centre).

Enforcing a mortgage

If a significant breach of a secured obligation occurs, the mortgagee may enforce the mortgage. There are two methods of enforcement: (i) through the courts; or (ii) through an out-of-court enforcement procedure (provided that the possibility of the out-of-court procedure is prescribed for in the mortgage agreement or a separate agreement between the mortgagee and the mortgagor).

Russian legislation provides for the following options when the mortgagee is enforcing the mortgage:

- appropriation of the mortgaged property by the mortgagee or sale of the mortgaged property by the mortgagee to a third party; or
- sale at an auction.

In a number of cases, the use of the out-of-court enforcement procedure is prohibited (for instance: if the first and second ranking mortgages provide for different types of enforcement procedures or if the mortgage secures different obligations in favour of co-mortgagees).

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

Resolution of real estate disputes

In Russia commercial disputes between legal entities may be referred to the competent state courts or, if the parties so elect, to arbitration tribunals. However, submission of a dispute for resolution at an arbitration tribunal should be carefully considered for the following reasons:

- if a dispute is arbitrated, an interested party will have to obtain an enforcement order through the Russian state courts to make an entry into the State Register based on the arbitral award (e.g. an entry on the ownership title to the property or an entry on the state

registration of an LTL, etc.);

- if a real estate dispute relates to registration issues, such dispute can only be submitted to state courts; and
- if a real estate dispute involves some kind of public relations other than state registration arrangements (e.g. issuance of construction or commissioning permits), such dispute can also only be settled by state courts.

Planning and construction issues

Different land categories and types of permitted use are assigned to land plots in order to optimise their utilisation.

Land categories

Under the Land Code, land in Russia is divided into seven land categories (each with a designated prescribed use):

- agricultural land;
- land of settlement;
- industrial land (for the purposes of industry, energy production, transport, communication, television, radio broadcasting, cosmic activities, defence and other special purposes);
- land containing specially protected areas and objects (e.g. nature parks);
- forest land;
- land near water; and
- reserved land.

Specific regulations may apply, depending on the land category. For example, when agricultural land is being sold, Russian regions enjoy pre-emptive rights of purchase, as do municipal

authorities, in the situations provided for by the relevant regional legislation. As mentioned above, foreign investors (including companies and individuals) are not allowed to own agricultural land, but may only obtain lease rights. Agricultural land that is not used in accordance with its designated prescribed use may be expropriated from its owner under a court decision.

Essentially, the most suitable categories for development and commercial construction are industrial land and land of settlement. It is possible to build warehouses, commercial buildings and production facilities on the land plots within these categories provided that the type of the land's permitted use allows it.

Permitted use of land

Each land category has different conditions for the use of land, and the Land Code requires that each plot be used only in accordance with the applicable category and established type of permitted use.

Since 2014, a type of permitted use of a land plot may only be determined in strict compliance with the classifier of types of permitted land use (the "Classifier") which provides for an exhaustive list of the types of permitted use. Local authorities have to bring local regulations on the territorial zoning (i.e. the rules of land use and development) in line with the Classifier by 1 January 2021. Although this deadline is almost reached, not all local authorities have

yet aligned their local regulations with the Classifier.

Change of land category and permitted use

Land category

It is possible to change the category of a particular land plot. For example, regional authorities may change a land plot's category from "agricultural" to "industrial" (e.g. for the allocation of a warehouse complex) subject to a number of obligatory procedures. A land plot may be assigned to the category of land of settlement only when it is annexed to the territory of a certain settlement (included in the borders of that settlement). This can be done only by amending/adopting a general plan of a certain settlement. Most settlements have now adopted their general plans. However, there are some rural settlements where town planning documentation is still missing.

Changing the category of forest land or land near water is more complicated (as it involves federal authorities) and is strictly regulated. Legislation provides an exhaustive list of circumstances allowing a change of category in these cases.

Permitted use

The owner of a land plot may change the type of permitted use at its own discretion according to the adopted town planning documentation (general plan of the settlement and rules of land use and development). Where town planning documentation is not adopted,

permitted use of a land plot cannot be changed. Also, it is generally prohibited to issue construction permits if rules of land use and development have not been adopted.

Zones with restricted use

Before recent law developments entered into force on 4 August 2018, the Russian legislation contained only fragmentary regulation of zones with restricted use. A new Federal Law⁶ introduced to the Land Code a new chapter on the legal status of zones with restricted use, thereby harmonising the legislation. In particular, an exhaustive list of 28 zones with restricted use was established. This list includes, among others, zones of energy industry facilities, railways, sanitary protection zones, etc. The Russian Government has to approve separate regulations for each type of zone with restricted use and has done so for most of such zones. It is also planned that the State Register will contain information about the boundaries of all zones with restricted use.

Developed land plots which are affected by zones with restricted use may only be used in strict compliance with the legal regime of the respective zones. Otherwise, the affected buildings and structures located on them may be subject to demolition. If they are demolished, their owners or other legal holders are entitled to demand their market repurchase price and/or compensation for losses from the owner of the capital structure around which the relevant zone is established, or from

the state or municipal authorities.

Town planning framework

The Town Planning Code stipulates that each urban settlement must adopt its town planning documents, including: (i) regional and municipal territory planning documents that establish the boundaries of various development zones in large territories; (ii) city general plans that set out the boundaries of various functional development zones within individual urban settlements; and (iii) rules for land use and development that establish territorial zoning and describe in detail what may be done in each territorial zone of each urban settlement. The town planning documents establish territorial and functional zoning of the settlement territories and indicate existing town planning limitations, such as "red lines" and protection zones. Construction planned for any new development must comply with the prescribed town planning limitations and zoning. For example, the construction of a large shopping mall in a recreational zone would not be permitted.

On 28 March 2017, the Moscow Government approved the rules for land use and development in Moscow. Any new development in Moscow must strictly comply with the requirements including (among others) the permitted use of a particular land plot, certain construction limitations and maximum buildings' height.

⁶ Federal Law No. 342-FZ "On Amendments to the Russian Town Planning Code and Certain Legislative Acts of the Russian Federation" dated 3 August 2018.

Another important document in respect of a particular land plot is the land plot development plan ("GPZU"). This document contains all information on the land plot which is relevant for construction: the type of permitted use, boundaries, minimum offsets from the boundaries, technical conditions for connection to engineering communications, etc. The land plot development plan is one of the mandatory documents that must be submitted in order to obtain the construction permit.

Construction

The construction process in Russia involves various key parties:

- a client ("zastroyshchik") – the entity who wants to build a property for itself or for its subsequent sale or lease;
- a technical customer ("tekhnicheskiy zakazchik") – a special professional company engaged by the client to supervise and manage the construction of the property;
- a general designer ("generalniy proektirovshchik") who develops the design documentation;
- a contractor ("podryadchik") or general contractor ("generalniy podryadchik") who performs the construction works for the client, either by itself or through subcontractors; and
- various specialised engineering entities that carry out surveys required for the construction.

The client must have rights to the land

plot (ownership or lease) where construction is envisaged.

Since the majority of land in Russia is still state-owned, before commencing any construction project, it is important to assess the issues of the land acquisition and obtaining authorisations and permits required for construction on it from various state authorities.

Acquisition of public land for construction

The Land Code stipulates a specific procedure for making publicly-owned land available to individuals and legal entities for construction purposes. Both Russian and foreign individuals or legal entities interested in obtaining land for construction may apply to the relevant authority for the allocation of a land plot. Any refusal to allocate land may be challenged in court (subject to certain restrictions).

Under the Land Code, there is a two-step approach to the provision of land which involves firstly, the planning of territory use, and secondly, the allocation of the land plot in accordance with the designated use.

As a general rule, where the main type of permitted use is construction, a land plot may only be granted for lease. However, in certain circumstances, land plots may be sold through an auction (e.g. for farming purposes) or without a tendering process⁷.

⁷ See Article 39.3(2) of the Land Code.

Allocation of land plots for construction is generally possible through a tendering process only in the form of an electronic auction.

Under the Land Code, there are 46 special grounds under which it is possible to lease a land plot without a tendering process (e.g. where an interested party is a legal entity that is responsible for the construction of power, heat, gas or water supply utilities or for implementation of a major investment project).

An interested party may itself initiate an auction. In this case, it is responsible for carrying out all the preparatory works required for formation of the publicly-owned target land plot.

Save for a few exceptions, a tenant does not have the priority right to renew the lease agreement for a publicly-owned land plot without an auction. This is aimed at enhancing competition in the land market and combating the abuse of rights by bad faith market players. In practice, however, the parties to a lease of public land often follow Article 621 of the Civil Code, which provides that, if a tenant continues to use a land plot after the expiry of the lease term and the landlord does not object, then the lease agreement is considered to be renewed for an indefinite term.

Furthermore, there is an exception from this general prohibition. In particular, a tenant may renew a lease agreement of a publicly-owned land plot without an auction if all of the following conditions

are met: (i) the land plot was initially granted without a tender; (ii) the application to enter into a new lease agreement is made before the expiry of the current one; (iii) no other person has an exclusive right to the land plot; (iv) the current lease agreement has not been terminated; and (v) the grounds permitting the conclusion of the land lease agreement without a tender remain applicable before the lease expires.

Apart from the above, land plots may also be provided to a person by the state or municipal authorities through investment schemes or public private partnership schemes⁸. In these cases, the title to the land plot is provided to the successful bidder within the time period set out in the respective agreement.

Seizure of land plots for state and municipal needs

The procedure for the seizure of land for state and municipal needs has the following key aspects: (i) a detailed state authorities' decision-making process for the seizure of land plots; (ii) a procedure for preparing and concluding seizure agreements; and (iii) the specifics of fixing the amount of compensation in view of the land seizure – such compensation is payable not only to landowners, but also to land users and tenants of land plots.

⁸ Please see the Infrastructure and public private partnerships chapter on page 217.

Holders of natural monopolies, subsoil users and other persons listed in the Land Code may initiate a land seizure procedure. Once the seizure decision is adopted by the relevant state authority, it is valid for three years from the date of adoption and may be challenged in court.

Expropriation of incomplete construction facilities

If a lease agreement of a publicly-owned land plot underneath a construction facility is terminated, the incomplete facility will be expropriated from the developer. An incomplete construction facility is disposed of by sale through an auction. Such a disposal will be possible only if all of the following conditions are met: (i) construction of the asset was not completed by the termination date of the lease agreement; (ii) the land plot was provided pursuant to a tender; and (iii) the delay in the asset's construction is not due to any action (or omission) of state or local authorities, or persons operating the utility networks to which the asset has to be connected. The purpose of these rules is to encourage developers to meet deadlines for construction projects on leased publicly-owned land plots. These provisions, however, do not apply where a lease agreement has been concluded before 1 March 2015.

Only a court may adopt a decision to dispose of an incomplete construction facility upon a claim to sell the facility through an auction. The claim may be filed by a state or municipal body

authorised to dispose of the relevant land plot. The proceeds of the sale must be transferred to the former owner of the incomplete construction facility (i.e. to the developer). However, the developer may extend the term of the lease agreement of a publicly-owned land plot without an auction once, in order to complete the construction. This can only be done if (i) an authority has failed to file a court claim to expropriate the incomplete construction facility within six months after the expiry of the lease term; (ii) the court has dismissed such a claim; or (iii) the asset has not been sold through an auction.

Construction permits

Any construction activity may only be performed on the basis of authorisations and permits issued by state authorities unless an exception applies. The list of such permits and authorisations may differ depending on the type of property to be constructed.

A construction permit must be obtained prior to the commencement of any construction works. This is a formal document that confirms that the design documentation meets the compulsory requirements of applicable law.

Construction permits are issued only in the following cases: (i) the applicant has valid rights to the land plot; (ii) the applicant has received a positive (state or non-state) expert opinion on the design documentation (if applicable); and (iii) there are no contradictions between the documents on rights to

the land plot, the design documentation and the land plot development plan.

The Town Planning Code requires the applicant for a construction permit to have rights (ownership or lease) to the land plot. If someone constructs a building on a land plot over which it has no rights, the building may be declared an "unauthorised structure" by the courts or municipal authorities, and demolished at the expense of the person who developed the "unauthorised structure"⁹.

A holder of rights to the land plot (acting as the client in the construction process) or a technical customer (engaged by the client and acting as its agent) may obtain a construction permit.

A construction permit contains a number of essential elements such as the time period for the construction works, the area of the constructed property and the name of the client. A valid construction permit is one of the documents required to commission the constructed property.

There are, however, some exceptions to this general rule. In particular in connection with non-residential real estate, non-capital buildings and structures can be built without obtaining a construction permit. This type of property was recently introduced¹⁰ in Russian law. Non-capital buildings and structures are defined as objects that are not attached permanently to a land plot and whose technical characteristics allow them to

be moved, dismantled and subsequently assembled without significant damage to their purpose and change to their main parameters.

Unauthorised structures

In August 2018, certain amendments were introduced¹¹ into Russian law to relax the regulations on unauthorised structures:

- a capital structure can now be qualified as an unauthorised structure only if it was built in violation of the rules and regulations that were in effect both when (i) the construction commenced; and (ii) such unauthorised construction was revealed;
- a facility cannot be qualified as an unauthorised structure if it was built in violation of the restrictions for the use of a land plot, and the owner of this facility did not know and could not have known about these restrictions;
- a court or municipal authority may now allow an unauthorised structure to be brought into compliance with (i) the rules for land use and development; (ii) town planning documentations; and (iii) obligatory construction

⁹ Please see the Unauthorised structures section below.
¹⁰ Federal Law No. 342-FZ "On Amendments to the Russian Town Planning Code and Certain Legislative Acts of the Russian Federation" dated 3 August 2018.
¹¹ Federal Law No. 339-FZ "On amendments to Part I of the Russian Civil Code and Article 22 of Federal Law on "Enactment of Part I of the Russian Civil Code" dated 3 August 2018.

requirements. This right was added to the right to decide on the demolition the unauthorised structure – which existed in the past; and

- minimum and maximum terms for the demolition (from three months to one year) and for bringing an unauthorised structure into compliance with the applicable requirements (from six months to three years) were introduced.

Commissioning

Property commissioning is the second most significant formal milestone in the construction process. Commissioning may be divided into two stages:

- acceptance of the works performed by the contractor/subcontractors by the client; and
- commissioning of the constructed property by the competent authorities.

The first stage is critical in respect of the contractual relationship with the contractor or general contractor. Following the acceptance of the works, a contractor or general contractor is entitled to claim for payment for the works performed (the payment mechanism is usually determined in the construction agreement). The warranty period begins to run from the date of acceptance.

The second stage is crucial for the state registration of the property. During this stage, the state construction supervisory authority examines the compliance

of the constructed property with the construction permit, the design documentation and the land plot development plan. If certain parameters (such as the total area, total structural volume, etc.) differ, the commissioning permit will not be issued, and it will be impossible to register the property in the State Register until the revealed deficiencies are fully eliminated.

Since 1 January 2017, the state cadastral registration of a newly-built building or structure is based on the application of the authority issuing the commissioning permit which must submit this application to the Registrar within five working days. Moreover, it is now clearly specified that, for the purpose of the state registration of the ownership title to a newly-built building or structure, it is sufficient that a lease agreement for the land occupied by the property be effective as at the commissioning date.

Membership in self-regulatory organisations and licences

Legal entities providing the following construction and design activities must become members of self-regulated organisations (“SROs”) which authorise them to carry out certain activities:

- designing buildings and structures;
- constructing, reconstructing and carrying out major repairs of buildings and structures; and
- engineering and surveying for the purposes of constructing buildings and structures.

With some exceptions, none of the survey, design and construction activities mentioned above are permitted without an SRO membership. Failure to comply with this requirement could result in criminal or administrative liability.

Both Russian and foreign legal entities may be members of an SRO. SRO membership fees depend on the type of activity and may be substantial.

In addition, some construction-related activities are still subject to licensing requirements. Examples of these activities include the installation of firefighting systems or the operation of some industrial facilities classified as posing fire or explosion hazards.

In July 2016, important amendments to the Town Planning Code concerning SROs and admission to the above mentioned survey, design and construction activities were approved by Federal Law No. 372-FZ dated 3 July 2016 (the “SROs Amendments”). Most amendments came into force on 1 July 2017 (with some exceptions mainly concerning a new approach to the organisation of SROs’ activities and the management of SROs, which became effective on 4 July 2016).

The most significant changes imposed by the SROs Amendments are the following:

- SROs for construction companies operate on a regional basis (i.e. any construction company must be a member of the SRO which

is registered in the region of the Russian Federation in which such construction company is itself registered). Exceptions from this regional registration principle are only provided for foreign legal entities and Russian companies incorporated in regions where no construction SRO was incorporated.

- All admission certificates issued by SROs were invalidated as of 1 July 2017. Therefore, the only document confirming the right to perform survey, design and construction activities will be an extract from the register of an SRO’s members (which will be valid for one month from the date of its issuance).
- Technical customers must be members of an SRO in order to legally perform their activities.
- In addition to the general indemnification fund (securing liabilities of SRO members in the event of personal injury or property damage resulting from the destruction or damage to a building or structure), there are some cases when SROs are required to set up another compensation fund securing contractual liabilities of the SRO’s members for non-fulfilment or improper fulfilment of their contractual obligations under the agreements concluded through tender procedures (i.e. under agreements with public authorities, or state, municipalities and other publicly-owned counterparties).
- The SROs Amendments also regulate in detail requirements applicable to

» Any legal entity or individual may own private land in the Russian Federation, subject to certain restrictions which regulate the legal status of the land plot.



(i) SROs; (ii) SRO members (such as an obligation to hire at least two postgraduate engineers having sufficient work experience and listed in the national register of specialists); (iii) special standards and internal documents of SROs; and (iv) other related organisational aspects of SROs' activities.

Corporate bankruptcy

General approach

The discussion in this chapter focuses on the Russian bankruptcy regime applicable to companies and also mentions specific features of the regime applicable to credit institutions.

