



DOING BUSINESS IN RUSSIA

Distribution and Investments in times of economical sanctions

June 2021

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GERMANY HUNGARY ITALY POLAND ROMANIA SLOVAKIA SPAIN TURKEY

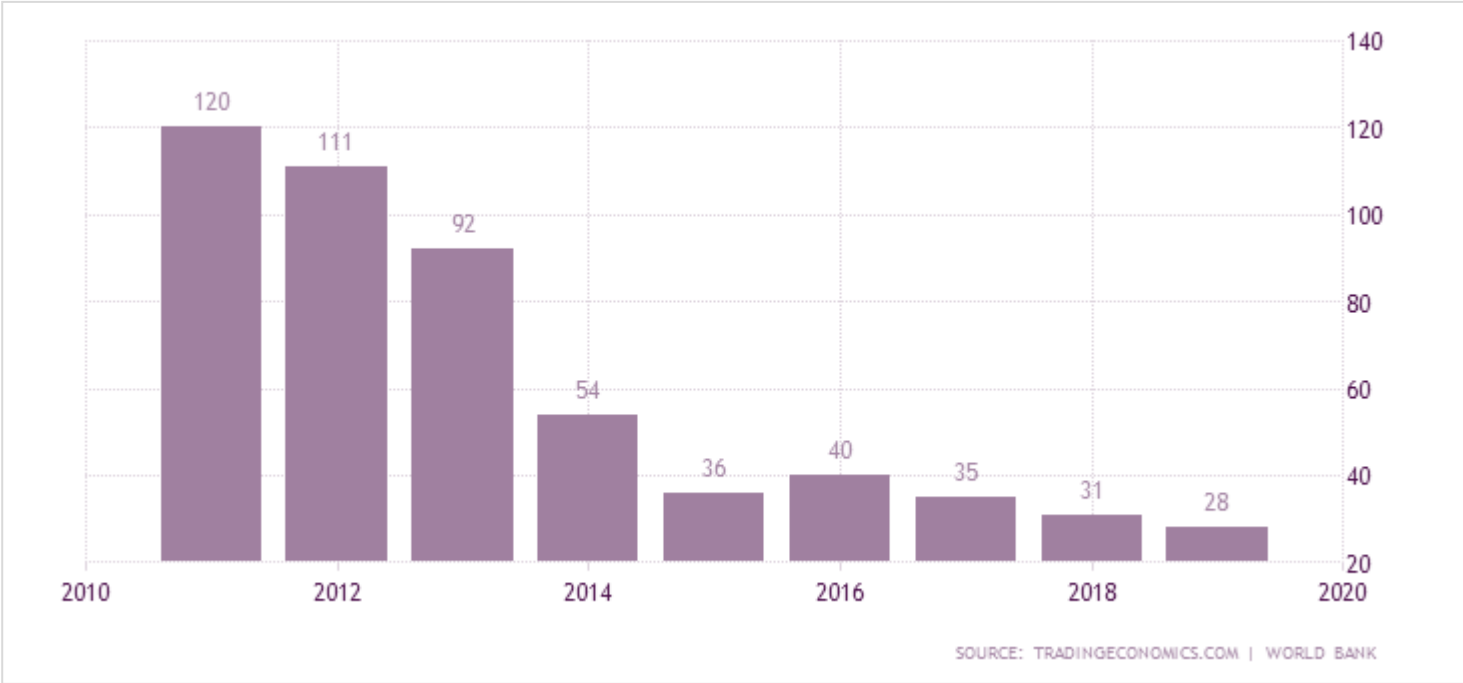
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- Market overview / market entry
- Corporate / M&A – foreign investments and transactions in Russia
- Tax and accounting framework
- Managing practical challenges (bureaucracy, customs, etc.)
- Business culture
- Q&A

