Legal Aspects of Doing Business in Russia

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Doing Business in Russia

Market Economy
The Russian Constitution recognizes the importance for business to be conducted freely within a compliance-based legal framework.

Freedom for Foreign Investment
Foreign investment concerns are subject to restrictions as to the aggregate ratio of foreign vs. domestic investment within certain national markets (e.g. banking, insurance, etc.).

Active Involvement of the State
The State is involved in business activity as both a regulatory authority and as a participant, including in the form of holding of entities’ share capital. There is a high level of formalization of corporate rules and obligations, as well as more permissive activities.

Due Consideration and Deference to the Individual Regions
The legal system is a mostly a federal structure, while some peculiarities in the law-enforcement process exist in distinct regions of Russia.
Russian Legal System: Key Points

- **Continental Law (Civil Law) System**
  Major sources of law – statutes and regulatory acts of high-level administrative bodies. Judicial decisions are not considered a source of law. Nonetheless, judicial holdings of the senior courts have significant influence for the lower courts in terms of construction of certain rules of law.

- **Federal Structure**
  Some property legislation, real estate legislation and other types of Russian legislation are regulated by acts of constituent entities of the Federation. Nonetheless, key issues are still under the jurisdiction of the Federal authorities.

- **Strict Division of Law into Separate Branches**
  Basic branches of legislation: civil legislation (including corporate rules and regulations), taxation, antitrust regulations, property legislation, etc.
Russian Legal System: Key Points

Unity of Civil Legislation
There are no sources of legislation for so-called *Commercial Law* in Russia. Civil legislation (*the Civil Code of Russia*) covers both corporate regulations and legal rules pertaining to how business is conducted.

Highly Formalized Private Legal Relations
Registration with the State is a requirement for many different legal acts including, for example, the appointment of a CEO, purchase and sale of shares in an LLC, etc.

Civil Legislation Reform
While the trend of formalism seems to be increasing, some elements from foreign law, such as *divisions of companies into public/private ownership*, and the definition of a *beneficiary of an offshore company*, are being introduced into civil legislation.
Russia’s Justice System

State Courts of Justice

- Courts of General Jurisdiction
- Commercial Courts in Russia (the Arbitrazh)
- System of Constitutional Justice (the Constitutional Court of Russia + courts of entities of the Federation)

Arbitration

- Arbitration institutions in chambers of commerce and industry
- Other arbitration

- Commercial disputes both between business entities and with state authorities are settled by Commercial Courts in Russia (the Arbitrazh Courts).

- In Russia, there is no special system of tax courts, as well as no separate system of administrative justice, except for courts concerned with intellectual property established in 2013.

- ICAC at the Chamber of Commerce and Industry of Russia (CCI) is the largest arbitration institution in Russia settling international commercial disputes.

- At every regional CCI, there is an international arbitration institution. In Moscow – Arbitration at the Moscow Chamber of Commerce and Industry.
Corporate Legislation in Russia

Corporate legislation in Russia has the following distinctions:

1) Applied uniformly throughout each of the 85 Russian regions.

2) Enhanced role of regulation by means of mandatory rules. Less important issues are left to the discretion of the business partners (shareholders).

3) Weak protection by shareholders agreements, which is strictly governed by the mandatory rules of statutory acts and the by-laws of an entity.

4) Formal approach to corporate acts, which are subject to being registered with the state to be legitimate, e.g. appointment of a CEO, purchase and sale of shares in an LLC, etc.

5) Lack of flexible corporate structures and project vehicles that are typical for Common Law countries, e.g. a definition of a beneficiary of a legal entity.

6) Public disclosure of corporate information about shareholders of a company. Nominal shareholder opportunities are limited.

Key sources of legislation:

- Civil Code of Russia, in effect since 1994
- Federal Law “On Joint-Stock Societies (Companies)”, in effect since 1995
- Federal Law “On State Registration of Legal Entities and Individual Entrepreneurs”, in effect since 2001
Business Corporate Forms

- **Business Partnerships**
  - They are equivalent to partnerships in the Common Law. Their activity is NOT based on the Corporate Veil Principle, i.e. partners are fully liable for obligations of the partnership.

- **Business societies (companies)**
  - They are equivalent to companies in the Common Law, and are divided into public/private. Their activity is fully based on the Corporate Veil Principle.

- **Representative offices and branches of foreign companies**
  - They are not separate legal entities, but are deemed as a “continuation” of the principal organization. Nonetheless, in some legal relations they are considered as subjects of legal relations. They are accredited by a special order which allows them to operate legally within Russia.
Business Societies (Companies)

**Limited Liability Company**
Governed by the Federal Law “On Limited Liability Companies”. Minimal share capital – 10,000 RUR / equiv. 135 EUR. Limitation on quantity of shareholders – no more than 50. Complicated share transfer process. Shares are not securities, there is no legal requirement for state registration. The most widely used corporate form in Russia.

**Joint-Stock Company**
Governed by the Federal Law “On Joint-Stock Companies”. Minimal share capital – 100,000 RUR / 1,335 EUR. No limitation on quantity of shareholders. Shares are publicly traded. The issue of shares must be registered with the state.

**Public Joint-Stock Company**
Governed by the Federal Law “On Joint-Stock Companies”. Minimal share capital – 10,000 RUR / 135 EUR. Limitation on quantity of shareholders – no more than 50. Shares may not be publicly traded, and must be transferred in accordance with the by-laws to a group of individuals or entities. The issue of shares must be registered with the state.
Taxation

Value Added Tax (VAT)
Object of Taxation – sale of goods (services) / construction for own needs / importing of goods
Rate – 18 %

Corporate Profit Tax
Object of Taxation – profit of an organization (income – expenses).
Rate – 20 %
(15 % - for dividends from Russian companies)
The concept of a permanent establishment is applied to foreign organizations.