The most important laws governing corporate bankruptcy proceedings are (i) Part I of the Russian Civil Code; and (ii) Federal Law No. 127-FZ "On Insolvency (Bankruptcy)" dated 26 October 2002, which is the principal piece of legislation on bankruptcy in Russia (the "**Insolvency Law**"). In addition, bankruptcy rules are set out in a number of regulations of the Government of the Russian Federation and other state bodies and are interpreted by the court practice, primarily in decisions and resolutions of the former Supreme Commercial Court and, currently, of the Supreme Court.

The Insolvency Law also includes the bankruptcy regime applicable to individuals (which falls outside the scope of this chapter).

There are no specific bodies responsible for conducting or overseeing bankruptcies in Russia. Bankruptcy proceedings are generally conducted by a commercial ("*arbitrazh*") court in the Russian region where the debtor's registered office is located.

Insolvency criteria

Under the Insolvency Law, the main criteria used to determine whether a debtor is insolvent are the debtor's inability to meet creditors' claims or to fulfil mandatory payment obligations for a period of three months from the date on which they fall due.

Stages of bankruptcy proceedings

Depending on the circumstances, the insolvent company may be subject to five different stages of bankruptcy proceedings:

- supervision;
- financial rehabilitation;
- external management;
- bankruptcy liquidation; and
- voluntary arrangement.

Preliminary step: initiating bankruptcy proceedings

As a general rule, bankruptcy proceedings may be commenced against all types of legal entities, with the exception of certain forms of state-owned enterprises, political parties and religious organisations.

The following are permitted to file a bankruptcy petition with a commercial court to have a debtor declared bankrupt:

- the debtor itself (i.e. its management bodies);

- a bankruptcy creditor;
- the competent authorities: the Federal Tax Service of the Russian Federation (the “**FTS**”) or the Federal Customs Service of the Russian Federation (the “**FCS**”); or
- a current or former employee of the debtor.

A debtor must file a bankruptcy petition with a commercial court to initiate its own bankruptcy proceedings if one of the insolvency criteria below is met:

- if the claims of one or more creditors are fulfilled, the debtor will be unable to fulfil its payment obligations towards other creditors;
- persons who are authorised to take a decision to apply for liquidation on behalf of the debtor decide to petition the court for the commencement of bankruptcy proceedings;
- if claims against the debtor’s assets are enforced, the debtor will be unable to continue, or will be significantly restricted in continuing, its operations;
- the debtor meets the “inability to pay” criterion (i.e. the debtor fails to perform its payment obligations when due as a result of insufficient funds);
- the debtor meets the “insufficient assets” criterion (i.e. the value of the debtor’s payment obligations exceed the value of its assets); and/or
- as a result of insufficient funds, the debtor is unable to pay wages and other payments due and payable to its current or former employees

pursuant to the Russian labour laws that are outstanding for more than three months.

The right of a bankruptcy creditor, the FTS or the FCS to file a bankruptcy petition with a commercial court to initiate bankruptcy proceedings arises if an unsatisfied aggregate debt of a corporate debtor exceeds RUB 300,000 (EUR 4,290), which is confirmed by an enforceable court decision or arbitral award (Russian or foreign).

 RUB 70 = EUR 1 *notional exchange rate used for convenience

Under the Insolvency Law, when a creditor is a credit institution, it is entitled to initiate bankruptcy proceedings with respect to its debtor immediately after the latter has met an insolvency criterion under the Insolvency Law. Credit institutions, unlike other creditors, do not require a court decision or arbitral award in order to ascertain their claims.

Moreover, a right to file for bankruptcy becomes conditional and arises only if a creditor has published a notice of its intention to file an insolvency petition against the relevant debtor in the Unified Federal Register of Legally Significant Data about the Facts of the Activities of Legal Entities

 www.fedresurs.ru

at least 15 days before filing the relevant petition with the court.

Initiation of bankruptcy proceedings is not automatic, and the applicant, being a creditor (except when it is a credit institution) or a debtor itself, must prove to the court that the debtor is insolvent.

A current or former employee of the debtor is entitled to file a petition for the initiation of bankruptcy proceedings if he/she has any severance or salary payment claims against the debtor.

Supervision

Supervision is a provisional stage of bankruptcy proceedings. Once supervision is introduced (automatically when the first bankruptcy petition is accepted by a court), a temporary manager is appointed to oversee the activities of the debtor. Such manager supervises the management bodies of the debtor, which remain in place. Supervision aims to (i) preserve the debtor’s property; (ii) analyse its financial state; (iii) complete a creditors’ register; and (iv) hold the first creditors’ meeting.

When the court accepts the bankruptcy petition, it may also impose interim measures (e.g. an arrest, a freezing order). The court’s ruling applies immediately. However, even though the ruling may be appealed, the appeal process will not suspend the execution of the court’s ruling.

Restrictions

As of the date of the court’s ruling, the debtor’s business will be restricted as follows:

- Creditors’ claims against the debtor and its assets are to be submitted only through the commercial court supervising the bankruptcy proceedings. That court decides on their inclusion in the creditors’ register maintained by the temporary manager (including the amount of the claim).
- The debtor is prohibited from paying out profits and dividends, as well as effecting set-offs that violate the order of priorities established by the Insolvency Law (subject to certain exceptions relating to liquidation (close-out) netting as provided below). The debtor may not alienate or purchase shares, facilitate the apportionment of a participatory interest or pay out its fair value, issue securities (excluding shares), reorganise its company structure or incorporate subsidiaries.
- Any property transactions with a value exceeding 5% of the debtor’s balance sheet value and any credit-related transactions are only permissible with the prior written consent of the temporary manager.

The debtor in the form of a joint-stock company is entitled to increase its share capital but only by way of a private placement of additional ordinary shares to be allotted to the shareholders or certain third parties. No issuance of any other emission securities is allowed. However, a debt-to-equity conversion is permitted. If the debtor’s shareholders/ participants or third parties repay the full amount of creditors’ claims according to

the creditors' register, the bankruptcy proceedings will be terminated.

Temporary manager

The temporary manager is nominated from members of a self-regulated organisation of insolvency practitioners. The party filing a bankruptcy petition must propose a self-regulated organisation or nominate an individual from that organisation. Where the party filing the bankruptcy petition fails to suggest an individual, the temporary manager is nominated by the self-regulated organisation of insolvency practitioners. In both circumstances, the appointment is subject to the court's approval.

The temporary manager is entitled to, amongst other actions, (i) seek injunctions to preserve the debtor's assets; (ii) obtain information from the debtor; (iii) obtain documents relating to the debtor's activities; (iv) claim before a court that transactions made by the debtor are invalid; (v) request the court to remove a director; and (vi) challenge any claims brought by a creditor.

Termination of supervision

Supervision is terminated on the date when a court makes a ruling to that effect. Possible outcomes could be the termination of the bankruptcy proceedings if the debtor's solvency has been restored or the introduction of one of the following stages of bankruptcy proceedings: (i) financial rehabilitation; (ii) external management;

(iii) bankruptcy liquidation; or (iv) voluntary arrangement (as applicable).

Under the Insolvency Law, supervision is to be conducted within the statutory time period applicable to insolvency proceedings in general (which is seven months) within which the bankruptcy case has to be examined by the court. The statutory period starts from the date of initiation of supervision and ends with the first creditors' meeting deciding on the next stage of the bankruptcy proceedings (subject to confirmation by the court). If the creditors are unable to make a decision, the court will make a ruling and introduce the next stage of bankruptcy proceedings (if necessary) at its own discretion.

Financial rehabilitation

This procedure is aimed at restoring the debtor's solvency and rescheduling (re)payment of the outstanding debts. Financial rehabilitation may last up to two years and commences immediately upon a court's ruling on its introduction.

Financial rehabilitation proposal

Debtors or both corporate and state creditors can propose financial rehabilitation at the first creditors' meeting. The details of the proposal depend on the party applying, but it would include at least: a financial rehabilitation plan, a debt repayment schedule, information on the security offered for performance of the debtor's obligations under the debt repayment schedule and, in the case of a debtor's proposal, minutes from the general

meeting of shareholders/participants authorising the decision.

Administrative manager

When the court initiates financial rehabilitation on the basis of a decision of a creditors' meeting, an administrative manager will also be appointed by the court. The role of the administrative manager predominantly involves monitoring the existing management bodies of the debtor, which remain in place. His/her key duties include: (i) maintaining a register of creditors' claims; (ii) examining reports on the progress of the financial rehabilitation plan; (iii) monitoring the debtor's discharge of current claims; and (iv) enforcing security provided to the debtor.

The powers of the administrative manager are, in broad terms, similar to those of the temporary manager.

Restrictions

The following restrictions will take effect from the date of the court's ruling to implement financial rehabilitation:

- Monetary and property claims are only to be submitted to the debtor in the course of the bankruptcy proceedings supervised by a commercial court.
- Previously introduced interim measures are cancelled.
- Penalties do not accumulate further (and they are calculated by reference to the last day of the indebtedness repayment schedule).
- Setting-off counterclaim(s) (subject

to certain exceptions), alienating or purchasing shares or property, facilitating the apportionment of a participatory interest or paying out its fair value, and allocating profits and dividends are prohibited.

The debtor must obtain the consent of a creditors' meeting in order to perform the following: (i) approving interested party transactions; (ii) approving property transactions with value exceeding 5% of the debtor's balance sheet value; (iii) lending and issuing guarantees; and (iv) adopting any decisions about its reorganisation and the incorporation of subsidiaries.

An administrative manager's consent is necessary for transactions, which increase the debtor's level of indebtedness by more than 5%, any sale and purchase of the debtor's property, assignments and borrowings.

External management

This stage of bankruptcy proceedings intends to restore the debtor's solvency and may last up to 18 months (with a possible six-month extension). The combined duration of financial rehabilitation and external management may not exceed two years. External management commences upon a court ruling, which must be based on the relevant decision of a creditors' meeting.

External manager

The court approves the appointment of an external manager when it decides to introduce external management.

Amongst other actions, the external manager is entitled to:

- manage the debtor's property;
- claim on behalf of the debtor;
- challenge the validity of the debtor's transactions and claim any resulting damages before a court;
- refuse to perform a debtor's transaction, when this transaction was not performed earlier in full or in part, if it creates a loss in comparison with other transactions;
- challenge creditors' claims; and
- implement the external management plan and report on the implementation of the creditors' meetings.

The external manager's authority is terminated on the date the court appoints a bankruptcy manager (when the debtor is declared bankrupt), or upon the appointment of a new executive of the debtor (when bankruptcy proceedings are terminated if debtor's solvency is restored).

Restrictions

When external management is introduced, the powers of the debtor's general director are terminated and transferred to the external manager. However, the debtor's management is afforded limited powers relating to transactions concerning capital, additional share issues and entry into specified major transactions (subject to the consent of the creditors' meeting).

A wide-ranging moratorium is imposed upon satisfaction of creditors' claims

(excluding current payments (e.g. judicial expenses and payment of salaries)).

Similar to the financial rehabilitation stage, interim measures which have been introduced earlier are cancelled. Monetary and property claims (including mandatory payments) may only be submitted in the course of bankruptcy proceedings which are supervised by the relevant commercial court.

Termination

External management will be terminated prematurely if the debtor discharges all creditors' claims.

Following the external manager's report, the creditors' meeting will adopt one of the following decisions by making a petition before the commercial court to:

- terminate the external management on the ground that the debtor's solvency has been restored and to proceed with paying creditors' claims;
- terminate the external management on the basis that all registered claims have been satisfied;
- declare the debtor bankrupt and start bankruptcy liquidation;
- consent to a voluntary arrangement; or
- extend the term of the external management.

The court will evaluate the external manager's report and is entitled to approve or reject it. The court should **approve** the external manager's report

if (i) all registered creditors' claims have been satisfied; or (ii) the creditors' meeting has decided to terminate the external management on the ground that the debtor's solvency has been restored and to proceed with paying out the creditors' claims; or (iii) the creditors and the debtor have consented to a voluntary arrangement; or (iv) the creditors' meeting has extended the term of the external management. The court should **reject** the external manager's report if (i) the registered creditors' claims have not been satisfied; or (ii) there are no grounds for restoring the debtor's solvency; or (iii) there are some circumstances that prevent a voluntary arrangement.

If (i) the creditors have petitioned the court to have the debtor being declared bankrupt; or (ii) the court has rejected the external manager's report; or (iii) such a report has not been presented to the court in due course, then the court may declare the debtor bankrupt and introduce the bankruptcy liquidation.

Bankruptcy liquidation

This stage of bankruptcy proceedings is designed to satisfy creditors' claims through the sale of the debtor's assets. Bankruptcy liquidation can be instituted for up to six months (with a possible further six-month extension(s)).

Consequences

The immediate effects of the bankruptcy liquidation include the following:

- Monetary obligations and mandatory payments of the debtor

are accelerated by virtue of statute.

- Interest no longer accrues. The same applies to financial (or other) sanctions arising from a failure to fulfil monetary obligations and mandatory payments (other than current payments).
- Information on the debtor's financial state is no longer deemed to be confidential.
- Existing encumbrances over the debtor's property are removed and no further encumbrances are allowed.
- The powers of the debtor's general director and board of directors are terminated and vested with the bankruptcy manager.

Bankruptcy manager

The court appoints a bankruptcy manager when a ruling for bankruptcy liquidation is issued. The bankruptcy manager acts until the bankruptcy liquidation is completed.

The principal duty of the bankruptcy manager is to search, return, evaluate, pool and arrange for a sale of the debtor's assets, and to pay out the debts to creditors. The bankruptcy manager also dismisses the debtor's employees. The bankruptcy manager assumes the powers of the debtor's general director, board of directors and meeting of shareholders/participants. The bankruptcy manager must publish notice of the debtor's bankruptcy within ten days of his/her appointment.

Bankruptcy liquidation: order of priorities

The Insolvency Law provides a specific priority order by which creditors' claims are to be satisfied. The priority order includes first, second and third priority claims.

Creditor claims made after the court's acceptance of the bankruptcy petition (so-called "current claims") are not included in the order of priorities as such and should be satisfied when they become due.

Current claims are satisfied in the following order: (i) judicial expenses and remuneration of persons involved in administering the bankruptcy proceedings; (ii) remuneration of employees (save for top management compensation packages), as well as contractors engaged for the purposes of the bankruptcy proceedings; (iii) remuneration of persons engaged by the bankruptcy manager for the purposes of administering the bankruptcy proceedings; (iv) operational expenses; and (v) other current claims.

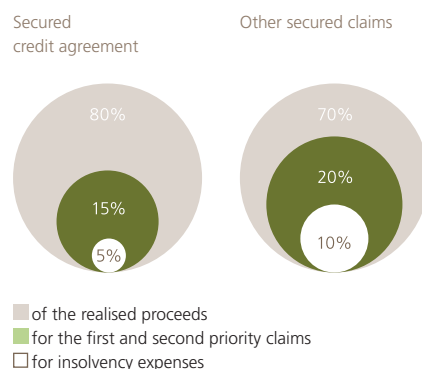
First priority claims include personal injury claims and moral damage claims.

Second priority claims include:

(i) severance benefits; (ii) the wages of the debtor's employees; and (iii) copyright royalties. **Third priority claims** include all other claims (both secured and unsecured, where secured claims mean claims secured by a pledge or a mortgage) including compensation to the debtor's top management.

Notwithstanding that the claims of secured creditors are accounted for in the third priority, they are satisfied in accordance with a special procedure largely separate from that applying to the unsecured creditors, i.e. the proceeds from the sale of the pledged property (capped to the principal amount and any accrued interest) are allocated as follows among secured creditors:

- For claims under a secured credit agreement, the lenders are entitled to 80% of the realised proceeds, with the remaining 15% for the first and second priority claims, and 5% for insolvency expenses;
- For other secured claims (other than under a secured credit agreement), the respective thresholds are 70%, 20% and 10% respectively.



Possible transition to external management

Where the financial rehabilitation or external management stages have not previously been instituted, the creditors' meeting may petition the court for a transition to the external

management stage during the bankruptcy liquidation stage. To do so, grounds must exist to believe that the debtor's solvency can be restored, and these must be backed by financial data. The transition will only be permitted if the debtor has sufficient assets to pursue independent economic activity.

Liquidation (close-out) netting

Obligations under qualifying financial agreements that are concluded on the basis of certain recognised master agreements¹ (derivative or repo), stock exchange trading rules or clearing rules are terminated in accordance with the terms of these agreements, stock exchange trading rules or clearing rules. This leads to the determination of a close-out amount which is calculated in accordance with the terms of the relevant master agreement, stock exchange trading rules or clearing rules, and the calculation of which can be made using close-out netting.

The Insolvency Law stipulates additional requirements for an agreement to be qualified as a master agreement. These criteria apply to domestic and cross-border transactions and agreements.

The above rules are applicable to financial agreements concluded prior to temporary administration or prior to the implementation of one of the stages of bankruptcy proceedings or, in the case of a credit institution, prior to the revocation of the banking licence. Temporary administration only applies to credit and other financial institutions

(as defined in the Insolvency Law). This is a temporary governing body that is appointed by the supervisory body of the relevant credit institution in order to restore its solvency, preserve its assets and retain its licence, which is a mandatory requirement for credit institutions to operate in Russia.

Voluntary arrangement

A voluntary arrangement can be entered into by the creditors and the debtor at any stage of the bankruptcy proceedings, in order to terminate such proceedings and give effect to an agreement between the debtor and the creditors. The debtor, creditors, third parties and authorised bodies are entitled to enter into a voluntary arrangement.

The decision to enter into a voluntary arrangement with the creditors or an authorised body must be approved at a creditors' meeting. The voluntary arrangement requires subsequent approval of the relevant commercial court.

A voluntary arrangement can only be terminated by a court, and only in respect of all creditors and/or authorised bodies. An application for termination may be put forward by creditors and/or authorised bodies which hold at least a

¹ Order No. 11-62/pz-n of the Central Bank of Russia dated 29 November 2011 recognises as "master agreements" only those master agreements which were prepared by International Swaps and Derivatives Association, Inc. (ISDA) or International Capital Market Association, Ltd (ICMA) respectively.