MARKET OVERVIEW / MARKET ENTRY

DOING BUSINESS RANKING RUSSLAND



DOING BUSINESS REPORT RUSSIA 2020

Topic Rankings	DB 2018 Rank	DB 2019 Rank	DB 2020 Rank
Overall	35	31	28
Starting a Business	28	32	40
Dealing with Construction Permits	115	48	26
Getting Electricity	10	12	7
Registering Property	12	12	12
Getting Credit	44	22	25
Protecting Investors	51	57	72
Paying Taxes	52	53	58
Trading Across Borders	100	99	99
Enforcing Contracts	18	18	21
Resolving insolvency	54	55	57

ECONOMIC BACKGROUND

- Eleventh economy worldwide (2019)
- Political goal: Top-Five
- Economical growth rates

2018	2019	2020	2021	2022
2,5 %	1,4 %	- 0,4 %	2,6 %	3,0 %

- Germany second important trade partner of Russia
- Russia mainly buys German machinery, automobiles and chemical products
- Ruble-Euro exchange rate since 2016 pretty stable
- but devaluation in 2020, currently around RUB 91/EUR 1
- Germany eighth biggest investor in Russia (if we do not count Cyprus, the Netherlands, Luxembourg, Bahamas, Bermudas and Irland, all tax heavans, even second biggest investor!)
- Still around 4,000 German companies working in Russia
- Also still arriving many newcomers

CORPORATE / M&A – FOREIGN INVESTMENTS AND TRANSACTIONS IN RUSSIA

M&A PURCHASE OF RUSSIAN COMPANIES

- Important: transactional pre-check
 - Involved parties
 - Deal structure
 - Restrictions as e.g. Law on Strategic Sectors, media etc.
 - Currency control restrictions (payments to bank accounts in Russia)?
 - Anti trust regulations?
- Letter of Intent / Preliminary contract / Confidentiality Agreement also used in Russia
- Legal and Tax Due Diligence with many Russian specifics
- Tax risks
- Investment protection agreement between Germany and Russia (similar agreements with many other countries)

M&A PURCHASE OF RUSSIAN COMPANIES

- Acquisitions normally mean „**share deal**“ – asset deals very rare
- **Share purchase agreements since 1 July 2009** need to be notarized
- **Notarization** only in front of a Russian notary
- **Representation of the buyer/seller** on the basis of powers of attorney possible
- Russian notaries only Russian law documents, SPA therefore subject to **Russian law**
- Other legal ways for transfer of shares possible: e.g. in-kind contribution to a foreign company, gift, heritage etc.

JOINT VENTURES

- **Legal framework** heavily improved, in particular the Russian LLC-Law
- **Shareholders agreements** possible
- Exit: **call- und put-options** can be structured and implemented according to Russian law
- **Dead-lock-solutions** regarding day-to-day management possible
- **Four-eye-principle possible since 2014**
- **Binding voting agreements** possible, **dividend payments abroad to foreign shareholders** technically easily possible

EU-SANCTIONS

- Still in force till end of June 2021 – extension very probable
- **Embargo for weapons, export prohibition for dual use goods** for military end-users
- Restrictions for Russia to access sensible technologies, in particular in the oil and gas sector
- Prohibition to issue, sale and purchase of securities with term of more than 90 days, if they were issued after 1 August 2014 from organizations with State participation
- Access to **international capital markets restricted** (US sanctions)

