Basic guide to investing in Russia

More information on Russian investment environment, economic and political situation can be found in the “Quarterly country report: Russia, with three-year forecasts”
Key political information

The Russian Federation is the largest state in the world, inhabited by 143.1m people. Russia is federal state, at the head of which sits the president, elected in universal elections held every four years. The executive branch of the state is the government, with the prime minister as its head. The legislature is a bicameral parliament made up of a lower chamber, the State Duma, and a higher chamber, the Federal Council.

Administration

The state is made up of 89 federal units: 21 republics, six countries, 49 regional districts, one autonomous region, 10 autonomous districts and two federal cities: Moscow and Saint Petersburg. Russia is also divided into seven federal districts:

- Far-East
- Siberia
- Urals
- North-Western
- Central
- Privolshskiy
- South.

The most interesting regions in terms of investment are: Central, North-Western and Privolshskiy, all located in the European part of the country.

Although only 25% of the land area of Russia lies in the European part, 75% of the country’s inhabitants live there. Over 80m people live in the Central, North-Western and Privolshskiy regions, which also have the best transport infrastructure, a well-qualified workforce and favourable climatic conditions.
Throughout the 1990s Moscow was practically the only centre attracting foreign investors. Even by 2003 almost 46% of all foreign investment in Russia was in the capital city. Since 2004, however, this trend has undergone changes, to the benefit of other, neighbouring, regions. In 2004, in the Central, North-West and Privolshskiy districts received $50bn of $92bn total foreign investment in Russia.

### Selected data for the European federal districts in Russia, 2005

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<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>143.1</td>
<td>581.4</td>
<td>412</td>
<td>94.8</td>
</tr>
</tbody>
</table>

### Selected regions of the Russian Federation

<table>
<thead>
<tr>
<th>Population in 2002 (m)</th>
<th>% share of region in GDP, 2003</th>
<th>Average monthly pay in June 2005 ($)</th>
<th>Investment in the region in 2004 ($ m)</th>
</tr>
</thead>
</table>

Source: Federal Statistics Service, August 2005
Starting economic activity in the Russian Federation

Foreign investors interested in undertaking economic activity in Russia can set up representative or branch offices in the country, and can set up as a new legal entity independently or jointly with a Russian partner.

The basic legal forms for undertaking economic activity in Russia are:
- Limited Liability Company (OOO)
- Closed Asset Company (ZAO)
- Open Asset Company (OAO).

The obligation to register with the state as a legal entity, both individual and corporate, is in the hands of the tax authorities. Registration of legal entities takes place in regional branches of the tax office handling registration of tax payers, according to the place where the legal entity is based.

The documents required to submit at the moment of registering a new legal entity are:

- an official P11001 form signed by the applicant (the plenipotentiary of the legal entity)
- a decision on establishing legal entity status in the form of a protocol from the founding meeting of the company, a contract or other documents in accordance with the laws of the Russian Federation
- founding documents of the legal entity – company statute and contract (original and copy certified by a notary)
- an extract from the foreign register of the legal entity’s country of origin or another appropriate valid document confirming his/her legal/founding entity status
- confirmation of registration payment
- application to enter the tax register on application form no.12-1-1.

1. Registration as a legal entity
2. Obtaining a stamp certifying status as legal entity
3. Obtaining a statistical number
4. Obtaining a Tax Identity Number (INN)
5. Registration as a payer of the uniform social tax
6. Opening a bank account.

Procedures for setting up a company are very complex. The legal regulations are specific and demand from the investor the necessary quantity of documents for each stage of registration. The procedures are as follows:

- an official P11001 form signed by the applicant (the plenipotentiary of the legal entity)
- a decision on establishing legal entity status in the form of a protocol from the founding meeting of the company, a contract or other documents in accordance with the laws of the Russian Federation
- founding documents of the legal entity – company statute and contract (original and copy certified by a notary)
- an extract from the foreign register of the legal entity’s country of origin or another appropriate valid document confirming his/her legal/founding entity status
- confirmation of registration payment
- application to enter the tax register on application form no.12-1-1.

The next stage is application to obtain a stamp confirming legal entity status. For this it is necessary to apply based on the location of the company’s headquarters to the City Stamp Office as well as the application and required stamp it is necessary to have:
- the decision of the company director on preparing the stamp
- certification of state registration (with a copy and original confirmed by a notary)
- confirmation by a notary of a copy of the company’s statute
- a document confirming the plenipotentiary status of the director of the company (e.g. the protocol from the founding meeting at which the director was chosen)
- a copy of documents confirming the director’s and head accountant’s identities.
The next step is obtaining statistical numbers. This is granted by the Federal Statistics Office (Goskomstat).