» The main criteria used to determine whether a debtor is insolvent are the debtor's inability to meet creditors' claims or to fulfil mandatory payment obligations for a period of three months from the date on which they fall due.



quarter of the value of creditors' claims on the date the voluntary arrangement was entered into.

The parties are entitled to file for the termination of the voluntary arrangement if the debtor defaults or significantly breaches the terms of the voluntary arrangement.

Import substitution and production localisation in Russia

Background

Around ten years ago, the Russian Government and legislators started to adopt measures aimed at increasing domestic production of goods and reducing the country's dependency on foreign goods. The events, which took place in Ukraine in 2014, further reinforced these measures as it became more obvious that it is very dangerous for the country's economy to be overly dependent on imported goods that (i) could be cut off at any time by sanctions; and (ii) are subject to currency exchange rates volatility.

Initially, the government's policy was simply aimed at import substitution by removing foreign goods from the Russian market and imposing restrictions on imported goods so that domestic goods would take their place. However, it quickly became clear that it was necessary to simultaneously attract foreign direct investments and provide incentives for foreign companies to localise their production in Russia.

Currently, a weak Russian rouble, relatively cheap and qualified local labour force, a free access to the CIS markets¹, including the country's deeper integration with Armenia, Belarus, Kazakhstan and Kyrgyzstan, which are members of the Eurasian Economic

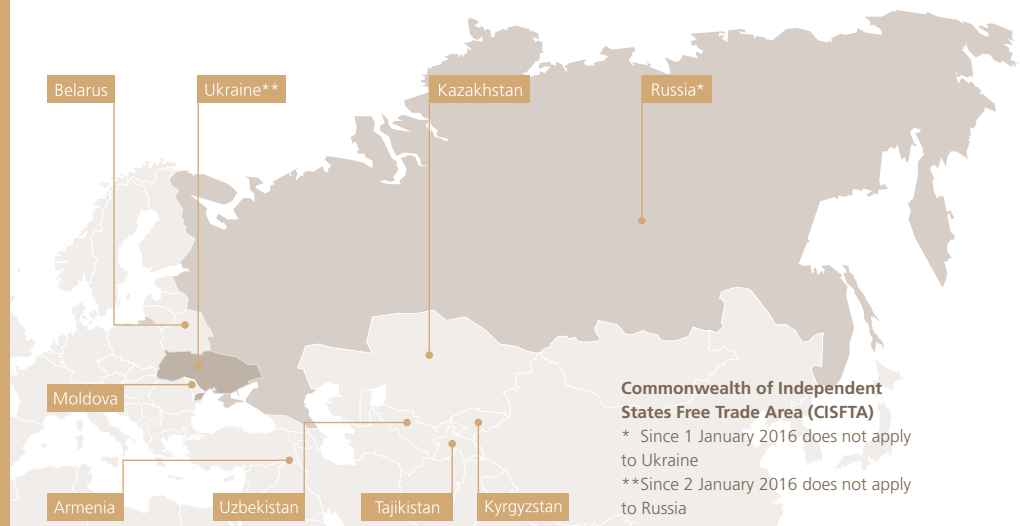
Union (the "EEU"), together with the incentives implemented by the Russian Government, have made the country an attractive place for production of goods.

Measures affecting goods importation and current import substitution legislation

The Russian Government has adopted plans for import substitution in more than 20 economic sectors. Most of these plans initially envisaged a gradual reduction in the level of foreign industrial products used in Russia and their replacement by domestic goods by up to 50-100% by 2020. Now these plans are under review with the aim to set additional indicators to be achieved by 2024 and even 2030. Similar action plans (or "road maps") have also been adopted in more than 30 regions in the country.

Also, the government has created a Government Committee for Import Substitution to coordinate the actions of the federal, regional and municipal

¹ Russia is a party to the Commonwealth of Independent States Free Trade Area (CISFTA) between Russia, Ukraine, Belarus, Uzbekistan, Moldova, Armenia, Kyrgyzstan, Kazakhstan and Tajikistan. However, Russia has suspended this regime towards Ukraine since 2016. In addition, Russia has bilateral free trade treaties with other CIS countries like Azerbaijan.



authorities and private companies involved in the implementation of the import substitution policy. Similar committees (expert councils) have also been set up at regional level. At the moment, these committees' activities are, however, limited mostly to regular meetings and briefings.

Some protective measures aimed at limiting the import of foreign goods were implemented within the framework of the Industrial Policy Law². In 2015, this law abolished the principle of treating domestic and foreign goods equally during state procurements of goods, as well as procurements by state-controlled companies by giving preferences to locally-produced goods. This concept has been further developed in the Procurement Law³ and the Law on Procurement by State-owned Companies⁴.

Apart from these general import substitution measures, the Russian

Government has also implemented politically motivated sanctions and counter-sanctions against goods from the US, EU, Ukraine and Turkey.

Some organisations making state orders occasionally try to overcome these restrictions by placing additional technical requirements on the goods that are procured in public tenders, which can only be met by foreign goods. However, the Russian anti-monopoly authorities monitor such practices in order to prevent them.

² Federal Law No. 488-FZ "On Industrial Policy" dated 31 December 2014.

³ Federal Law No. 44-FZ "On the Contractual System for the Procurement of Goods, Works and Services for State and Municipal Needs" dated 5 April 2013.

⁴ Federal Law No. 223-FZ "On the Procurement of Goods, Works and Services by Certain Legal Entities" dated 18 July 2011.

Import restrictions on Russian authorities' procurements

Generally, under the Procurement Law, the state and municipal authorities may purchase both domestic and foreign goods. However, for bidding purposes, some goods from the EEU enjoy a 15% pricing preference over goods⁵ from other countries.

There are also certain types of foreign goods that can only be procured when there are no domestic or EEU analogues. The number of such goods is constantly increasing. So far, this prohibition applies to the following sectors:

- military equipment;
- vehicles;
- clothes and shoes;
- electronic goods;
- medical equipment;
- pharmaceutical products; and
- food products.

In some cases, foreign goods are not disqualified at the beginning of public procurement tenders. Such foreign goods are rejected only if two comparable Russian goods participate in a tender (the "third odd one out" rule). The lists and categories of prohibited goods are compiled and amended according to the Decrees of the Russian Government.

Import restrictions on procurements by state-owned and some private companies

Any companies which are controlled primarily by state or municipal authorities are deemed to be state-owned. State-owned companies' procurements are

regulated separately from authorities' procurements.

Although the Law on Procurement by State-owned Companies does not formally introduce any prohibitions or place restrictions or limitations on purchases made by private companies (save for express exceptions), the state may prescribe under Decrees of the Russian Government that such companies must first procure Russian goods rather than goods of foreign origin.

In practice, it is becoming increasingly common for some large "quasi-state" companies (in particular, in the oil & gas and railways industries) to set certain restrictions and limitations on foreign goods on the basis of their internal regulations, even if they are not legally obliged to do so.

In other cases, even if private companies are selling goods to other private companies, the sellers may indirectly become subject to restrictions if the buyers are ultimately dealing with the public sector. That is, if the private buyer of goods ultimately supplies state authorities.

This protectionist regime is also imposed on private companies that implement investment projects that are subsidised

⁵ Order No. 126n of the Ministry of Finance of Russia "On the Conditions for Admitting Goods Originating from a Foreign State or a Group of Foreign States for the Purpose of Procuring Goods for State and Municipal Needs" dated 4 June 2018.

by the Russian state and listed in the Investment Projects Register. Such private companies may not procure certain industrial products without obtaining the consent of the Government Committee for Import Substitution.

Russian sanctions and other trade protectionist measures

In addition to the general non-country specific limitations on foreign goods, Russia has also imposed certain country-specific sanctions and counter-sanctions on some foreign goods.

In response to the economic sanctions⁶ imposed mainly by the US and EU, Russia has imposed an embargo (through the Executive Orders of the Russian President and Decrees of the Russian Government) and closed most of its food market to food items and agricultural goods from the US and EU and also from other countries (Canada, Australia, Norway, Ukraine, Albania, Montenegro, Iceland and Liechtenstein).

The banned goods, according to Russian Government Decree No. 778 dated 7 August 2014, include certain agricultural products, raw materials and food items, which are originating from the above-listed countries, namely:

- meat (including beef, pork and poultry) and meat products (including sausages) fresh, chilled or frozen;
- fish, shellfish and seafood;
- milk and dairy products (including cheese and curds);
- vegetables, edible roots and tuber crops;

— fruits and nuts.

However, beef, poultry, frozen and dried vegetables, which are used for making baby foods, as well as some other goods, were subsequently excluded from the list of food items that are under embargo⁷.

Moreover, at the end of 2015, as a result of political tensions with Turkey due to the shooting down of a Russian fighter jet near the Syrian border, Russia also imposed⁸ a raft of sanctions on Turkish companies, goods and froze its bilateral cooperation with the country. The subsequent improvement in their bilateral relations has enabled Russia to review and partially lift its sanctions against Turkey.

There are also worldwide tariff wars that affect Russia. For example, the US has increased its import tariffs on Russian aluminium and steel, while Russia, as a retaliatory measure, has increased its import tariffs on some US goods, such as road construction equipment.

The Russian Government has repeatedly said it will continue to respond proportionately to any similar “unfriendly” actions. The latest example of such reaction by the Russian Government was the banning of

a number of goods of Ukrainian origin or goods transiting through the country to Russia in December 2018⁹. The ban was a response to the Ukrainian Government’s imposition of import restrictions on Russian goods earlier that year. The Russian ban affects food products, construction materials, machinery and equipment (including spare parts), such as tractors, turbines, cables and agricultural equipment.

Other measures

Two Russian agencies, the Federal Service for Surveillance on Consumer Rights Protection and Human Wellbeing (“Rospotrebnadzor”) and the Federal Service for Veterinary and Phytosanitary Surveillance (“Rosselkhozadzor”), can also impose restrictions on the importation of certain goods, most often food products, which fail to meet the country’s standards or safety requirements. Although formally aimed at protecting consumers, this mechanism is, in practice, often used by the Russian authorities against foreign goods for political reasons. For example, restrictions are implemented on food products from Ukraine, Moldova, Poland, Turkey and other countries from time to time.

Localisation incentives

Along with the above restrictive measures, the Russian Government and legislators have created several incentives for foreign companies to localise their goods in Russia by opening production plants in the country, instead of simply importing their goods from their factories in other countries.

The main types of incentives are:

- goods produced in Russia are not subject to the restrictions imposed on imported goods;
- tax benefits¹⁰; and
- subsidies.

The “Made in Russia” solution

Given the significant share of the public sector, especially when combined with the procurements of goods carried out by state-controlled companies, the restrictions imposed on imported goods effectively and significantly limit the access of importers of foreign goods, except those involved in consumer goods, to the Russian market.

Accordingly, foreign companies whose goods are subject to restrictions can maintain their shares or get full access to the Russian market if they open production plants in the country. Such plants can use imported components. However, they must carry out production activities that will allow their end products to be classified as “domestic” goods.

The EEU’s customs laws and regulations generally determine whether products may be regarded as Russian goods. A product is assigned a certificate of Russian origin if it is fully manufactured or is “sufficiently processed” in the country.

⁶ Please see the Introduction on page 12.
⁷ The list of sanctioned goods may be adjusted from time to time.
⁸ Russian Government Decree No. 1296 dated 30 November 2015.

⁹ Russian Government Decree No. 1716-83 dated 29 December 2018.
¹⁰ Please see the Tax system chapter on page 66.

There are two main criteria for defining sufficient processing:

- **formal criterion:** as a result of processing, one product is transformed into another in such a way that, according to the classification of goods for customs purposes¹¹, leads to a change in the first four digits of the product's classification code (e.g. a plank, which has code No. 4407, is manufactured into a wooden box with code No. 4415);
- **value criterion:** this is when industrial or technical processing leads to a certain percentage of added value increase in the finished product, compared to its components. There are specific rules as to how to calculate such added values for different types of goods (e.g. not all assembly works may count towards added value for the purposes of considering end products as "domestic" goods).

The Russian origin of goods is confirmed¹² in the following ways:

- by an ST-1 Certificate, which is issued in accordance with the Agreement on the Rules for Determining the Country of Origin of Goods in the Commonwealth of Independent States, which was adopted in Yalta on 20 November 2009;
- by an expert opinion of the Russian Chamber of Commerce; or
- under a special investment contract that was signed with the manufacturer.

General direct investment incentives

Quite a few direct investment incentives are available in Russia, for example:

- entering into special investment contracts (SPICs), which are now being rebooted into SPIC 2.0 due to the low efficiency of the initial version¹³;
- obtaining the status of a regional investment project;
- locating production in an industrial park;
- locating production in a production cluster;
- becoming a resident of a special economic zone¹⁴;
- claiming benefits provided by a bilateral investment treaty; and/or
- obtaining subsidies from the state budget.

These instruments may sometimes overlap and synergise with each other.

Sector-specific impact of import restrictions and localisation requirements

Whereas the general rules on import restrictions and localisation are the same,

¹¹ Decision No. 54 of the Council of the Eurasian Economic Commission "On Approval of the Common Commodity Nomenclature for Foreign Economic Activity of the Eurasian Economic Union and the Common Customs Tariff of the Eurasian Economic Union" dated 16 July 2012.

¹² According to Russian Government Decree No. 719 dated 17 July 2015.

¹³ Please see the Environment, energy efficiency and renewables chapter on page 207.

¹⁴ Please see the Tax system chapter on page 66.

certain concepts, such as the criteria of a unique foreign product (meaning it has no equivalents in Russia), sufficient processing criteria and procurement restrictions may vary, depending on the industry sectors. For instance, as outlined below, the following sectors have their own specific criteria:

- mechanical and electrical engineering and metal industries;
- food products and food processing;
- construction machinery;
- automotive industry;
- information and computer technologies; and
- medical products and pharmaceuticals.

Mechanical and electrical engineering and metal industries

For some types of industrial products, the production process must satisfy specific criteria established by Russian Government Decree No. 719 dated 17 July 2015 for a product made in the country to be classified as 'domestic'.

Such requirements depend on the types of products involved. The most frequently used criteria require:

- certain industrial operations to be carried out in Russia;
- a manufacturer to have sufficient rights to the relevant design and technical documentation;
- the percentage of foreign-made components used for manufacturing the product to be gradually reduced from 50% to 10%.

Food products and food processing

The imposition of import restrictions

and sanctions on a wide range of foreign food products in a very short time adversely affected the local market as it was not ready for such negative developments. This led to a rise in prices and a reduction in the variety and quality of agricultural products and foodstuffs in the country.

However, with time, the ban on foreign food items led to a significant increase in local food production and ongoing boom in the industry. Probably, this was one of the few industries in Russia that showed real and significant growth as a result of the government's protective measures.

Preferential treatment

Russian Government Decree No. 832 dated 22 August 2016 (as further amended) stipulates a list of 27 types of food products that enjoy a preferential treatment in public tenders if they are manufactured locally. According to this Decree, public authorities, when procuring food products included in the list, are obliged to reject any bids from manufacturers whose products are not made in the EEU, if there are two or more bids for the supply of the same food products that originate from the EEU (the "third odd one out" rule).

The list of foreign food products, which are restricted for public procurements, as approved by Decree No. 832, includes fish, shellfish, seafood, meat (beef, pork and poultry) fresh, chilled or frozen, dairy products (cheese, butter and milk), as well as sugar, salt, rice and

wine. Also, the general price discount preferences apply for tender purposes.

Federal Law No. 264-FZ "On the Development of Agriculture" dated 29 December 2006 establishes a raft of incentives and support measures, such as subsidies, refinancing of loans and tax incentives, for local food producers.

Sanctioned goods

All the sanctioned goods (listed in Russian Government Decrees No. 778 and No. 1296) are blocked from entering the country by customs officials at the border (save for their transit transportation). Such goods are subject to immediate destruction.

Although Russia is a member of the EEU, it prohibits importing or reselling banned food products through Belarus and Kazakhstan (the two members of the EEU that did not support the ban), provided that the ultimate destination of such products is Russia.

There have been some discussions about the liability of local retailers, who sell banned products, and some draft bills were prepared, but no legislation has been adopted to date.

Banned goods which are processed in Kazakhstan or Belarus for subsequent sale in Russia are not prohibited from entering the country. However, the level of processing required in such case has to be significant enough to justify a change in the country of origin of such

goods (as indicated by a special certificate of country of origin issued by the Belarusian or Kazakhstani authorities). This means that simple re-labelling or re-packaging of banned goods in Belarus or Kazakhstan does not resolve the issue. Besides, processing may not be suitable for many banned goods or could require some additional investments.

Special criteria for obtaining a certificate of country of origin

The countries of origin of agricultural products and foodstuffs are determined according to the general rules and criteria of sufficient processing as established by the Agreement on the Rules for Determining the Country of Origin of Goods in the Commonwealth of Independent States dated 20 November 2009.

Specifically, it is expressly stated that the following goods are considered as originating from an EEU member state:

- vegetables that are produced or picked (harvested) in an EEU member state;
- animals born or raised in an EEU member state and products made from these animals in such state;
- products of hunting and fishing in an EEU member state; and
- goods made from any of the above listed products.

There are, however, specific criteria for some types of goods (e.g. beef meat, meat products, dairy products, bread, chocolate, juice and wine). For such

goods, the *ad valorem* rule (mainly 50%) can be applicable as a separate condition, or together with the requirement to fulfil certain other conditions and perform certain industrial and technological operations.

It is worth mentioning that the following operations (specific to food production) do not meet the requirement of sufficient processing:

- milling and polishing cereals and rice;
- colouring sugar;
- peeling, seeding and cutting fruits, vegetables and nuts; and
- slaughtering and meat cutting.

Construction machinery

According to Russian Government Decree No. 656 dated 14 July 2014, certain types of foreign construction machines are not allowed to take part in public goods procurement tenders.