RUSSIAN SANCTIONS

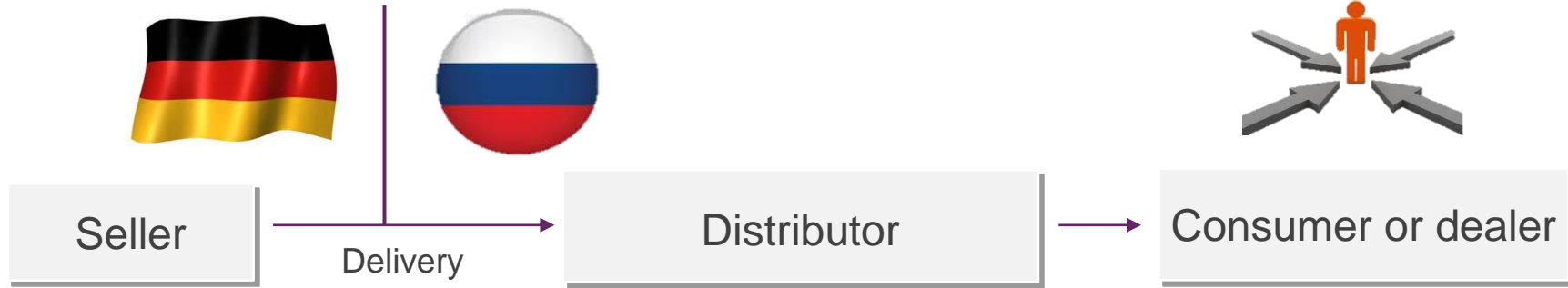
- Import prohibition for certain agricultural products
- Affected States: USA, EU, Norway, Canada, Australia
- List can be extended or reduced

HS-Codeproduct	Product name
0201	Beef, fresh or forzen
0202	Frozen beef
0203	Pork
0207	Chicken meat and meat products
aus 0210*	Salted meat etc.
0301, 0302, 0303, 0304, 0305, 0306, 0307, 0308	Fish and sea food
0401, 0402, 0403, 0404, 0405, 0406	Milk and milk products
0701, 0702 00 000, 0703, 0704, 0705, 0706, 0707 00, 0708, 0709, 0710, 0711, 0712, 0713, 0714	Vegetables etc.
0801, 0802, 0803, 0804, 0805, 0806, 0807, 0808, 0809, 0810, 0811, 0813	Fruits and nuts
1601 00	Sausages etc
1901 90 110 0, 1901 90 9100	Cheese etc.
2106 90 920 0, 2106 90 980 4, 2106 90 980 5, 2106 90 980 9	Other food products based on milk and vegetable fat

EXPORT OBSTACLE: IMPORT SUBSTITUTION

- General approach: bring added value chain into the country
- Preference of Russian products to foreign products to support Russian economy
- Restrictions valid for State companies and organizations, not for private business
- Import substitution did not have a remarkable impact on imports (2019, GTAI-report)
- July 2014 – List of prohibited goods for public tenders
- Other restrictions to buy goods (medical technical products, IT, transportation vehicles, pharmaceuticals etc.)

DIRECT DELIVERY TO RUSSIAN PARTNER



PROS

- Quick access to the Russian market
- No necessity to build up a dealer network
- Customs, warehouse, logistics „headache“ of Russian partner
- No tax in Russia

CONS

- Dependency on distributor/dealer
- No control
- Lack of knowledge of Russian market
- Risk of grey import schemes by partner
- Permanent establishment risks in certain situations

CONTRACTS - GENERAL

- General rules to be considered for cross-border contracts with Russian partner?
 - Contract shall contain all major clauses and essential content (subject, prices etc.)
 - Written form! Bilingual (English-Russian)!
 - Powers of the signees need to be checked. Russian companies are represented by its general director, other signees need a power of attorney
 - Contracts shall be stipulated in accordance with tax and customs law (and practice)
 - Services and delivery content shall be regulated in two different contracts (or separately regulated in one contract)
 - Liability and penalties
 - Choice of applicable law
 - Place of jurisdiction / arbitration
 - INCOTERMS? (new INCOTERMS since 1 January 2020)

BRANCHES IN RUSSIA

- Foreign companies can be active in Russia through a
 - Representative office or a
 - Branch
- Difference: branches can carry out commercial activity, representative offices are entitled to carry out auxiliary activities only
- Branches cannot import goods for resale on the Russian market
- Important for assembly projects: Foreign companies have to register for tax purposes if the duration of the services lasts 30 days or more per calendar year!