A company must first apply to obtain a Tax Identification Number (INN). The application for an INN is made together with the application for state registration. The full set of required documents is as follows:

- the application to be entered into the register
- a document confirming payment of founding capital
- eligibility to establish a chief accountant and on entrusting the responsibility of running the account books to the managing director
- confirmed copies of documents evidencing the company’s establishment and a decision on creating the role and selection of the managing director
- documents confirming the right to the address at which the company is headquartered (rental agreement, ownership rights documents, etc)
- copies of documents of the managing director’s and chief accountants’ identities and evidence that they possess an INN; eventually power of attorney.

In accordance with Russian law, each legal entity has the obligation to register as a payer of the uniform social tax, which goes to three state funds: the Social Insurance Fund, the Pension Fund and the Obligatory Medical Insurance Fund. Registration is made via the tax office.

The final stage is the requirement to set up a bank account. The first step in this regard is notary confirmation of a bank card, one with the applicant’s usual signature and stamped. The standard requirement is supplying two example signatures; the first should be the managing director’s or that of other senior management personnel, while the second is of personnel handling the company’s finances (chief accountant, finance director). To obtain confirmation of a bank card the applicant must present notary evidence of state registration, founding documents (statute, contracts), the protocol of the meeting establishing the company, the decision on selecting the managing director, chief accountant and others whose signatures are on the card. The cards must be signed in the presence of a notary.

As well as the notarial confirmation of the bank card the following documents are usually required to open a bank account:

- a fully completed and signed set of bank documents (application to open an account, agreement to use the bank’s services)
- a notarially confirmed copy of the state registration certificate
- a notarially confirmed copy of the certificate on obtaining statistical code numbers
- a notarially confirmed copy of the certificate on being on the tax register
- a certificate from the three social funds
- a notarially confirmed copy of the founding documents (statute and contract)
- a stamped confirmation and signature of the managing director on the decision to set up the company (the protocol of the founding meeting)
- a stamped confirmation and signature of the managing director on the decision to select the managing director
- a stamped confirmation and signature of the managing director on the decision to select the managing director and others with the right to sign bank documents.

On opening a bank account it is necessary to inform the tax office within 10 days.
Depending on the type of activity being undertaken and the form of the legal entities, the regulations may require additional documents.

The tax system

The Russian tax system is very complicated and contains many contradictions. It includes about 20 different taxes and fees often established by individual legal acts. All function on the basis of federal jurisdiction, although in the area of the last two categories regional and local authorities have the right to set fees and establish specific procedures. In addition, deviations are possible from the main body of law governing tax and this in consequence means varying rates of fees payable.

The basic tax brackets in Russia, 2005

<table>
<thead>
<tr>
<th>Tax Type</th>
<th>Description</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct taxes</td>
<td>corporate income tax (CIT)</td>
<td>24%</td>
</tr>
<tr>
<td></td>
<td>personal income tax (PIT)</td>
<td>13%</td>
</tr>
<tr>
<td></td>
<td>uniform social tax</td>
<td>8%, 10%, 20%, 26%</td>
</tr>
<tr>
<td>Indirect taxes</td>
<td>tax on excavators of raw materials (depending on the raw material)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>VAT</td>
<td>0%, 10%, 18%</td>
</tr>
<tr>
<td></td>
<td>Excise tax</td>
<td></td>
</tr>
<tr>
<td>Indirect taxes</td>
<td>Property tax (assets)</td>
<td>no higher than 2.2%</td>
</tr>
<tr>
<td></td>
<td>Games tax – from 1,500 to 25,000 roubles,</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Transport tax from 5 to 200 roubles</td>
<td></td>
</tr>
<tr>
<td>Local taxes</td>
<td>Advertising tax</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Tax on land allocated by the local authority</td>
<td></td>
</tr>
</tbody>
</table>

In relation to foreign companies that have not set up permanent structures in Russia the following pro rata brackets have been created:

- 15% for dividends and incomes from companies with a foreign capital share
- 20% for some other incomes, including interest from capital.

Source: Ministry of Taxation of the Russian Federation, August 2005

Representative offices and branches of foreign companies are subject to pay taxes on the same terms as Russian companies. When establishing taxation principles, revenues can be lowered by raising costs, as is the case for Russian companies. Each federal district has an assigned tax office. In the Central district this is Moscow, in the North-West Saint Petersburg and in the Privolshskiy district – Nizhny Novgorod.