Russian Government Decree No. 2781-r dated 31 December 2015 applies to state-owned companies and listed companies. The Decree lists construction machines that cannot be bought by such companies without the consent of the Government Committee for Import Substitution.

This list includes, amongst others, bulldozers, tractors, excavators, graders, loaders and road rollers. The adoption of the list has led to an increase in tender prices (by up to 40%) and a reduction in the variety and quality of procured products.

Special criteria for obtaining a certificate of country of origin

There are specific criteria, established by Russian Government Decree No. 719 dated 17 July 2015, for some types of construction machines (e.g. bulldozers, tractors, excavators, graders, loaders and road rollers). These criteria vary, depending on the types of products. The most commonly used criteria require:

- certain industrial operations (e.g. assembling, welding, painting) to be carried out in Russia;
- a manufacturer to have sufficient rights to the relevant design and technical documentation;
- at least one authorised service centre to be located in any EEU member state (i.e. Armenia, Belarus, Kazakhstan, Kyrgyzstan or Russia).

Automotive industry

According to Russian Government Decree No. 656 dated 14 July 2014, foreign vehicles cannot take part in public goods procurement tenders, except when such vehicles are produced under a SPIC regime within a limited period (five years from the time of signing the special investment contract or three years from start of production) or under an industrial assembly regime. The importation and use of such vehicles are not restricted for other purposes. However, high customs tariffs (which, in fact, are prohibitive) may apply in such case.

Existing practice

The localisation system in the Russian automotive industry was primarily based

on customs incentives. With its accession to the WTO, Russia lost the authority to control its customs duties and pledged to eliminate customs barriers by 1 July 2018. Notwithstanding the long transitional period set for the Russian automotive industry, the WTO rules took effect before the expiration of some of the existing investment agreements. Starting from 1 July 2018, the Russian Government implemented special state support measures to compensate the importers' expenses related to increased customs rates.

Another acute problem in this space stems from the devaluation of the Russian rouble. The Russian state usually signs investment agreements with automobile producers, under which the latter commit to increase the added value to their vehicles in the country over a certain period. In most cases, the automakers are initially required to ensure 40% of local added value and subsequently increase it to 60%. Although the automakers have difficulty in finding qualified local suppliers (and this is public knowledge), they have somehow managed to attain these percentage benchmarks until the rouble's drastic devaluation. Now it has become even more difficult to reach these benchmarks as the costs of imported materials have increased significantly due to the devaluation of the national currency.

Since almost all investment agreements previously signed in the automotive industry have already expired, most of

the manufacturers have entered into SPICs.

Information and computer technologies

Since 1 January 2016, foreign software products have been banned from public goods procurement tenders, except when:

- the Unified Register of Russian Programmes for Computers and Databases (the “**Register**”) does not contain the software product of the required category; or
- the software product in the Register does not meet the user's requirements.

All software products, including operating systems, are affected. While, thanks to the above-listed exceptions, foreign software products are not completely banned for use by the public authorities in Russia, Russian developers are likely to squeeze out foreign software products from the local market in the long run by filling the Register with domestic software products.

At the same time, foreign software remains in high demand by public entities affected by these restrictions. To circumvent such restrictions, some local public authorities often set their goods procurement requirements in such a way that only their desired foreign software products can fully meet them. The authorities are trying to close this loophole by imposing the criterion of equivalence. Thus, with time, the localisation option looks more

promising for foreign software developers who want to stay on or enter the Russian software market.

Special criteria for obtaining a certificate of country of origin

Under the current procedure for including software products in the Register, the owner of the software must be:

- the Russian Federation;
- a region of the Russian Federation;
- a municipality of the Russian Federation;
- a Russian non-commercial legal entity, whose management body is directly or indirectly appointed by the Russian Government, a Russian region or a Russian municipality and/or Russian citizens, whose decisions may not be determined by a foreign person or entity;
- a Russian commercial legal entity, provided that 50% of its shares are directly or indirectly owned by the Russian Federation, a Russian region, a Russian municipality, a Russian non-commercial legal entity or Russian citizens; or
- a Russian citizen.

Medical products and pharmaceuticals

Russian Government Decree No. 102 dated 5 February 2015 stipulates a list of locally-made medical devices that enjoy preferential treatment in public goods procurement tenders. According to this Decree, public authorities, when procuring medical devices included in this list, are obliged to reject any bids from manufacturers of medical devices

that do not originate from the EEU if there are two or more bids by manufacturers of the same medical devices from the EEU (the “third odd one out” rule).

Moreover, all medical devices manufactured in Russia are awarded a 15% pricing preference in public tenders. This means if the winning bidder (i.e. the bidder offering the lowest price) offers non-EEU-made medical devices, it must grant an additional 15% discount on the price of such goods.

Similar rules are set out by Russian Government Decree No. 1289 dated 30 November 2015. The Decree significantly limits the access of foreign pharmaceuticals which are included in the so-called ‘Essential Drugs List’ to public goods procurement tenders and provides for a 15% discount.

Existing practice

There have been a few court cases where distributors of foreign medical devices have tried to appeal the public authorities' decisions to apply the “third odd one out” rule. However, the Russian courts have confirmed the legitimacy of the application of the rule to all the medical devices included in the list provided for by Russian Government Decree No. 102, as well as the local public authorities' obligation not to consider medical devices, whose country of origin is not confirmed by an ST-1 Certificate or other means, as locally-made products.



Undoubtedly, localisation of foreign goods in Russia is the key to having an advantage over competitors who do not have local operations in the country, as well as enjoying the benefits of the CIS Free Trade Area.



Special criteria for obtaining a certificate of country of origin

On 2 August 2016, the Russian Government adopted Decree No. 744 "On Amendment of Decree of the Russian Government No. 719 dated 17 July 2015", which provides for specific localisation criteria for different types of medical devices.

For most medical devices, a product may be deemed to have been made in the EEU, provided that: (i) the share of the foreign materials used in its production does not exceed 50% of its final cost; and (ii) a company which is a tax resident in the EEU holds the rights to the technical and engineering documentation of the device to an extent that is sufficient to produce it for a period of not less than five years.

Furthermore, the localisation criteria may include a requirement to operate a service centre in Russia which can handle warranty service, repair and

technical maintenance of the medical equipment, as well as a requirement to have exclusive intellectual property rights to the software products that are required to operate the equipment, etc.

Regarding pharmaceuticals, under Russian Government Decree No. 744 dated 2 August 2016, any drug may be deemed to have been produced in the EEU if the following manufacturing stages are performed in the EEU: (i) production of the final dosage form; (ii) packaging; and (iii) quality control release. The list of particular technological operations, comprising the "production of final dosage forms" for different types of medicines (tablets, capsules, syrups, etc.) was set by Order No. 4368 of the Russian Ministry of Industry and Trade dated 31 December 2015. Such operations may include, depending on the dosage form, mixing the components, dry or wet granulation, capsulation, compression and other methods of production of pharmaceutical drugs.

Banking sector

Banking industry

The Russian banking industry is still characterised by a large number of credit institutions (836 as of 1 January 2020¹) and by a high level of concentration of capital.



In 2018-2019 the Central Bank of Russia (the "CBR") continued its policy of reducing the number of credit institutions, aiming for their consolidation and the closer supervision of their activities in the current economic climate. Consequently, a noticeable number of banking licences were revoked in the last two years.

As of 1 January 2020, 60.43% of the banking sector's total assets were held by the top five Russian banks². State-owned banks³ continue to play a significant role in the stabilisation and development of the Russian banking sector.



Legislative and regulatory framework

The legislative framework regulating the Russian banking sector is provided under Federal Law No. 395-1 "On Banks and Banking Activities" dated 2 December 1990 (the "**Banking Law**") and Federal Law No. 86-FZ "On the Central Bank of the Russian Federation" dated 10 July 2002 (the "**CBR Law**"). Credit institutions' bankruptcy is regulated by Federal Law No. 127-FZ "On Insolvency (Bankruptcy)" dated 26 October 2002, which now governs the relevant procedures instead of the special bankruptcy procedures that were previously in force in the banking sector. These laws and related regulations:

- define what is a credit institution⁴;
- set out the list of banking operations and other transactions that may be performed by credit institutions;

¹ https://www.cbr.ru/Collection/Collection/File/25856/obs_208.xls

² As of 1 January 2020, the top five Russian banks in terms of net assets are Sberbank (RUB 28.9bn, i.e. EUR 412.9m); VTB (RUB 14.3bn, i.e. EUR 204.3m); Gazprombank (RUB 6.5bn, i.e. EUR 92.9m); National Clearing Centre Bank (RUB 4bn, i.e. EUR 57.2m); and Alfa-Bank (RUB 3.8bn, i.e. EUR 54.3m); www.banki.ru/banks/ratings/ (all conversions are based on a notional rate of RUB 70 = EUR 1, as used for convenience throughout this guide).

³ Such as Sberbank, VTB, Gazprombank, etc.

⁴ Here and further, banks and non-banking credit institutions.

- establish the framework for the registration and licensing of credit institutions; and
- determine the regime governing bankruptcy proceedings and the protection of credit institutions.

The CBR is Russia's sole financial markets regulator. It is legally and financially independent from the Russian Government. The CBR consists of a Moscow-based Head Office, which includes its Board of Directors, the National Banking Council and central administrative departments, a number of regional branches in the various regions of the Russian Federation (which are called "National Banks" in certain republics), and its local departments.

Under the CBR Law and the Banking Law, the CBR is responsible for regulating banking activities and is authorised to adopt mandatory regulations concerning banking and currency operations. The CBR actively uses its powers and has created a detailed and extensive body of regulation on key areas, including: capital and net worth requirements – Directive No. 1260-U dated 24 March 2003 and Regulation 646-P of 4 July 2018; mandatory economic ratios and reserves – Instruction No. 199-I dated 29 November 2019 and Regulation 507-P dated 1 December 2015; currency control – Instruction No. 181-I dated 16 August 2017; and provision for losses – Regulation No. 590-P dated 28 June 2017.

Licensing and operations

Licensing

A credit institution must be licensed by the CBR in order to conduct "banking activities", as defined in the Banking Law. Credit institutions may be incorporated either as joint-stock or limited liability companies.

Since 1 June 2017, the Banking Law provides for the two types of banking licences:

- **universal banking licences;** and
- **basic banking licences.** The basic banking licence restricts the operations that the bank can carry out in relation to foreign clients and counterparties. Its holder is also prohibited from opening correspondent accounts with foreign banks (except for correspondent accounts required to participate in a foreign payment system) and can invest only in a limited range of securities. On the other hand, a bank with a basic licence enjoys lower capital⁵ and other regulatory requirements and limited disclosure obligations.

If a bank intends to carry out particular banking operations (e.g. operations with a foreign currency, with funds of individual clients or with precious metals), they must be expressly indicated in the universal banking licence or the

⁵ Since 1 June 2018 the capital of a bank with a universal banking licence should be not less than RUB 1bn (EUR 14.3m), while that of a bank with a basic banking licence should be not less than RUB 300m (EUR 4.3m) (subject to some exceptions).

basic banking licence or be permitted in a specific licence to carry out operations with precious metals issued by the CBR to the bank.

The CBR may **deny the issuance** of a banking licence in the event of: (i) the non-compliance of application documents with Russian law requirements; (ii) the unsatisfactory financial standing of the founders and their controlling persons; (iii) the non-compliance with the qualification requirements of the managers; or (iv) a member of the supervisory board (board of directors), a founder with more than 10% of shares (participatory interests) or its controlling persons having an unsatisfactory business reputation as defined by the law. The CBR may **revoke** a banking licence, for example, in cases of capital inadequacy, breach of banking and other Russian law requirements (including breach of anti-money laundering regulations), for carrying out banking operations that are not authorised by the relevant banking licence, or the insolvency of a bank.

Apart from banking licences, there are also special licences issued to non-banking credit institutions enabling them to conduct certain types of banking operations with respect to settlement and payment transactions, deposit and investment of funds of legal entities and clearing operations.

Acquisitions

Acquisitions in the banking sector are subject to specific banking and anti-monopoly rules.

Banking rules

According to the Banking Law, the CBR must:

- give its **prior consent** to any acquisition relating to (i) more than 10%, more than 25%, more than 50%, more than 75% or 100% of the voting shares; or (ii) more than 10%, more than 1/3, more than 50%, more than 2/3 or 100% of participatory interests, in a credit institution;
- give its **prior consent** when a company, group of companies or individual acquires direct or indirect control of a shareholder(s) of a credit institution holding more than 10% of the voting shares or participation interests in the respective credit institution; and
- be **notified** of an acquisition of more than 1% (but less than 10%) of the voting shares or participatory interests in a credit institution.

Anti-monopoly rules

Prior approval by the Russian Federal Anti-monopoly Service is required if the proposed acquisition relates to:

- more than 25%, more than 50% or more than 75% of the voting shares, or more than 1/3, more than 50% or more than 2/3 of participatory interests, in a credit institution, or more than 10% of the assets of a credit institution; and
- the target is a credit institution whose assets exceed RUB 33bn (EUR 471.9m).

Operations

Banks may carry out a wide range of banking operations and provide various services. Non-banking credit institutions may only conduct a limited number of banking operations, such as maintaining accounts and processing payments on behalf of various entities.

The Banking Law provides that the following services qualify as “**banking operations**” and are subject to obtaining an appropriate CBR licence:

- taking deposits from individuals and legal entities (both demand and fixed-term deposits);
- investing the deposited funds as a principal, and opening and maintaining bank accounts for individuals and legal entities;
- performing settlements in accordance with the instructions of individuals and legal entities, including correspondent banks, from/to their bank accounts;
- providing cash, cheque, promissory note, payment document handling services and over-the-counter services to individuals and legal entities;
- selling and purchasing foreign currency (including banknotes and coins);
- taking deposits in precious metals and investing them, opening precious metal accounts and conducting operations on precious metal accounts; and
- processing payments of funds (including e-money transfers) in accordance with the instructions

of individuals without opening bank accounts (excluding payments by post).

In addition to banking operations, credit institutions are permitted to: (i) give suretyships for the obligations of third parties contemplating payment in cash; (ii) accept assignments of rights to demand payment in monetary form; (iii) perform trust management of monetary funds and other assets for individuals and legal entities; (iv) engage in operations with precious metals⁶ and coins made of precious metals; (v) lease out special premises and safe deposit boxes to individuals and legal entities for document and valuables storage; (vi) effect leasing operations; (vii) engage in factoring operations; (viii) provide consulting and information services; and (ix) issue bank guarantees. A credit institution may enter into any other transaction in compliance with the relevant Russian legislation.

Under the Banking Law, a credit institution cannot engage in manufacturing, commodities trading (excluding precious metals⁷) or insurance activities. However, these restrictions do not extend to any cash-settled commodity derivative transactions.

Deposit insurance

Under the Deposit Insurance Law⁸, a bank may only attract deposits from or open accounts for individuals, entrepreneurs and small business enterprises (“**SBEs**”) if the bank is a member of the deposit insurance system.

The Deposit Insurance Law established the Agency for Insurance of Deposits. The Agency has a supervisory role over the deposit insurance system. Its responsibilities include collecting insurance contributions, managing the funds held in mandatory insurance pools, establishing insurance premiums and monitoring insurance payments. Once a bank has been granted a banking licence which allows it to open accounts and deposits for the relevant clients, it is entered into the Agency’s register and needs to apply to the CBR to become registered as a participant in the mandatory deposit insurance system.

Participation in the deposit insurance system is subject to a number of requirements:

- The CBR must be satisfied that the bank’s financial accounts and reports are true and accurate.
- The bank must be in full compliance with the CBR’s stringently monitored mandatory economic ratios (capital adequacy, liquidity, etc.).
- The bank must fully comply with the CBR ratios for the assessment of the quality of the bank’s capital and assets, profitability and liquidity, in addition to the CBR’s requirements for the transparency of its ownership structure, risk management system and internal control.
- The CBR must not be conducting any enforcement actions in respect of the bank, nor must any grounds for these enforcement actions have arisen during the CBR’s review of the bank’s application.

Failure to satisfy these requirements or choosing not to participate in the deposit insurance system will result in the bank being unable to attract deposits from or open accounts for individuals, entrepreneurs and SBEs.

Member banks pay a contribution into a deposit insurance fund. These contributions are calculated as a percentage of the average daily balance of relevant deposits maintained with a particular bank, subject to an established cap. All individual depositors, entrepreneurs and SBEs with deposits in member banks are entitled to 100% compensation for aggregate amounts up to RUB 1.4m (EUR 20,000).

The anti-money laundering law

Federal Law No. 115-FZ “On Combating Money Laundering and the Financing of Terrorism” (the “**AML Law**”) came into force on 1 February 2002, and has been revised a number of times to reflect the global developments in this area. It is the primary legislative act in the Russian Federation aimed at preventing money laundering activities and the financing of terrorism, and is supported by numerous recommendations, binding instructions and regulations of the CBR and other authorities.

⁶ In accordance with Federal Law No. 41-FZ “On Precious Stones and Precious Metals” dated 26 March 1998 and related legislation.

⁷ On the basis of a licence to carry out operations with precious metals.

⁸ Federal Law No. 177-FZ “On Insurance of Deposits of Individuals in the Banks of the Russian Federation” dated 23 December 2003.

The AML Law applies to individuals and legal entities engaged in transactions with monies (and other assets) in Russia, as well as so-called “regulated entities” and the state authorities responsible for monitoring money laundering activities in Russia. It provides for mandatory internal procedures and reporting requirements in the event of any suspicious or otherwise monitored transactions.

Financial institutions, such as banks and non-banking credit institutions, professional participants of the securities market, insurance and leasing companies, postal and other non-credit institutions that deal with the transmission of money (the “**Regulated Entities**”), are required, with limited exceptions, to perform due diligence by ascertaining the identity of a customer (and beneficiary) and monitoring transactions for suspicious activity. To ensure compliance, most Regulated Entities are obliged to develop and implement sophisticated internal regulations and procedures. They must also maintain a sufficient level of education and training on these matters for relevant employees.