SUBSIDIARIES: IMPORTANT QUESTIONS

- Do you know the market for your products in Russia?
- Place of business in Russia?
- Costs (rent, employees, logistic services, hotels etc.)
- Human resources issues are key issues
- No incorporation without a general director
- No incorporation without a office address
- Bank accounts
- Bookkeeping internally or outsourcing?
- Logistic partner / customs broker
- Warehouse issues? Etc.

„TRIPLE“ OOO (THE RUSSIAN LLC)

- OOO can be founded by one or more persons
- No Russian shareholder/participant necessary
- Incorporation of a one participant OOO not allowed, if the sole participant has itself only one participant
- **Minimum share capital** RUB 10,000 (EUR 120)
- Sole foundation document of the OOO is the charter, which has to have a certain content
- Foundation process takes around 4 weeks if all documents are in place (registration itself at the Tax Inspection takes five working days)

TOP ISSUES IN TAX

OVERVIEW: MAJOR TAXES IN RUSSIA

- **Profits tax** - 20% (taxable income minus deductible costs), special rates - 15% (dividends to foreign companies), 13%, 0%, exemptions. Reduced rates or exemptions based on DTTs, E.g. 5% on dividends to a German corporation with a share of at least 10% and EUR 80,000
- **VAT** - 20%, or 10% (food, etc.), 0% (export, etc.), exemptions; Country of origin principle for services plus special regulations (e.g. country of destination principle related to advice, advertising, engineering services, marketing, etc.)
- **Personal income tax** - scale for residents: 13% and 15% on ordinary annual income starting from RUB 5 million (approx. EUR 55,000) in excess, the same for payroll of HQS regardless of residence (residence: when at least 183 calendar days per year); 30% for non-residents; special rates for certain types of income (e.g. 35% on lottery winnings) and exemptions (e.g. sale of property after certain holding period)
- **Social security contributions** - paid only by employers, individual entrepreneurs; tariffs in total approx. 30% (some are scaled), reduced for SMEs (15% starting from certain amounts), substantially reduced tariffs for certain businesses (e.g. IT)
- **Corporate property tax** - no more than 2.2% average annual depreciated book value (but cadastral value for foreign businesses without commercial presence in Russia), currently only real estate taxed (the regions determine the rate)

PERMANENT ESTABLISHMENT BY SUPPLY CONTRACTS

- Often: permanent establishment and obligation to tax registration when providing additional services in Russia
 - Installation supervision, commissioning, etc.
 - Construction and assembly works
 - Trainings
- When services are provided at one location for 30 days and more during the year: obligation to tax registration and creation of a permanent establishment (DTT exception: construction sites / installation projects over 12 months calculated from the start of work or formal admission to construction site)
- Permanent establishment:
 - Obligation to pay profits tax, tax base determined based on functional analysis (could be challenged in the absence of clear calculation method)
 - Other taxes of the permanent establishment: direct payment, e.g. VAT (VAT offsets allowed, also for construction sites)

- Important: Russian VAT on electronic services with mandatory registration, also for B2B service providers, special rate - 16.67% on gross amounts
- All intercompany contracts with IT - components / services can fall thereunder, also licenses, SaaS, etc.
- List of electronic services (Art. 174.2 Tax Code), inter alia:
 - Rights to software, databases (including updates), technical support
 - Internet advertising
 - Marketplaces in internet
 - Internet presence (websites, social networks, etc.)
 - Web hosting
 - Cloud technologies

E-SERVICES

- Exceptions:
 - Simple ordering of goods via the Internet
 - Rights to software, databases on physical data carriers
 - Consulting by email
 - Services of the internet providers

- Failure to register: fines
 - for non-registration: 10% of sales of such services in Russia
 - for non-payment of taxes: 20% of the non-paid tax plus late payment interest
 - for not filing the tax returns