Legal conditions for investment

The key legislation governing investment activity in the Russian Federation is a law from February 1999 "On investment activity in the Russian Federation realised in the form of investment expenditures." In the case of foreign investments, international laws signed by Russia take precedence over domestic legislation. A legislative amendment covering investment in Russia was passed in July 1999: the law "On foreign investment in the Russian Federation" ensures equality of treatment and stable conditions for undertaking economic activity for foreign investors. It outlines the means for resolving disputes via international arbitration, ensures ease of repatriation of profits and outlines state guarantees protecting foreign investment. The document states that legal regulations governing foreign investors’ activity and the guidelines governing dispensation of profits
cannot be less advantageous than the same regulations governing Russian investors, with the exception of those under federal legislation.

**Special Economic Zones**

Special Economic Zones (SSEs) in Russia are not a new phenomenon, with the first of nine opened even before the collapse of the USSR. In the years since then more have been registered. In total 33 SSEs exist and in some cases additional sub-zones have been set up. In most cases the establishment of SSEs in Russia has not brought the expected results in terms of investment, and has also caused widespread cases of companies avoiding tax payments. Companies were able to register with tax offices that were most beneficial for them, thus paying lower, preferential, tax rates. Of all the SSEs only two function properly: Kaliningrad and Saint Petersburg. These are the only two zones that have in large measure managed to attract foreign investment. By the end of 2004 in Kaliningrad over 2,200 new companies with foreign capital involvement had been set up.

**The number of companies in Kaliningrad by foreign investors at the start of 2004, by country**

<table>
<thead>
<tr>
<th>Country</th>
<th>Number of Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lithuania</td>
<td>603</td>
</tr>
<tr>
<td>Poland</td>
<td>568</td>
</tr>
<tr>
<td>Germany</td>
<td>358</td>
</tr>
<tr>
<td>Latvia</td>
<td>136</td>
</tr>
<tr>
<td>Belarus</td>
<td>79</td>
</tr>
</tbody>
</table>

Source: Administration of the Kaliningrad Oblast, August 2005

Despite the fact that the Kaliningrad and Saint Petersburg SSEs partially achieved the aims set out for them represents an exception. The other zones did not fulfil their assigned roles of attracting foreign investment. For this reason planned new zones at the federal level have been suspended since 2000.

In 2005 the government, aiming to attract foreign investment, decided to renew the SSE programme on new terms.

The new SSEs in Russia

Investors, after meeting all the relevant criteria, will be able to obtain tariff and tax relief, lower visa payments and simplified administrative procedures.

In July 2005, the Federal Council passed a new project on special economic zones. In accordance with the new document Russia will have two types of zone: industrial-production and technical-promotional. The legislation foresees them functioning for 20 years. The latter will be able to locate on sites no larger than 2 km² next to high schools and research institutes. Production zones will be able to site on territory no larger than 10km². Zone residents can be both individual enterprises and companies. After fulfilling the appropriate criteria, companies operating in the SSEs will obtain the following exemptions and relief:

- customs tariff relief (and in special cases after fulfilling the appropriate criteria, also the possibility of exemption from customs payments)
- VAT exemptions and returns
- preferential rates for renting local property
- administrative relief (associated with simplified visa procedures)
- restricted numbers of inspections both from customs and tax authorities.

A region expressing interest in creating a SSE on its territory must obtain approval for the project from the federal authorities. The Russian government decides on granting permission in this respect. The winning projects will be selected by means of competition.

The Russian authorities, after negative experiences of companies avoiding tax payment, have adjusted specific solutions in the case of registering the terms on which companies will be able to participate in the new SSE projects. In line with the legislation’s regulations, registration and the right to operate in the zones will be granted only to those companies operating in their territory.

**Companies benefiting from exemptions in the SSEs cannot:**

- have additional sources of income other than those associated with the production of their stated good(s)
- register other organisations in the framework of their company.

Companies are obliged to own all their own fixed assets in the SSE territory.

Legislation additionally specified regulations for investment in the industrial-production zones. In line with the law, the investor is obliged to invest no less than €10m, €1m in the first year after the moment of signing the agreement (in the case of technical-promotional zones financial brackets are not indicated).

Guarantees protecting investors, apart from the civil code, are also included in the legislation and state that after the start of realising an investment project the investment climate cannot be worsened, for example, by disadvantageous administrative decisions. In the case of SSEs certain investment rules apply that cannot be broken, for example, the state cannot liquidate the SSE. That is, if the federal authorities have accepted that an SSE is to be established it must exist for the full period of its validity.

In accordance with the legislation the pre-existing SSEs will be annulled. Of the previously functioning zones only Kaliningrad and Magadan will remain.

The Ministry of Economy and Development will oversee the Specific Activities of the Special Economic Zones in Russia. The most senior figure responsible for monitoring the SSEs is Yuriy Zdanov. Interest in creating their own SSEs has been expressed to date by city authorities in Moscow, the Moscow District, Saint Petersburg, Novosybirsk and Tomsk.
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