In addition, according to recent amendments to the AML Law, Regulated Entities which are members of a banking group or a banking holding⁹ are entitled to exchange client information to identify clients as required by the AML Law (provided that they comply with certain requirements). However, this new rule does not allow the transfer of client

information to foreign parent banks or foreign members of a banking group.

The Regulated Entities must identify and report transactions of a suspicious nature to the Federal Financial Monitoring Service, a designated monitoring authority. These transactions, among others, include cash or non-cash transactions of at least RUB 600,000 (EUR 8,580) and immovable property transactions of at least RUB 3m (EUR 42,900), or the equivalent of these amounts in foreign currency. If one of the parties to a transaction is suspected of being related to terrorist activity, the transaction is subject to mandatory control regardless of the amounts involved.

The Russian anti-money laundering legislation is consistent with the relevant international practice and provides for advanced identification and control procedures in respect of foreign politically exposed persons (so-called “PEPs”).

The CBR may undertake preventative and/or enforcement measures in respect of a Regulated Entity involved in transactions that infringe the anti-money laundering legislation. These measures may include:


- informing the entity of the CBR’s concern regarding its activities;
- suggesting that the entity provides the CBR with a programme for improvement; and
- establishing additional monitoring measures.

Enforcement measures may also include the imposition of a penalty and the withdrawal of the banking licence. The Russian Criminal Code provides for criminal liability for breaches of the legislation on anti-money laundering and this includes penalties and imprisonment for the bank’s management.

Bank secrecy

Similar to other jurisdictions, Russia has a set of rules for bank secrecy which are set out in the Banking Law. Accordingly, a Russian licensed bank may disclose information about any of its customers (including the relevant customer’s operations) only to that customer, courts of general jurisdiction, commercial courts, certain governmental bodies and law enforcement agencies. In the event of unauthorised disclosure of any information so received, the respective authorities bear civil (compensation of damages), administrative and criminal liability under Russian law.

In practice, if a third party wishes to gain access to information in relation to the account balance of an account holder, the account holder must expressly authorise their account bank to release the relevant information. However, some banks take the more conservative view that such authorisation is not possible on the basis that it is not specifically provided for in the banking legislation.

 Please note that Russian authorised banks are also subject to Russian data protection legislation¹⁰.

FATCA and CRS

Critical provisions of FATCA (i.e. the US Foreign Account Tax Compliance Act 2010, which came into force on 1 July 2014) apply extraterritorially and in order to counteract tax evasion require foreign financial institutions to report to the US Internal Revenue Service (the “**IRS**”) information on their clients who have US tax residency status.

In the absence of an intergovernmental agreement on a FATCA compliance mechanism between the US and Russian Governments¹¹ and but for the adoption of Federal Law No. 173-FZ¹² regulating how Russian financial institutions can report to foreign (in particular US) tax authorities, these institutions (or more specifically, their officials), would have faced administrative sanctions and criminal charges for breaching Russian bank secrecy legislation following any transfer of data to the IRS. This law was, to an extent, to the relief of Russian financial institutions, but also imposed certain new reporting obligations on

⁹ The terms “banking groups” and “banking holdings” are defined in accordance with the Banking Law.

¹⁰ Please see the Personal data protection chapter on page 115.

¹¹ A FATCA compliance mechanism was discussed between the US and Russian Governments in early 2014. However, the negotiations of an intergovernmental agreement which would allow Russian financial institutions to comply with extraterritorial FATCA requirements have been suspended.

¹² “On the Peculiarities of Financial Transactions with Foreign Citizens and Legal Entities and Amendments to the Code on Administrative Offences” dated 28 June 2014.

» Acquisitions in the banking sector are subject to specific banking and anti-monopoly clearance rules.



their new reporting obligations on their officials, including an obligation on them to disclose to the Russian tax authorities that a client is a foreign taxpayer.

Russia also takes part in the OECD's Common Reporting Standard (the "CRS") which provides for automatic exchange of taxpayer information between the tax authorities of the participating countries. This means that (i) Russian financial institutions (including banks) are obliged to disclose information on their clients who are tax residents of other CRS participating

countries to the Russian tax authorities; and (ii) the Russian tax authorities will engage in further exchange. Russia started to exchange financial information in September 2018. The Russian legal framework for an automatic exchange mechanism is now being developed¹³. According to the OECD automatic exchange portal¹⁴,



as of February 2020, Russia intends to exchange taxpayer information with 68 countries, while 95 countries confirmed that they will provide information on Russian taxpayers to the Russian tax authorities.

¹³ The law on the implementation of CRS requirements into Russian legislation was adopted in November 2017; the Resolution of the Government No. 693 "On the Implementation of the International Automatic Exchange of Financial Information with the Competent Authorities of Foreign States (Territories)" dated 16 June 2018 provides for the procedural details of the automatic exchange mechanism.

¹⁴ www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/exchange-relationships/#d.en.345426

Environment, energy efficiency and renewables

Environment

Over the past years, Russia has adopted complex environmental legislation that is generally in line with commonly accepted international standards. Its practical implementation, however, remains limited due to the general character of regulations and the inconsistent application of the corresponding penalties. This forces the legislator to develop the respective regulations further with clearer commitments and a more transparent system of liabilities and sanctions.

The development of Russian environmental legislation in close connection with other relevant sectors is also driven by the desire to incentivise Russian-based production and therefore support the so-called "localisation" trend¹.

For example, on 30 June 2015, a new Federal Law on industrial policy² (the "Industrial Policy Law") entered into force, setting out the main principles that govern specific incentives intended to support the development of industrial production in Russia. The law includes specific support to be granted to projects involving the use of so-called "best available technologies" ("BATs"), which are closely linked to the implementation of environmentally efficient solutions.

Notwithstanding these incentives, investment in environmentally efficient technology in Russia remains low in comparison to developments in the rest of the world. This is due to regulatory constraints as well as to a lack of public awareness and understanding of environmental issues.

Legislation on environmental protection

The main federal law setting out the fundamental principles of environmental regulation in Russia is Federal Law No. 7-FZ dated 10 January 2002 "On Environmental Protection" (the "Environmental Protection Law"). The Environmental Protection Law provides for an overall framework for environmental management and imposes general requirements related to the construction and operation of various facilities that may be harmful to the environment.

Types of environmentally dangerous facilities

The Environmental Protection Law classifies facilities depending on the level of their environmental pollution and indicates which methods of state

¹ Please see the Import substitution and production localisation in Russia chapter on page 183.

² Federal Law No. 488-FZ dated 31 December 2014.

control are applicable to each category of facility, as follows:

Category of facility	Facility description (level of environmental pollution)	Method of state control
Category I	Environmentally dangerous facilities (generally relate to the industries of energy, heavy metallurgy, etc.)	Integrated activity permits (valid for seven years)
Category II	Facilities with moderate environmental impact	Declarations on environmental impact (valid for seven years)
Category III	Facilities with insignificant environmental impact	Industrial ecological control programmes (also applicable to categories I and II)
Category IV	Facilities with minimal environmental impact	None

The criteria to classify facilities are currently established by Government Decree No. 1029 dated 28 September 2015.

Only facilities of categories I and II are subject to an obligation to meet the requirements of maximum allowable emission and discharge values.

Environmental fees relating to emissions, discharges and waste management

The environmental fees (pollution discharge fees) are calculated for each waste ingredient and pollution type depending on the level (volume or weight) of the danger they pose to the environment and public health.

The following activities are subject to environmental fees:

- the emission of polluting substances into atmospheric air by stationary sources;
- the discharge of polluting substances into bodies of water; and
- the storage and burial of production and consumption waste.

The corresponding environmental fee structure is calculated depending on the following elements:

- pollution within the permissible norms and established limits;
- application of an increasing coefficient for certain regions and environmental facilities based on ecological factor;
- application of an increasing coefficient for the above-limit discharge (x25 for waste, and x25 or x100 for other polluting substances depending on the facility's category); and
- application of an incentive system (reducing coefficients down to x0 or increasing coefficients up to x100 depending on the application of environmentally friendly technologies and BATs; implementation of

measures and plans aimed at reduction of pollution, etc.).

In addition, on 22 April 2016, a Government Decree setting the rates of the environmental fee relating to the management of production and consumption waste came into force³. Such environmental fee must be paid by goods manufacturers and importers who fully or partially fail to perform their waste management obligation by not meeting the established compulsory recycling targets⁴. The list of goods, in respect of which this environmental fee is payable, is quite broad and contains 54 types of goods including textiles, paper products, petroleum products, plastic products, batteries, computers, communications and electrical equipment. The environmental fee rates are set in Russian roubles for each ton of the product and/or packaging to be recycled and range, for example, from RUB 2,025 (EUR 29) for accumulators to RUB 33,476 (EUR 478) for rechargeable batteries.

₹ RUB 70 = EUR 1 *notional exchange rate used for convenience

“Waste reform”

On 1 January 2019, the so-called “waste reform”⁵ was launched in Russia.

Its main goals are to organise the process of household waste treatment, including its disposal, and to implement the separate collection of such waste.

To this end, each region⁶ has to implement the following measures:

- prepare and approve a regional waste treatment scheme;
- select a regional operator responsible for the waste treatment process in the relevant region;
- set regional waste treatment tariffs payable by all entities and individuals generating waste;
- build waste sorting and processing facilities; and
- implement a separate waste collection system.

As of 1 January 2020, most regions of Russia approved waste treatment schemes, selected regional operators and set relevant tariffs.

However, in many cases, regional operators are suffering from insufficient and irregular financing and lack of available facilities. The adopted regional waste treatment schemes are not always well developed and usually require additional revisions.

³ Russian Government Decree No. 284 dated 9 April 2016.

⁴ The compulsory recycling targets are set for 2018-2020 by Russian Government Ordinance No. 2971-r dated 28 December 2017. Ambitious compulsory recycling targets have been set for 2020, including for (i) metal containers (30%); (ii) tyres and rubber products (30%); and (iii) petroleum products and glass (25%).

⁵ Federal Law No. 503-FZ “On Amending the Federal Law on Production and Consumption Wastes and Certain Legislative Acts of the Russian Federation” dated 31 December 2017.

⁶ Save for Moscow and Saint Petersburg, for which the launch of the “waste reform” has been postponed to 1 January 2022.

There is room for improvement in this sphere, which, notwithstanding the above, remains attractive for potential investors. This is particularly true for the creation of the required infrastructure (e.g. waste sorting and processing plants; waste collection and transporting vehicles and equipment) and the implementation of separate waste collection systems in the regions.

Setting emission quotas

On 1 January 2020, the Russian Government launched an experiment on setting emission quotas⁷.

The experiment will be carried out in 12 industrial cities of Russia until 31 December 2024.

The ultimate goal of the experiment is to reduce atmospheric air pollution.

At the first stage, the authorities will:

- adopt a complex plan of measures for the reduction of emissions in each city; and
- prepare summary calculations in order to identify the main pollutants and facilities emitting such pollutants.

Thereafter, the quotas will be set for the above facilities, and entities or individuals operating them will bear additional obligations to limit emissions in order to meet the set quotas and regularly report to the supervising authorities.

Sanitary protection zones

The regulation of sanitary protection

zones (“**SPZs**”) in Russia has always been deficient. For a long time, the relevant provisions on SPZs have been provided by the sanitary and epidemiological rules (“*SanPiNs*”), but these did not contain comprehensive regulation.

According to Federal Law No. 342-FZ⁸, all estimated or preliminary SPZs established earlier will cease to exist by 2022, and all SPZs will be established in accordance with the new rules.

From 1 January 2022, SPZs and the related restrictions will be deemed to be created from the date of their registration in the Unified State Register of Immovable Property.

Government Decree No. 222 dated 3 March 2018 further provides that SPZs must be established in relation to facilities which have a chemical, physical or biological impact on humans and the environment (“**Hazardous Facilities**”).

It is expressly prohibited to use the land plots located within the boundaries of an SPZ for the following purposes:

- building residential real estate, educational and medical units, children’s recreation organisations,

7 Federal Law No. 195-FZ “On Carrying out an Experiment on Setting Quotas of Emission of Polluting Substances Amendments and Amending Certain Legislative Acts of the Russian Federation Relating to Reduction of Atmospheric Air Pollution” dated 26 July 2019.

8 Federal Law No. 342-FZ “On Amendments to the Russian Town Planning Code and Certain Legislative Acts of the Russian Federation” dated 3 August 2018.

- open-air sports facilities, recreation and gardening zones;
- setting up food, pharmaceutical or drinking water production facilities, if the quality of the relevant products may be affected by neighbouring Hazardous Facilities;
- building or refurbishing capital structures if their permitted use does not comply with the restrictions established within an SPZ.

Any person affected by an SPZ is entitled to arrange for necessary measurements to be effected and submit an application for reducing the SPZ without the consent of the owner(s) of the relevant land plots or Hazardous Facilities. Previously, any changes to an SPZ initiated by third parties were subject to such consent. This change is supposed to intensify the land development process.

Industrial policy legal framework

In line with the shift towards an import substitution model for the Russian economy, the Industrial Policy Law prioritises regional development and favours Russian-based manufacturers. This forces international investors to change their business models by favouring industrial production within Russia.

For example, the Industrial Policy Law expressly introduced preferences for Russian-based production with priority for goods produced in Russia for public procurements.

However, given the framework nature of the Industrial Policy Law (meaning that

its general principles and provisions are implemented through other laws and secondary legislation), this preferential regime is applicable to specific areas such as military equipment, vehicles, medical equipment, pharmaceutical products and certain types of food products.

Special investment contracts

The Industrial Policy Law created a new contractual framework for projects in the industrial sector by introducing the concept of special investment contracts (“**SPICs**”). Under such contracts, investing companies that undertake to implement investment projects will be guaranteed long-term incentives by the Russian State.

What mainly distinguishes SPICs from other contractual arrangements formalising public-private partnerships is that the state does not contribute budgetary funds or state-owned property to the relevant project.

The cost of these state incentives is expected to be offset by the anticipated positive economic effect for the state in the form of new infrastructure, jobs and taxes being paid by new businesses.

New rules for entering into SPICs (so-called “SPIC 2.0”) were adopted by Federal Law No. 290-FZ “On Amendments to the Federal Law on Industrial Policy regarding the Regulation of SPICs”⁹. In particular,

9 Federal Law No. 290-FZ “On Amendments to the Federal Law on Industrial Policy regarding the Regulation of SPICs” dated 2 August 2019.

- these new rules provide for the following:
- SPICs are available only to those investors who intend to introduce modern technologies (as indicated in a list to be approved by the Russian Government).
 - A SPIC has to be entered into through a tender process initiated by the public party or the investor itself. As a general rule, this will be in the form of an open tender. However, if the project relates to military, special or double-purpose technologies, a closed tender will be organised.
 - A SPIC is implied to be a contract between (i) the investor; (ii) the Russian Federation; (iii) the relevant Russian region; and (iv) the relevant municipality where the project is intended to be implemented.
 - The duration of a SPIC will depend on the volume of investments, but will not exceed 20 years.
 - The previous minimum investment threshold (RUB 750m, i.e. EUR 10.7m) is no longer applicable.
 - One SPIC may only be concluded with one investor. This differs from the previous rules ("SPIC 1.0"). Under SPIC 2.0, it is no longer possible to add other participants on the investor's side (such as co-investors, involved parties) who could also qualify for government support measures.
 - The total amount of financial state support under a SPIC may not exceed 50% of the total investment required by such SPIC. If this limit is

- exceeded, the provision of state support measures to the investor is suspended.
- The main tax benefit for a SPIC participant remains the income tax rate of 0% to be paid to the federal budget and the possibility of reducing its regional component down to 0%.
 - SPICs that were concluded under the "SPIC 1.0" rules remain in force. Such SPICs can be amended or terminated by the parties on the basis of the laws then existing at the time of their conclusion. However, it is not possible to enter into a new SPIC under the previous regime.

The new SPIC 2.0 regime is aimed at increasing the transparency of the procedure and introducing a number of positive aspects in the regulatory framework. However, lack of required secondary legislation, which was initially meant to be adopted by the end of 2019, prevents all parties from implementing investment projects under the new regime. Secondary legislation is expected to be adopted in the second quarter of 2020.

Currently, there is another draft of a federal law aiming to regulate the conclusion of agreements affording support to investments in the Russian Federation. This draft bill introduces a new type of agreement – on the promotion and protection of investment ("SZPK"). Unlike SPICs, SZPKs are supposed to be used not only in production-based industries, but also in

other sectors such as services, intellectual property, infrastructure. It also provides for a less formal contract conclusion process – by just filing a declaration on the implementation of the investment project.

Since this bill has not been adopted yet, it is difficult to forecast how SPICs and SZPKs will coexist.

Incentives

The Industrial Policy Law introduced the following incentives for the industrial sector:

- financial support in the form of various subsidies (for R&D expenditures and for the development of industrial infrastructure) to be granted on the basis of tenders, with priority being given to projects involving the use of BATs (please see next section for more details);
- refinancing of loans and access to long-term loan financing on competitive terms¹⁰;
- various types of tax incentives, such as special incentives to be provided until 2025 for some investment projects that have been duly approved by the Russian Government¹¹; and
- creation of dedicated state funds to stimulate industrial development (by way of loans, grants, equity participation in project companies, leasing, etc.).

BATs

The concept of BATs was introduced by Federal Law No. 219-FZ dated 21 July 2014 but only entered into force to the

full extent on 1 January 2020. To date, several relevant Government Decrees and Ordinances have already been adopted on the applicable list of industries¹², BAT qualification and BAT handbooks¹³, etc.

The criteria for a technological process, technological method or equipment to be considered as a BAT generally include the following:

- minimal level of negative environmental impact;
- cost efficiency of implementation and operation;
- use of resource-efficient and energy efficient methods;
- implementation period; and
- industrial introduction at two or more enterprises impacting the environment in Russia.