- Registration and more information at: <https://kioreg.nalog.ru/en>

REPRESENTATIVE OFFICES

- Current trend: frequent tax audits re: activities of non-commercial representative offices of foreign companies
- “Non-commercial” means no permanent establishment, but exclusively preparatory and auxiliary activities.
- Creation of the permanent establishment, if:
 - Participation in contract negotiation or signing (approval of essential contractual terms, e.g. assortment, quantity, delivery time; PoA with signatory right issued to head of the rep. office)
 - Activities in favor of third parties (e.g. other group companies)
 - Regular participation in contract performance (obtaining certificates, technical advice, maintenance, etc.)
 - Commercial decisions related to supply contracts (discounts, bonuses, etc.)
- Creation of a permanent establishment: 20% profits tax on “taxable income minus deductible costs” (exception: free of charge activities in favor of third parties - efficient profits tax rate 4% on costs), as well as other taxes - VAT, corporate property tax, etc.
- Cost recharge from the head office possible, but with limitations

INTERCOMPANY SERVICES

- Intercompany services – often challenged in cases when Russian subsidiary deducts expenses for tax purposes
- The following tests should be passed for deduction purposes:
 - Arm's length principle
 - Reality
 - No duplication
 - No shareholder activities
 - Functional analysis
 - Economic or commercial value of services for the Russian subsidiary
- Plus general requirements according of Article 252 of the Russian Tax Code: expenses should be economically justified, properly documented and aimed at income gaining

INTERCOMPANY FINANCING

- Frequent cases with loans: tax deduction of loan interest is challenged if a Russian borrower has cash gaps or losses
- along with the denial of deduction for profits tax purposes: re-qualification of loan interest to dividends resulting in Russian withholding tax), as long as thin capitalization rules apply
- New rules on equity financing / for contributions to company assets:
 - such contributions deductible from the tax base when making payments to shareholders in the event of the liquidation of the company/exit of the shareholder (previously this was only possible for the charter capital contributions)
 - tax-free transfer allowed regarding property rights and/or by companies with indirect participation (e.g. by a “grandmother” entity), but not allowed for offshore companies

BENEFICIAL OWNERSHIP

- **DTT benefits (e.g. reduced withholding tax rate on dividends, exemption from withholding tax on interest and license fees)** can be applied, when:
 - A) Documentary confirmation of the residency of the income recipient is provided;
 - B) Provisions of the DTT are fulfilled;
 - C) *de facto* Principle Purpose Test is fulfilled (MLI does not apply to the DTT with Germany)

- **A) Documentary confirmation:**
 - Certificate of residence from the tax administration
 - Confirmation of the actual right to obtain income (information on staff, office address, confirmation of the absence of obligation to make further transfers to third parties, etc.) - important to present to the Russian company before payment
 - *Optional:* defense file with additional documents from the income recipient:
 - Lease and other contracts
 - Statutory documents, excerpt from the company register
 - Financial reports
 - Employment contracts
 - confirmation of tax payments made, etc.

INCLUSION OF ROYALTIES INTO THE CUSTOMS VALUE

- Last trend: increase of number of customs audits, especially regarding the revision of the customs value with attempts to include license fees and dividends
- Customs value - basis for calculating the customs duty; customs value plus customs duty - tax base for the import VAT.
- Inclusion of royalties into the customs value, if:
 - License fees relate to the goods (e.g. trademark license):

AND

- License fees is a precondition for further sale

INCENTIVES FOR SME

- SME criteria in Russia:
 - Annual turnover: no more than RUB 2 billion (approx. EUR 22 Million);
 - Personnel: no more than 250 employees;
 - Foreign entity participation: no more than 49%, but does not apply to shareholders who meet SME criteria. This should be confirmed by the Russian audit company, only then entry into the SME register
- Incentives, if a company is listed in the SME register (new regulation: monthly update, previously annually)
- Main incentive: reduced tariffs of social security contributions
- Non-tax and COVID benefits for SMEs of the affected branches

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