Social Insurance Premium
Object of Taxation – all payments to employees of an organization
Rate - 30 %
NB: The employer bears the burden to pay the social insurance premium to the State Funds.

Corporate Property Tax
Object of Taxation – real estate and chattels belonging to organizations
Rate – up to 2,2 %
(is set in regions of Russia)
Currency Regulation and Expatriation of Profits

Key principles of currency regulation and control

- Residential Principle of Treatment.
  *Residents* include all legal entities incorporated and registered in the Russian jurisdiction including with foreign shareholders.
  *Nonresidents* include any foreign persons (legal entities) including their representative offices and branches accredited in Russia.

- Freedom for currency transactions between nonresidents while transferring money abroad.

- The following forms of transferring money abroad:

  | Dividends Payment | • May be made in quarterly intervals  
  |                  | • In general, are subject to taxation in rate of 15%. Russian-Portuguese DDT sets the rate of 10% if a company holds more than 25% in its overseas subsidiary for 2 years prior to the payment. |
  | Direct Transfers   | • Are permitted only between the representative office or a branch of a foreign company in Russia and their principal organization abroad.  
  |                  | • In general, are not subject to taxation and currency control. |
  | Transfers as consideration in obligations | • Are permitted between all persons.  
  |                  | • Might be subject to taxation for retention of VAT or corporate profit tax from the receiver of funds abroad. |
Intellectual Property Protection

Legal regulation of intellectual property in Russia is one of the foremost aspects of the legal regime of doing business in Russia.

The legal regime for IP protection consists of the following:

- copyright law;
- related rights law;
- patent law;
- means of individualization of goods (services) and legal entities;
- other.

Principle of *state registration* for required for intellectual property to be protected by law.

An object of intellectual property may be an object of contract under either an *agreement on transfer* or a *license agreement*.

Russian regulation complies with the regime of TRIPS WTO. Russia is a party to the major conventions: *Patent Cooperation Treaty* (PCT), *Madrid System of International Registration of Marks*, etc.
Protection of Foreign Investment in Russia

Federal Law “On foreign Investment in Russia” was adopted in 1999 and since then has been the principal source for regulating the legal regime of foreign investment in Russia.

Key guarantees for foreign investors:

- National treatment of a foreign investor and profit made from the investment.
- Full access of foreign investors to securities markets as well as the guarantee of legal protection of their interests and rights.
- A guarantee in case of nationalization and seizure.
- «Grandfather Clause». A guarantee in cases of unfavorable changes in the tax regime in Russia.
- The guarantee of proper dispute settlement in Russian state courts or in international arbitration institutions.
- The guarantee of expatriation of profits and other funds abroad.
- The guarantee of freedom to incorporate a Russian subsidiary.
- The possibility to establish representative offices and branches of foreign business organizations in Russia.
Portugal/Russia
Avoidance of Double Taxation

The Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital and the Protocol thereto were signed on 29 May 2000 and took effect in Russia 1 January 2003.

Key provisions:

- **Art. 5** – the concept of a *permanent establishment*. Typical terms of the OECD Model Convention as of 1995. For a construction site the term of 12 months is set.

- **Art. 7** – business profits. In cases of no permanent establishment, tax shall be levied in the state of the company’s registration. In cases of a permanent establishment – in the state of the permanent establishment.

- **Art. 10** – dividends. General rule: taxes may be levied in the state of payment as well as in the state of the recipient but shall not exceed 15%. The tax rate in the state of payment is limited to 10 % in cases where the receiver holds more then 25% share capital for more then 2 years.

Rate – up to 2.2 % (is set in regions of Russia)
Portugal/Russia
Avoidance of Double Taxation

Key provisions:

- **Art. 11** (interest) and **Art. 12** (royalties). General rule: taxes may be levied in the state where the interest and royalties arise as well as in the state of such recipient thereof. The tax rate in the state where the interest and royalties arose is limited to 10% when the recipient is a beneficial owner of the interest or the royalties.

- **Art. 23** – elimination of double taxation.

- **Art. 26** – exchange of information. Typical terms of the OECD Model Convention as of 1995 (with due consideration to banking secrecy).

Corporate Property Tax
Object of Taxation – real estate and chattels belonging to organizations
Rate – up to 2.2% (is set in regions of Russia)
About Mr. Labin:

Dmitry heads Danilov & Konradi’s litigation practice and advised in a full range of transactional matters. He has been a professor in the International Law Department at the Moscow Institute of International Relations (MGIMO University) since 2000 and is a visiting fellow at the Higher School of Economics National Research University (Moscow) and at the University of Central Lancashire – UCLAN Cyprus.

Dmitry is an advocate and is an arbitrator with the Moscow Chamber of Commerce and Industry Arbitration, and the Chair of three Moscow CCI Commissions for cooperation with the Republics of Cyprus, Portugal, and Brazil.

About Danilov & Konradi LLP:

Danilov & Konradi LLP is a boutique corporate law firm offering one of the most experienced, dedicated teams of international attorneys in Russia. The firm’s practice focus is mergers and acquisitions, general corporate, oil and gas, private equity, corporate finance, tax, antitrust, and foreign direct investment.

Danilov & Konradi LLP’s Russian-American background allows the firm to bridge the gap between clients and their counter-parties in cross-border transactions and disputes.