A list of industry-specific BATs is provided in 51 specialised handbooks, which have been developed by a BAT Bureau created in January 2015 and adopted by Rosstandart.

In terms of incentives, starting from 1 January 2020, manufacturers who implement BATs do not have to pay environmental fees for emissions and discharges (if within the permissible

¹⁰ Russian Government Decree No. 1044 dated 11 October 2014.
¹¹ Russian Government Decree No. 623 dated 24 May 2017.
¹² Russian Government Ordinance No. 2674-r dated 24 December 2014.
¹³ Russian Government Decree No. 1458 dated 23 December 2014.

norms). Moreover, companies shifting to BATs are eligible for financial support through a special fund granting loans for modernisation purposes.

Energy efficiency

Russia offers unique opportunities for investors who want to implement projects in the energy efficiency (“EE”) sphere and, more particularly, for representatives of countries that already possess experience of implementing EE and energy saving (“ES”) technologies.

The main piece of legislation for EE matters is Federal Law No. 261-FZ “On Energy Saving and Energy Efficiency Increase and Amending Certain Legislative Acts of the Russian Federation” dated 23 November 2009 (the “EE Law”). It created a legislative, economic and organisational stimulus for ES and increasing EE.

To facilitate the efficient use of energy resources and to support and encourage ES, the EE Law provides for several groups of EE requirements applicable to various sectors, notably including the construction (EE requirements as to buildings, structures and installations) and the public sectors.

EE requirements for buildings, structures and installations

According to Russian EE rules, buildings, structures and installations (with only a few exceptions) must comply with the **obligatory requirements**. The Russian Ministry of Construction, Housing and Utilities is responsible for setting these

requirements¹⁴ in accordance with the special rules adopted by the Russian Government¹⁵. The EE requirements are to be revised at least once every five years and should cover:

- the maximum energy consumption limits for buildings/structures;
- requirements relating to the architectural, functional, technological, construction, engineering and technical solutions influencing the EE of buildings/structures; and
- requirements relating to specific construction elements of buildings/structures, applicable equipment, technologies and materials.

These EE requirements on design, construction, reconstruction and major repairs identify the parties (developers/builders/owners) responsible for implementation. Failure to comply with them may result in administrative liability¹⁶.

EE requirements for public sector

One of the main priorities of the EE Law is the public sector. For instance, **energy consumption reduction targets** are set for publicly financed institutions. Moreover, companies with

state participation and companies carrying out regulated types of activities are also obliged to adopt and implement programmes aimed at increasing EE.

All purchases by state or municipal clients must be made in accordance with ES and EE requirements fixed by the Russian Ministry of Economic Development with the agreement of the Russian Ministry of Energy, the Russian Ministry of Industry and Trade, and the Russian Federal Anti-monopoly Service. These requirements which concern the public procurement of certain types of goods, works and services whose performance requires considerable amounts of energy consumption, include, in particular:

- limits on energy consumption; and
- technological solutions influencing the EE of goods/works/services ordered.

The federal authorities referred to above must monitor and analyse the EE of publicly procured goods, works and services on an annual basis, and they must prepare annual proposals for reviewing the EE requirements for public procurement.

Energy service agreements

Energy service agreements are entered into between a customer (private or public sector) and a contractor to provide works and services aimed at ES and greater EE.

These agreements must include the following **mandatory conditions**: (i) the volume of ES guaranteed by

the contractor; (ii) the expiration date (which may not be less than the term necessary to achieve the ES set by the agreement); and (iii) other mandatory conditions required under Russian legislation.

The **discretionary terms** of an energy service agreement may include, among other things (i) a clause setting the price for the works and services, subject to the results attained or expected to be attained upon the performance of the contract (e.g. the value of ESs); and (ii) a clause stipulating the obligation of the contractor to install and commission energy meters.

Clauses containing the essential elements of an energy service agreement may be included in contracts of sale and purchase, supply and transport of energy resources (except natural gas not used as motor fuel). Model terms of these contracts have been approved by the Russian Ministry of Economic Development.

Energy audit mechanisms

Previously, the EE Law provided for two main types of energy audit: voluntary and obligatory. According to Federal Law No. 221-FZ¹⁷, there now is only one type of energy audit, namely voluntary.

¹⁷ Federal Law No. 221-FZ “On Amendments to the Federal Law “On Energy Saving and Energy Efficiency Increase and Amending Certain Legislative Acts of the Russian Federation” and article 9.16 of the Administrative Offences Code of the Russian Federation” dated 19 July 2018.

¹⁴ Order of the Russian Ministry of Housing and Building No. 1550/pr dated 17 November 2017.

¹⁵ Russian Government Decree No. 18 dated 25 January 2011.

¹⁶ A “per breach” penalty for company officials at the rate of RUB 20,000 - 30,000 (EUR 286 - 429); for individual entrepreneurs – RUB 40,000 - 50,000 (EUR 572 - 715); for legal entities – RUB 500,000 - 600,000 (EUR 7,150 - 8,580).

Energy audits may only be conducted by companies and individual entrepreneurs who are members of self-regulated organisations. The audit should be aimed at:

- collecting objective data on the volume of energy used;
- defining EE indicators;
- defining the ES potential and increasing EE; and
- developing and evaluating a list of possible programmes which target EE increase.

The results of the energy audits must be reflected in an **energy passport** comprising information on the presence of energy meters, the volume of energy used and the variations of such volumes, etc. Copies of energy passports are forwarded to the Russian Ministry of Energy which is responsible for processing, systematising and analysing the information contained in these passports.

Instead of obligatory energy audits as provided earlier by the EE Law, state and local authorities as well as state-owned and municipal institutions now have to submit annual declarations of electric power consumption.

Incentives

In order to encourage private investors to participate in the EE programme, the EE Law proposes a range of financial/tax incentives.

Such incentives for commercial companies include, in particular:

- investment tax credits of up to 100% for companies investing in EE and ES technology;
- accelerated depreciation of assets categorised as having high EE or assets classified in the top EE class ("**Qualifying Assets**");
- three-year corporate property tax exemption on newly accounted for Qualifying Assets; and
- partial compensation of interest on loans granted by Russian banks for the purpose of investing in ES and increased EE technology.

Renewables
State policy

Since the adoption in 2009 of the Russian Energy Strategy to 2030, the Russian legal and regulatory framework has improved but still remains somewhat inconsistent, with the renewable energy sources ("**RES**") generation target being revised several times.

A Government Ordinance¹⁸ in 2009 set a target of 4.5% by 2020, excluding large hydropower plants of more than 25MW. A Government Ordinance¹⁹ in July 2015 shifted this target to 2024.

The above target corresponds to approximately 5.4GW of newly installed RES capacity (excluding large hydropower plants) by 2024, and is to be achieved using three renewable technologies:

¹⁸ Russian Government Ordinance No. 1-r dated 8 January 2009.

¹⁹ Russian Government Ordinance No. 1472-r dated 28 July 2015.

solar, small hydro and wind, with the latter covering the major share of approximately 3.3GW.

As of 1 January 2019, according to the Russian Ministry of Energy, hydro, solar and wind power account for 20.3% of the country's total installed power capacity of about 243.24GW.



The Russian legal and regulatory framework sets the rules on wholesale and retail energy trading, and offers certain incentives.

Subsidy scheme and tariffs

A so-called "premium scheme" applied to the wholesale prices for RES generated electricity, was introduced in 2007 by an amendment to Federal Law No. 35-FZ "On Electricity" dated 26 March 2003 (the "**Federal Electricity Law**"). However, largely due to the consumer price concerns and legal difficulties with developing a clear implementation mechanism, this price scheme, which would have been equivalent to a feed-in tariff, has never been put in practice.

In 2011, another support mechanism was introduced by the Federal Electricity Law: the promotion of RES through the capacity market. This scheme aims to ensure the financial viability of investments into renewables by concluding "Capacity Supply Agreements" with RES project developers.

The legal framework for this scheme was further developed in 2013 under Government Decree No. 449²⁰ ("**Decree 449**"). Decree 449 establishes the regulatory mechanisms for selecting new RES projects and for their supply agreements. Under a capacity supply agreement, the grid company (Distribution System Operator) undertakes to purchase electricity from RES-generation facilities in the relevant region in order to compensate for transmission losses. The Russian regulatory body, the Market Council, introduced regional incentive schemes for qualifying RES projects. These projects enjoy long-term tariffs, which aim to guarantee returns on investment over 15 years. The capacity to be produced by such facilities is selected by way of annual tenders for renewables at a price that is usually several times higher than the price for existing conventional capacity.

More specifically, the bidders must provide a technical description of the project, including the percentage of localisation (local content) and project financing/guarantee structures. On that basis, the trading system administrator will select the winning bids, and a relevant RES capacity supply agreement will be signed. After completion of the construction, the authorities check that the generating facility meets certain requirements, such as those relating to the localisation of the equipment installed on the generating facility.

²⁰ Russian Government Decree No. 449 dated 28 May 2013.

Various other financial, legal and tax incentives are available at the local, regional and federal levels, depending on the specifics of a particular RES investment project (e.g. region of investment and degree of localisation, type of capital expenditure, legal and project financing structure such as a SPIC – please see relevant section above for more details).

However, although this is a significant step towards the creation of a regulatory framework designed to promote clean energy production in Russia, there are still restrictions. Firstly, this scheme is only applicable to RES generation facilities eligible for the wholesale market (5MW capacity or more). Secondly, it does not allow the promotion of renewable energy technologies in the regions of Russia that have fully regulated tariff systems and the more isolated regions, where the deployment of renewables is economically feasible and supported by the availability of renewable resources. Thirdly, and above all, only projects in which a certain percentage of Russian technology and locally-produced components have been used (the so-called “local content requirement”) may qualify for the purposes of favourable pricing regime. For example, for 2020 to 2024, for wind projects, the required degree of localisation is equal to 65% and, for solar projects, it is 70%²¹. A Government Decree²² and an Order²³ of the Russian Ministry of Industry and Trade provide the local content requirements for each type of RES, and also provide the

formula to calculate a relevant degree of localisation. This is a key condition to ensure project bankability and thus sustainability, as a reduction factor is applied to tariffs for projects without the required degree of localisation (35% for solar power and 45% for wind, small hydro and waste treatment power sources)²⁴.

Recent developments

The Russian Market Council, based on amendments to the Rules of the Wholesale Electricity and Capacity Market²⁵, launched in 2019 an annual tender for the construction of facilities generating electricity from RES as follows: 78.1MW of wind, 5.6MW of solar and 229.832MW of small hydro projects. The winners got 15-year capacity supply agreements under Decree 449.

Only three projects were selected in 2019. This tender was less attractive than the one held in 2018, when more than 1.2GW were tendered. This is because low volumes were proposed to bidders in 2019. At the beginning of 2019, more than 90% of the targeted capacity under the current programme²⁶

21 Russian Government Ordinance No. 1-r dated 8 January 2009.

22 Russian Government Decree No. 426 dated 3 June 2008.

23 Order No. 3788 of the Russian Ministry of Industry and Trade dated 24 September 2018.

24 Decree 449.

25 Russian Government Decree No. 432 dated 11 April 2017.

(which is covering the period up to and including 2024) had already been awarded to various market participants, mostly in wind and solar energy projects.

The market is now awaiting new regulations regarding the period beyond 2024. It is unclear whether the renewable energy sector will receive state support after the expiry of the current incentives.

That said, most market participants are confident that the Russian Government will continue to support the RES market and the current programme will be extended until 2035.

However, the exact volumes are not defined yet.

Russian green certificates could be used to supplement the existing incentive structure. This is currently under discussion. It is envisaged that, by selling these green certificates, consumers could reduce their total amount of payments for capacity under the current support mechanism of capacity supply agreements. As for power suppliers, the green certificates could act as a source of return on their investment.

Apart from the wind and solar focus, in 2017-2018 Russia introduced a set of legislative amendments aiming to extend the existing renewable energy scheme to energy-from-waste facilities²⁷. Currently only the Republic of Tatarstan and the Moscow Region are included in the list of Russian regions where such facilities are to be built. In 2018, two new Russian

regions were added to the list: the Krasnodar Krai (55MW) and the Stavropol Krai (55MW). However, no bids were submitted for these new projects and the 2018 tender for the construction of waste-burning plants was not successful. In 2019, no tender was announced at all.

Outlook

Russia has the potential to increase the use of all types of renewable energy technologies. Historically (since the Soviet period), it has a well-developed hydropower segment. Its bioenergy potential is also significant, as this technology is used in the agriculture, forestry, infrastructure and trade sectors. But today, the Russian renewable energy policy is focusing on accelerating the deployment of wind and solar photovoltaic.

More generally, there are a number of drivers in Russia that explain the increasing focus on renewables and decentralised energy. New energy solutions are seen as a way to modernise the power system, but they are also a part of a broader socio-economic development model to achieve higher living standards. In addition, a decentralised electricity generation system is of interest to Russia’s remote and distant regions, as it is economically

26 Russian Government Ordinance No. 1-r dated 8 January 2009.

27 Russian Government Decree No. 397 dated 31 March 2017, Russian Government Decree No. 802 dated 6 July 2017.

» Russia offers unique opportunities for investors who want to implement energy efficiency and renewables projects, particularly for investors with experience of implementing technologies in these spheres.



impractical to extend high-voltage electricity lines to these regions.

Furthermore, decentralised electricity generation is also interesting and attractive for industrial complexes. It offers opportunities for them and allows them to become more independent from the centralised power system. The current situation of relatively high electricity prices is another reason to explore new energy solutions.

Finally, in response to the EU and US sanctions²⁸, Russia's local content requirements have become one of its main economic policy drivers supporting inbound investments and technology transfers to develop local innovative technologies, including in the RES sector.

²⁸ Please see the Introduction on page 12.

Infrastructure and public private partnerships

General approach

Over the last decade, infrastructure and public private partnership ("PPP") projects have been of great interest to both the public sector and private investors.

The number of PPP projects in Russia continues to increase consistently, mainly due to regional projects, especially in the communal utilities (including water, wastewater, waste management) and energy sectors. However, since 2019 more and more PPP projects are being implemented in the field of social and health welfare.

As of the end of 2019, there are more than 3,500 PPP projects in Russia in various forms and at different stages of implementation. The total volume of attracted investments is RUB 3.9tn (EUR 55bn),



RUB 70 = EUR 1

*notional exchange rate used for convenience

of which RUB 2.8tn (EUR 40bn) are funds of private investors. In the past year, more than 200 large and medium-sized PPP projects went through the stage of commercial closure. The total amount of contracted investments in PPP projects is estimated at approximately RUB 600bn¹ (EUR 9bn).



High profile projects like the Western High-Speed Diameter (one of the largest PPP projects in Europe), the M4 Toll Road, the Pulkovo Airport, the M-1 Odintsovo By-Pass, the Moscow-Saint Petersburg Toll Road, the Pulkovo airport and the Platov airport projects have been successfully implemented and have already been operating well for a few years.

But the large number of new PPP projects has not come without shortfalls. Many large-scale PPP projects have been postponed, suspended indefinitely, converted into public procurements or even cancelled (e.g. Ufa Eastern exit highway, the Moscow-Saint Petersburg High-Speed Rail project (VSM-1), the Neva Water project, the Orlovsky Tunnel, the Palace of Arts on Vassilevsky Island, the Nadex light train in Saint Petersburg, the Lena River Bridge project, etc.).

¹ <https://pppcenter.ru/press-tsentr/novosti/chem-zapomnitsya-2019-god-proekty-konkursy-zakonodatelstvo-trendy/>

In addition, some consumers have complained about the quality of services that they have been receiving under some PPPs. Some granting authorities have also been complaining about the poor quality of PPP applicants, leading them to cancel some of their tenders. It has been reported² that the number of lawsuits over PPPs has increased through the years, and this trend is expected to continue in future. As a result, there have been repeated calls from Russian authorities (especially the Federal Anti-monopoly Service and the Ministry of Construction, Housing and Utilities) to create legal mechanisms that would help better control the screening of candidates, the implementation of PPPs and ensure a better quality of services provided.



A new global trend for quality infrastructure investment has emerged. It is materialising in Russia through the development of criteria for evaluating PPP projects. At the end of 2019, VEB.RF and The National Centre for PPP introduced an initial bill for quality infrastructure investment criteria³. These criteria should help the local PPP market overcome this issue.



It is also worth mentioning that there is a local dualistic trend in the nature of PPP projects. Most of the high profile deals that involve a significant amount of investment are tailor-made to the needs of a particular project, well prepared by teams of qualified specialists and involve very competent investors, contractors and representatives of authorities. On the other hand, regional and especially municipal projects are much less sophisticated. And this results in lower quality and moderate outcomes of such projects, and also makes the benefits of PPPs less obvious for regional and local authorities.

At the same time, growing volumes of mid-market and small PPP projects, especially in communal services, motivate some investors to develop standard-form documents to increase the average quality of projects and make them a standard financial service ready for replication. Sberbank of Russia is one of the most active players in the area of developing standard solutions. It has many representative offices in almost every region of Russia and would like to use this network to its advantage by enabling regional managers to actively finance PPP projects on the basis of standard documents developed at its headquarters.

² www.vedomosti.ru/economics/articles/2017/12/27/746650-voprosov-k-rinku-kontsessii

³ <http://avtodor-invest.com/news/v-veb-rf-obsudili-vnedrenie-printspov-kachestvennykh-infrastrukturnykh-investitsiy-v-rossii/>

There is also a healthy pipeline of infrastructure and PPP 'mega' projects in Russia, including the Eastern High-Speed Diameter in Saint Petersburg and the "TsKAD" (Central Ring Road) around Moscow, as well as many regional projects, which shows that the PPP sector is far from stagnant.

The adoption of a new federal law on PPP in July 2015, which had been debated for several years, was a significant milestone in the development of the PPP legal framework in Russia. The first PPP projects within the framework of the federal PPP law were successfully launched in 2018.

Russian federal and regional authorities alike are becoming increasingly engaged in the development of PPPs. At the federal level, Russia's lower chamber of parliament (the State Duma) operates a PPP council. The Ministry of Economic Development is the government body responsible for PPP policy in Russia. Several federal ministries also manage PPP councils, including the Ministry of Culture, the Ministry of Public Health, the Ministry of Finance and the Ministry of Construction, Housing and Utilities (the latter two Ministries have been especially active in recent years). At the regional level, most regions have adopted their own PPP laws which will remain in effect until 2025, notwithstanding the adoption of the federal PPP law.

The trend over recent years shows that Russian authorities view the PPP sector as a leading tool for infrastructure

development and for attracting private (both domestic and foreign) investment. Even though some regional authorities with little experience in the PPPs remain sceptical, the federal Government is actively advocating this instrument, including situations in which the Government declines to provide co-financing for regional infrastructure, unless it is a PPP.

Key PPP legislation

Federal PPP legislation

At the federal level, PPP projects are regulated by:

- Federal Law No. 224-FZ "On Public-Private Partnership, Municipal-Private Partnership in the Russian Federation and on Amendments to Certain Laws of the Russian Federation" dated 13 July 2015 (the "**PPP Law**");
- Federal Law No. 115-FZ "On Concession Agreements" dated 21 July 2005 (the "**Concession Law**");
- the Civil Code of the Russian Federation (the "**Civil Code**");
- the Land Code of the Russian Federation and laws regulating land;
- the Town Planning Code of the Russian Federation and laws regulating construction activity;
- the Budget Code of the Russian Federation (the "**Budget Code**") and associated regulations (e.g. Russian Government Decree No. 18 "On the Procedure for Management of the Fund of National Welfare of the Russian Federation" dated 19 January 2008); and

- laws and decrees regulating specific industries (e.g. Federal Law No. 257-FZ “On Motorways” dated 8 November 2007).

PPP Law

The PPP Law was adopted in July 2015 and entered into force on 1 January 2016.

Generally, the PPP Law is aimed at unifying the principles regulating PPPs, defining the powers of public authorities when entering into partnerships with the private sector and specifying the procedures for entering into PPP arrangements.

In particular, the PPP Law includes the following provisions that help define, characterise and regulate PPPs:

- While the PPP Law does not set out an exhaustive list of forms for implementing PPP projects, it nevertheless allows for private ownership over the infrastructure facilities (thus enabling BOO, BOOT and other standard PPP models based on private ownership). This is in contrast to the Concession Law which requires the state to retain ownership over the infrastructure facilities.
- PPP is defined as the cooperation of a public partner (the Russian Federation, a region or a municipal authority) and a private partner (a Russian legal entity) on the basis of a PPP agreement entered into pursuant to a tender procedure and aimed at increasing the quality and availability of public services by attracting private investment.
- A PPP project may be initiated either by the public or the private partner; thus providing investors with a right to enter into a PPP agreement through a non-tender private initiative procedure.
- Major Russian state-controlled PPP market players (such as state banks VEB.RF, Sberbank, VTB, Gazprombank and state investment funds such as the Russian Direct Investment Fund) are expressly prohibited from controlling more than 50% in a private partner. As a result, they will need to enter in consortia with private entities, including foreign investors, to finance PPP projects under the PPP Law. There have been calls to ease this rule since the PPP Law entered into effect.
- A PPP agreement is to be signed for a minimum of three years.
- PPP agreements regulated by the PPP Law are distinct from concession agreements, which are implemented on the basis of the Concession Law. And the PPP Law does not apply to concession agreements.
- The list of objects under PPP agreements (the “**Objects**”) is exhaustive and includes, in particular, private roads, bridges, roadside utilities, public transportation (excluding metros), railways, pipelines, sea and river ports, airports, electricity generation plants, public health facilities, social infrastructure and, since 2016, agricultural and industrial facilities – which is expected to promote investments in those two sectors. In 2018, the list of Objects was supplemented by IT facilities emphasising the overall trend in e-development. Any infrastructure that cannot be held in private ownership according to Russian law is excluded from the scope of regulation of the PPP Law and may only be subject to a concession agreement.
- Under a PPP agreement, the private partner must (re)construct the Object, fully or partially finance such (re)construction as well as operate and/or maintain the Object. The private partner may also be required to prepare the design documentation, and fully or partially finance the operation and/or maintenance of the Object.
- As a general rule, the private partner remains the owner of the Object after the PPP agreement expires provided, however, that the amount of financing contributed by the private partner exceeds the financing of the public partner.
- If, during the effective term of a PPP agreement, the applicable federal, regional and/or local laws and regulations are amended and this adversely affects the private partner, then the parties must review the provisions of the PPP agreement to restore the economic balance initially envisaged by the parties, as well as the property and financial interests of the private partner.

The PPP Law also generally defines such matters as the preparation of the PPP agreement, the content of the tender documentation, the tender procedures and control over the implementation of PPP projects. Under the PPP Law, some aspects of the implementation of PPP projects are to be regulated by subordinate legislation adopted by the Russian Government.

Despite the adoption of the PPP Law, some important issues still remain unresolved.

First of all, the PPP Law only applies to the types of Objects expressly listed in it. For example, public utilities (heat, water and gas supply facilities) are not mentioned in the PPP Law and, thus, the relevant PPP projects can only be implemented under the Concession Law. As a result, some proposals aimed at broadening the scope of the PPP Law are tabled regularly.

Secondly, the PPP Law does not expressly provide guarantees for the return on investment. Some limited income guarantees are mentioned only for those projects where the activity of the private partner is regulated and prices (tariffs) are fixed by public authorities, such as in waste infrastructure projects.

Concession Law

The Concession Law was adopted in 2005. Since then, it has been repeatedly amended in order to make it more practical to implement concession projects in various sectors.

The Concession Law applies to certain types of infrastructure such as roads and roadside utilities, pipelines, sea and river ports, airports, public utilities, railways, metros, and other public transportation and public health facilities.

The Concession Law sets out the general rules for entering into concession agreements, including the tendering rules and the material terms that these agreements must include.

In particular, under the Concession Law it is possible for an investor to initiate a concession project and enter into a concession agreement without a tender through a private finance initiative. The grounds on which the grantor may decline the offer of an investor to enter into a concession agreement are limited by law.

However, the Concession Law provides that a concession agreement can be concluded out of tender only if there are no applicants other than the investor.

Under the Concession Law, a change of concessionaire is permitted before the conceded object is commissioned, subject to the grantor's consent.

Regional PPP legislation

Over the last decade, most Russian regions have adopted their own regional PPP laws in order to provide options for implementing PPP projects based on private ownership over the infrastructure objects. At the time, private ownership based schemes were either not

provided for under federal law, or expressly prohibited by the Concession Law. The most notable example is the Saint Petersburg PPP law of 2006.

Significant regional projects implemented under the Saint Petersburg PPP law include the Western High-Speed Diameter and the Pulkovo Airport.

Whilst other Russian regions have followed Saint Petersburg's example by adopting their own regional PPP laws, the adoption of the new federal PPP Law in July 2015 has significantly affected this practice.

Under the PPP Law (which is a federal law), the regional PPP laws may remain in force, but will have to be brought in line with provisions of the PPP Law by 2025.

In the meantime, all PPP projects implemented since 2016 are regulated by the PPP Law and not regional PPP laws. As a result, regional PPP laws remain applicable for the PPP projects that were initiated before 2016 and generally such projects are "grandfathered" by the PPP Law itself.

Alternative schemes or quasi-PPP

Alternative PPP schemes have been implemented in the past on the basis of other legislation, such as the investment contracts of the Budget Code, long-term leases with investment undertakings governed by the Civil Code, and public-private joint ventures based on the privatisation legislation as well as

general civil and corporate law principles. These alternative schemes have always been questionable from a legal perspective. Consequently, some courts applied the Concession Law or the so-called "Public Procurement Law"⁴ with respect to such contracts, resulting in the cancellation of many projects. With the new PPP Law, the legality of some alternative schemes (i.e. those not provided for by the PPP Law or the Concession Law) is even more questionable, with the exception of those options expressly provided for by other federal legal acts or quasi-PPP projects that are managed not by the state authorities, but by state-controlled companies like FSUE Rosmorport or SC Russian Highways.

For example, the Public Procurement Law provides for the conclusion of life-cycle agreements for the (re)construction and operation of infrastructure. This option is available in Russia since Government Decree No. 1087 dated 28 November 2013 came into force. The Decree provides that life-cycle agreements may be used for the design and construction of roads, ports, communal utilities, waste management, rail objects as well as for the procurement of aircrafts, vessels and transport vehicles, including railway and metro cars. At the same time, in 2014, partially to avoid the application of the Public Procurement Law, the city of Moscow lawfully provided financing to its controlled enterprise, the Moscow Metro, which is not subject to the Public Procurement Law and may conduct more flexible tender procedures that still

protect the best interests of the state, while making projects more attractive for investors and financing institutions. As a result of an open tender held by the Moscow Metro, several life-cycle contracts for the financing, manufacturing and maintenance for 30 years of more than 1,000 railcars were signed. Those agreements and tenders were based on best practices of the PPP market and general provisions of the Civil Code.

Another example of a PPP-like instrument that is now successfully in operation is the public-private joint venture established by the Russian Post and VTB Bank (AO NLT) aiming to construct cutting-edge logistics centres throughout Russia.

Russian PPP environment Governmental commitments

The Russian authorities have adopted several programmes aimed at modernising infrastructure, including roads, railways, airports, power generation plants, as well as healthcare and social infrastructure.

The Government provides support to private investors in order to attract foreign investment. For instance, it co-finances and/or guarantees PPP projects.

⁴ Federal Law No. 44-FZ "On the Contractual System for the Procurement of Goods, Works or Services for State and Municipal Needs" dated 5 April 2013.

It also provides tax credits and other benefits prescribed for special economic zones⁵.

Transport

The Ministry of Transport is the state body responsible for the development and investment policy in all areas of transport. Each means of transport (roads, airports, railways, etc.) is under its supervision and is managed by a specialised entity, which, in turn, reports to the Ministry of Transport.

Some PPP transport projects which will be implemented in the coming years in Russia include:

- the transport project Europe-West China;
- sections 5-3 and 4 of the *TsKAD*;
- a bridge in Novosibirsk;
- a private parking system in Saint Petersburg;
- a bypass ("*obkhod*") of Khabarovsk;
- a private tram in Saint Petersburg;
- a high-speed tram in Samara;
- a railway link from Saint Petersburg's centre to Pulkovo airport; and
- the further modernisation of Moscow's airports (first of all Sheremetyevo, in respect of which a concession agreement has been signed, and then Domodedovo and Vnukovo), as well as of the airports of Noviy Urengoy, Vladivostok, Irkutsk, Omsk and Oryol (Yuzhny).

Roads

The state company Russian Highways is responsible for, among others, PPP projects in relation to federal roads. Under

its activity programme for 2010-2024, as approved by the Government⁶, Russian Highways will be allocated RUB 1.42tn (EUR 19.9bn) to (re)construct highways, develop new international routes and create a chain of multifunctional road service zones through PPP projects. Most PPP projects are planned to be implemented under long-term investment as well as concession agreements and operation & maintenance contracts.

Railway

JSC Russian Railways ("**RZD**") operates a monopoly in the Russian railway sector and is currently implementing a number of investment projects, such as the reconstruction of the Baikal-Amur and Trans-Siberian railway links and the Moscow-Kazan High-Speed Rail project (VSM-2).

The design of the Moscow-Kazan High-Speed Rail project was completed in 2017 as a procurement for RZD and was financed by the state. Concession agreements for the construction and operation of some sections of the Moscow-Kazan rail link will be entered into, which alongside state financing will require a significant amount of private investment. Construction was expected to begin in 2018. According to public estimates⁷,

⁵ Please see the relevant section of the Tax system chapter on page 66.

⁶ Order No. 2146-r of the Government of the Russian Federation dated 31 December 2009 (as amended).

⁷ www.eng.hsrail.ru/hsrail-Moscow-Kazan/project-profile/



the total value of the project will exceed RUB 1tn (EUR 13.3bn). That said, it is now highly likely that this project will be cancelled due to unfavourable traffic and projected income analysis. Instead, a toll automobile road will be built to Kazan, and the VSM-1 high-speed rail project between Moscow and Saint Petersburg will be revived.

The VSM-2 project was supposed to become part of an even more ambitious project, the "Silk Road Initiative", aimed at creating a high-speed rail link between Europe and China through Russia. Even if VSM-2 is cancelled, the Silk Road Initiative may still be implemented in the future.

On the positive side, two major railway projects were signed in 2019 involving:

- a concession agreement regarding a freight railway line to the Togliatti special economic zone with a total amount of investments of approx. RUB 0.9bn (EUR 12.8m); and
- a concession agreement regarding a freight railway line to the Kaluga special economic zone with a total amount of investments of approx. RUB 655m (EUR 9.3m).

Communal utilities

Utilities have long been a successful and receptive area for private investment. They also are thought to offer a great

potential for foreign investment. As an inheritance from the Soviet Union, Russia received a large number of publicly-owned housing and utility facilities, most of which are in poor condition, requiring urgent repair or modernisation.

The Government – and especially the Federal Ministry of Construction, Housing and Utilities which is implementing a programme for the development of communal utilities – is actively attracting private investment into the communal utilities sector. The Government is ensuring long-term commitments of the state towards investors and tariffs to cover both capital and operational expenses, as well as guaranteed profit. In some sectors where tariffs cannot cover both capital and operational expenses (e.g. waste management), additional state financing is available.

It is expected that a new programme for the development of communal utilities (to be completed by 2035) will be adopted in 2020 aiming to provide individuals with high-standard and affordable housing and communal utilities.

Waste management

Waste management is likely to be a pressing issue in the coming years, since a significant number of existing waste disposal facilities are waste dumps and quite a few of them are reaching maximum capacity. Some of these dumps are poorly managed, which sometimes results in toxic fumes.

That said, there is a need for private investment in waste management, including investment in modern means of disposal and recycling.

The Concession Law was amended in 2015 to include industrial waste facilities as potential objects of concession agreements (previously only facilities operating with household waste could be the subject matter of concessions).

There is currently a debate as to whether concessions or PPPs would only be effective if the private partner also becomes a regional waste management operator⁸. However, this cannot be legally guaranteed because regional waste management operators are selected via separate tenders.

At the same time, it is possible to implement some quasi-PPP projects based on contracts with regional operators without an additional concession or PPP agreement. For example, the subsidiaries of the Rostekhnologii state corporation won tenders to become the regional operator for significant amounts of waste treatment in the Moscow Region and Tatarstan.

A new state corporation operating in waste management, the Russian Ecological Operator, was incorporated in 2019. It is responsible for coordinating efforts on waste treatment at a federal level, re-cultivating existing waste dumps. It also accumulates know-how and participates in investment projects

related to waste treatment. This state corporation is expected to play a role similar to that of SC Russian Highways in the management of automobile roads.

Power (heating and electricity sector)

Tariffs in the heating sector in Russia are traditionally relatively high compared to those in other sectors, while the equipment used is old and inefficient. This makes this sector open for private investors, including foreign investors and producers of modern equipment. As a result, there are currently many regional projects of different scale (from one to several districts) being at various stages of implementation.

Many of the existing plants are combined heating and electricity producing plants, which generates an additional source of income. Projects using renewable energy sources, such as biogas, biomass and peat, can further benefit from green tariffs granted by the state as an incentive for renewable energy, which can be three to five times higher than the standard market price for electricity.

By-product electricity generated by waste treatment plants to be constructed in Russia is also considered as renewable energy.

⁸ This means that the private partner basically becomes the default waste management operator for the region, and it provides waste management services to all customers of the region. Thus, the status of the regional operator guarantees demand and cash flow.

Water and wastewater
Under the law on water supply and wastewater treatment⁹, infrastructure in this field must remain within the public property domain. That means that the new PPP Law is not applicable to this type of facility and instruments available for private investment into this sector are limited to concession agreements, long-term lease agreements and other quasi-PPP models where ownership is not transferred to the investor.

Amendments to the Concession Law which have been effective since 1 January 2017 actually increased the number of concession projects in water and wastewater infrastructure.

Housing
In 2015, a law on capital renovation of housing¹⁰ introduced a new fee for capital renovation of apartment buildings which must be paid by all urban population. The fees are accumulated either by state-controlled regional funds responsible for the renovation of housing in specific regions, or by municipalities which contract directly with companies for renovation works with respect to particular housing objects. Such funds will in the future become the resource for financing capital repairs of apartment buildings.


Apartment buildings are currently not mentioned among possible objects of concession or PPP projects. However, the Russian Government may be developing plans for attracting financing for capital repairs. Given the existing

trends, this mechanism might be of a PPP or of a quasi-PPP nature.

Healthcare sector
PPP has also begun to develop actively in the healthcare sector: hospitals and innovation centres are being built in the regions.

In 2019, numerous agreements were concluded for construction in the healthcare sector. Moreover, in the Novosibirsk Region, a PPP project for the creation of city clinics was completed.

Investment in healthcare infrastructure is also actively supported by the Government through long-term commitments to buy the services of private operators of infrastructure facilities through state social security funds, as well as through the implementation of life-cycle agreements.

 Please see the *Alternative schemes or quasi-PPP* section above.

There are already a number of successful healthcare infrastructure projects in Russia, some of which are implemented by foreign investors. More projects are about to take off in the near future in Moscow, Saint Petersburg, the Leningrad Region, Vologda, Udmurtia, Ulyanovsk, Novosibirsk, Samara and other major regions of Russia, including a number of nuclear medicine projects

⁹ Federal Law No. 416-FZ dated 7 December 2011.
¹⁰ Federal Law No. 271-FZ dated 25 December 2012.

in major Russian cities such as Moscow, Rostov, Tomsk, etc.

One of the new trends is creating medical clusters, such as the Medical Cluster in Skolkovo and the International Moscow Medical Cluster, which will provide different benefits for their respective residents.

Social infrastructure

PPP projects in social infrastructure are primarily initiated in the regions, such as the construction of retirement homes in the Moscow Region and in Buryatia, several sport facilities in the Nizhniy Novgorod Region, a college for gifted children in Omsk, education facilities in the Pushkinsky District of Saint Petersburg and the construction of 25 kindergartens in Tomsk. Five concession agreements for the construction of schools in the Khanty-Mansiysk Region were concluded in 2019.

The main obstacles for investors in this field are the return on investment and lack of available guarantees. Given that the payment profile of consumers is relatively low, the cash-flow of social projects is usually based on the availability of payments made by the relevant state authorities (grantors).

Financing

The state corporation VEB.RF is the Russian development bank primarily responsible for developing and funding PPP projects in Russia. VEB.RF provides financing for projects deemed to be of primary importance to the Russian

Government and which are carried out on a PPP basis. There are a variety of methods which allow VEB.RF to participate in infrastructure projects, such as providing guarantees, suretyships and loans, and also through equity finance.

Investment and commercial banks involved in PPP projects remain Russian for the most part, with Sberbank, VTB and Gazprombank (all of which are state-owned) leading the way, together with Russian pension funds, such as Leader. However, the PPP Law (which prohibits state-controlled entities from having more than 50% control over a private partner) requires these major state-owned players to enter in consortia with private investors to implement PPP projects. This development is expected to benefit private investors in Russian infrastructure in view of the stable market position and resources of these major players. Unlike PPPs, concessions are not affected by such restriction, so far.

Legal issues

Some of the innovations that have been introduced, including within the framework of the Civil Code reform, have brought the PPP legal environment in Russia one step closer to international best practices in the fields of PPP and project finance. These include concepts such as:

- options;
- independent guarantees;
- security deposits;
- pre-contractual liability;
- the reimbursement of losses arising from the occurrence of certain

- events specified in a contract (the intended equivalent of the English law concept of an “indemnity”); and
- representations (“*zavereniya ob obstoyatelstvakh*”) (an intended equivalent of “representations” and “warranties” as used in contracts under English law).

Despite these legal developments, further amendments to the current civil legislation are still required to address the concerns of financing organisations and increase the bankability of PPP projects in Russia.

PPP projects in Russia are generally structured based on market practice and experience accumulated by market players. At the same time, the legislation is rather broad and usually does not elaborate in sufficient detail on various aspects of PPP projects, which leaves room for interpretation and negotiations.

Most of the time, disputes are settled amicably through negotiations because all the parties involved are interested in the success of the project. It means that there are rather few court rulings available that could bring light on the potential interpretation of the PPP legislation.

In the past years, there have been three major landmark disputes involving:

- the Orlovsky Tunnel;
- the Kaga-Sterlitamak-Magnitogorsk automobile road tender; and
- LLC Glavnaya Doroga (a concessionaire for a toll road).

The takeaways from these cases are rather mixed. On the one hand, some of the instruments that are crucial for PPP projects (like ‘special circumstances’ allowing cost and time relief) have been confirmed as viable, which is very positive. On the other hand, PPP related disputes have been exempt from commercial arbitration (both international and domestic) because the courts considered them of public importance. Each of these disputes came as a shock to the market and the whole PPP community, as they have shown that even concepts that seem well established for experienced investors may at any moment be criticised and sometimes challenged in court by some authorities who only occasionally deal with PPPs (like the Federal Anti-monopoly Service), unless such legal concepts are expressly provided for in the legislation.

Prospects for infrastructure projects

A number of PPP projects in various sectors have already been announced or are expected in the coming years.

Russian federal and regional authorities have recognised the need to develop infrastructure projects on a PPP basis. These authorities have already taken some positive steps to create the legal framework necessary to attract both foreign and domestic investors to this type of projects, such as the adoption of the PPP Law and amendments to the Concession Law enabling private finance initiatives.

» Developing infrastructure is one of the major challenges and priorities in Russia. To reinforce positive trends of private financing into infrastructure, innovations are constantly introduced to the Russian legislation, including within the framework of the Civil Code reform. This ongoing effort has already made the PPP legal environment in Russia acceptable for investment and brought it much closer to international best practices in the fields of PPP and project finance.



These factors will likely help support current initiatives and possibly create new opportunities in the Russian infrastructure market.

Oil & gas

Alongside other natural resources, oil and gas remains the “flagship” and one of the most highly regulated sectors of the Russian economy. Its legal framework is centred around the regime of the Russian subsoil, its use and licensing.

Legislative framework

The key legislation framing up the legal regime of the Russian oil & gas industry is:

- Federal Law No. 2395-1 “On Subsoil” dated 21 February 1992 (the “**Subsoil Law**”); and
- Federal Law No. 225-FZ “On Production Sharing Agreements” dated 30 December 1995 (the “**PSA Law**”).

The Subsoil Law serves as the cornerstone of the legislation on the use of subsoil in Russia and essentially regulates all key issues relating to geological surveying, exploration and production of natural resources, including oil and gas. The PSA Law specifically deals with the collaboration of Russian and foreign investors with the Russian state in geological surveying, exploration and production of natural resources under production sharing agreements (“**PSAs**”). The PSA Law is essentially dormant: all three PSAs currently implemented in Russia were signed before its enactment.

Ownership and licensing

In Russia, all subsoil resources belong to the state until such time as they are extracted by a private investor pursuant to a duly granted licence. Following such extraction, the resources become the property of the licence holder.

The Federal Agency for Subsoil Use (“**Rosnedra**”) is responsible for awarding, amending, transferring and extending the licences in respect of any onshore blocks, except for so-called “strategic” blocks (as defined below). Licences to strategic blocks (including offshore) may only be awarded to investors pursuant to a decision of the Russian Government.

Restrictions on foreign investors Strategic blocks

Licences

Under the Subsoil Law, companies incorporated in foreign jurisdictions are prohibited from obtaining licences to use strategic blocks (blocks of federal significance), which include:

- those containing deposits with the following reserves, as evidenced by the state register of reserves:
 - recoverable oil reserves of 70m tons or more; or
 - gas reserves of 50bn cubic meters or more;
- subsoil plots located in the inland sea waters, territorial sea waters

- or on the continental shelf of the Russian Federation (the so-called “offshore” blocks); and
- subsoil plots that can only be developed using land used for defence or security purposes.

Only a company established in Russia may hold a licence for a strategic block. Special requirements apply to the acquisition by a foreign investor of “control” over such company. Additional limitations are also established in relation to companies holding licences for the areas extending to the Russian continental shelf (see below).

The Russian Government may restrict the ability of Russian companies with direct or indirect foreign ownership to participate in an auction or tender for the right of subsoil use of a strategic block.

Unless otherwise provided by federal law, if a subsoil plot is included in the published list of subsoil blocks of federal significance, such subsoil block will retain this status indefinitely, notwithstanding any subsequent change to the criteria listed above.

Acquisitions of Russian companies operating a strategic block

Under the Strategic Industries Law¹ when a foreign investor wishes to acquire “control” over a Russian company holding a licence for a strategic block, it must seek the approval of a special commission headed by the Chairman of the Russian Government².

The requirement is triggered if a foreign investor acquires at least a 25% interest in the licence holder. It also applies in certain other cases, including, for example, if under a shareholders’ agreement the acquirer is given at least 25% of the seats on the board of directors.

Special restrictions are established for foreign investors controlled by any foreign state. Such investors may not acquire “control” over a strategic licence holder (and so their aggregate interest must be less than 25%). Approval is also required for the acquisition by such investors of an interest in a strategic licence exceeding 5%.

Exceptions to these requirements may be set out in relevant international agreements which Russia is a party to. In addition, most of the rules do not apply if, following the acquisition, the strategic licence holder would remain more than 50% owned by state-controlled companies such as Gazprom or Rosneft.

Offshore blocks

Subsoil blocks that are fully or partially located on the Russian continental shelf may only be licensed to a Russian company (i) that is more than 50% owned or controlled by the Russian

state; and (ii) that has at least five years of development experience within the Russian continental shelf.

These special limitations do not apply to other offshore blocks – the inland sea/territorial sea waters. They remain within the category of “strategic” and are subject only to the general requirements applying to strategic licence holders.

Non-strategic blocks

Foreign companies are not disqualified by law from obtaining a licence in respect of a non-strategic block. However, in practice, foreign licence holders of a non-strategic block in Russia are rarely encountered. Therefore, foreign companies usually hold mineral rights to such blocks indirectly through their Russian subsidiaries.

Licences

Issue and term of licences

Mineral rights are documented by a licence which is essentially a permit issued by the Russian state to conduct a particular type of activity in respect of a given subsoil block. Subsoil licences do not give any surface rights to the territory on which the activity is to be carried out. Therefore subsoil users must obtain land use rights (usually under a lease³) separately.

Geological surveying licences

A licence for geological surveying is issued without a tender or auction:

- generally for up to five years;
- for up to seven years in respect of subsoil blocks located at least

- partially within certain Russian regions; and
- for up to ten years for offshore blocks.

The validity term of a geological surveying licence can be extended to enable the licence holder to complete the works under the licence.

Exploration and production licences

Exploration and production licences can be issued for the project life span. Their term can be extended provided that the licence holder has not breached any terms of the licence and proved the need to extend the licence term in order to complete the production cycle within the licensed area.

Exploration and production licences may only be issued through a tender or auction, except (i) where a holder of a geological surveying licence has made a commercial discovery; and (ii) in respect of some of the strategic blocks exempted by the Russian Government from the standard tender/auction procedure.

Combined licences

Combined licences cover geological surveying, exploration and production. They can be granted in respect of blocks with proven reserves that require substantial additional exploration.

¹ Federal Law No. 57-FZ “On Procedures for Foreign Investment in Companies of Strategic Significance for National Defence and Security of the Russian Federation” dated 29 April 2008.

² Please see the Strategic industries section of the Common forms of business structures for foreign investors chapter on page 34.

³ Please see the Real estate and construction chapter on page 157.

The issue conditions and term of this type of licence are the same as for an exploration and production licence.

Transfer of licences

Since subsoil licences are acts of government, neither the licences themselves, nor any mineral rights thereunder, are transferable (including by way of sale, pledge or other disposal or encumbrance), except pursuant to special rules set out in the Subsoil Law.

These rules specifically permit the transfer in certain instances (except for the transfer of licences to strategic blocks to companies with foreign participation), including a transfer:

- within a group of companies (from a parent to a subsidiary, from a subsidiary to a parent and between subsidiaries as directed by the parent);
- following a merger or consolidation of the licence holder with another company;
- following a spin-off or split-off of a new company (from the licence holder);
- from a shareholder to a joint venture where the shareholder holds at least 50% of the equity interest (subject to certain conditions). Foreign investors often enter into joint ventures with Russian companies on this basis in order to obtain access to their subsoil licences.

Any such transfer requires a special decision of Rosnedra. Licences to strategic blocks may not be transferred

to entities with foreign participation other than with the permission of the Russian Government.

For the above reasons, an “acquisition” of a Russian subsoil licence is mainly possible through the purchase of an interest in the company holding the licence, or by forming a joint venture with the current licence holder and subsequently transferring the licence to the joint venture. In certain cases where obtaining an equity interest in the licence is not possible for regulatory or other reasons, contractual arrangements are put in place to give the foreign investor benefit of the licence.

PSAs

In Russia, PSAs have been aimed at providing investors with greater stability in the tax⁴ and regulatory aspects of subsoil development in the long run.

Since 2003, the PSA regime has been significantly curtailed. PSAs are only available if the block was put out to auction and the auction failed. This means that a PSA is a second choice of the state, used where the relevant blocks are not of interest to subsoil users on standard licence terms. Hence, the most lucrative blocks are awarded on the basis of the general subsoil licensing regime. As noted above, to date not a single PSA has been awarded under the PSA Law.

⁴ Please see the Tax system chapter on page 65 for an outline of the PSA tax regimes.



In Russia, all subsoil resources belong to the state until such time as they are extracted by a private investor pursuant to a duly granted licence.



Your key contacts in Russia



Jean-François Marquaire
Managing Partner
Head of Projects & Infrastructure
T +7 495 786 4000
T +7 495 786 4084
E jean-francois.marquaire@cmslegal.ru



Leonid Zubarev
Senior Partner
Head of Commercial
Head of Insurance
T +7 495 786 4000
T +7 495 786 3085
E leonid.zubarev@cmslegal.ru



Anton Bankovskiy
Partner
Head of Intellectual Property
T +7 495 786 4063
E anton.bankovskiy@cmslegal.ru



Konstantin Baranov
Partner
Head of Banking & Finance
T +7 495 786 4070
E konstantin.baranov@cmslegal.ru



Maxim Boulba
Partner
Head of Competition | Head of TMT
& Public Procurement
T +7 495 786 4023
E maxim.boulba@cmslegal.ru



Georgy Daneliya
Counsel
Head of Japanese Desk
T +7 495 786 3065
E georgy.daneliya@cmslegal.ru



Valeriy Fedoreev
Partner | Head of Employment
Head of Sports Law
T +7 495 786 4060
E valeriy.fedoreev@cmslegal.ru



Dr Thomas Heidemann
Partner
Head of Automotive
T +7 495 786 4049
E thomas.heidemann@cmslegal.ru



Christophe Huet
Partner
Employment
T +7 495 786 4051
E christophe.huet@cmslegal.ru



Gregor Kennedy
Counsel
Corporate/M&A
T +7 495 786 4059
E gregor.kennedy@cmslegal.ru

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The Legal 500



Natalia Kozyrenko
Partner
Head of Energy & Climate Change
T +7 495 786 4069
E natalia.kozyrenko@cmslegal.ru



Artashes Oganov
Partner
Head of Real Estate
T +7 495 786 4086
E artashes.oganov@cmslegal.ru



Hayk Safaryan
Partner
Head of Customs
T +7 495 786 3059
E hayk.safaryan@cmslegal.ru



Elena Tchoubykina
Counsel
Banking & Finance
T +7 495 786 4035
E elena.tchoubykina@cmslegal.ru



Dominique Tissot
Partner | Head of Tax
Head of Energy Efficiency & Renewables
T +7 495 786 3088
E dominique.tissot@cmslegal.ru



Vsevolod Tyupa
Counsel
Head of Life Sciences & Healthcare
T +7 495 786 4097
E vsevolod.tyupa@cmslegal.ru



Sergey Yuryev
Partner
Head of Dispute Resolution
T +7 495 786 3081
E sergey.yuryev@cmslegal.ru



Vladimir Zenin
Partner
Head of M&A
T +7 495 786 4030
E vladimir.zenin@cmslegal.ru

About CMS

Staff

> 8,000

Lawyers

> 4,800

Partners

> 1,100

49 NEW PARTNERS IN 2019, TAKING THE TOTAL TO OVER 1,100

Operating in

70 cities

Across

43 countries

EUR 1.426bn

turnover for 2019

19 PRACTICE AND SECTOR GROUPS WORKING ACROSS OFFICES

>> #1 CEE, DACH, Germany (Mergermarket)

>> #1 Germany, UK (Thomson Reuters)

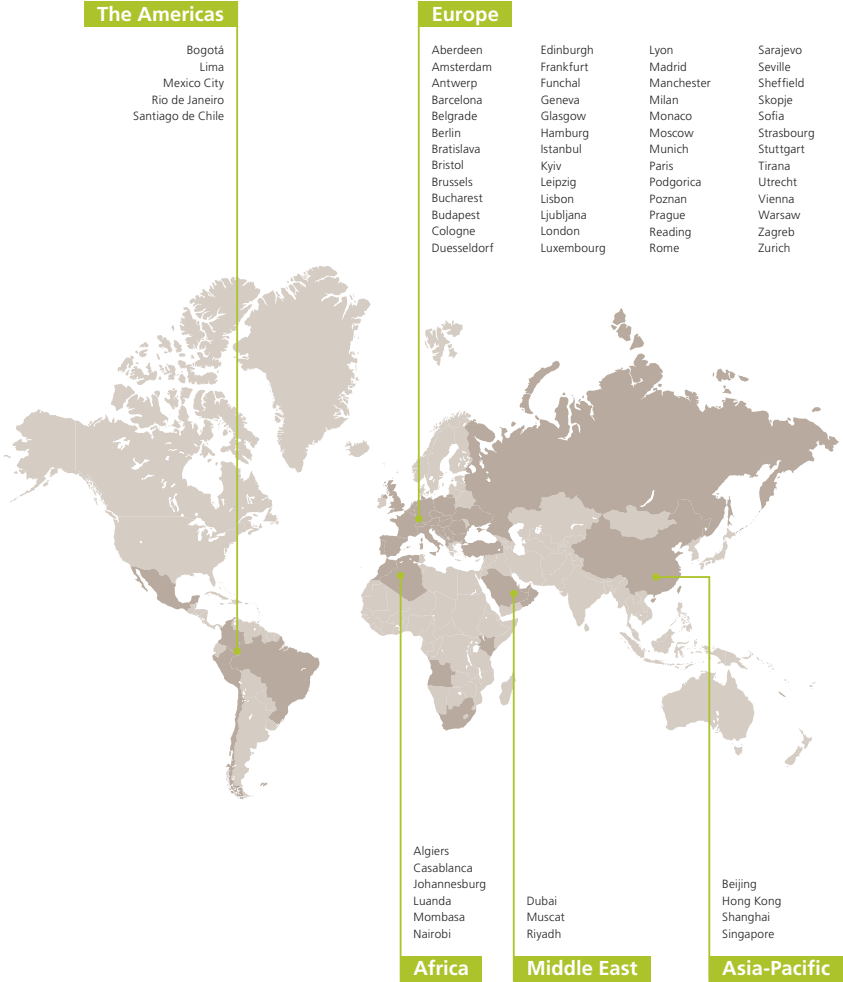
>> Top rankings in 2019 M&A League Tables (by deal count)

#1 by Bloomberg in Europe, Germany and UK

#1 by Mergermarket in CEE, DACH and Germany

#1 by Thomson Reuters in Benelux and Germany

>> #1 Europe, Germany, UK (Bloomberg)





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