

Doing Business in Russia

2009



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1. Introduction

UHY is an international organisation providing accountancy, business management and consultancy services through financial business centres in over 70 countries throughout the world. Business partners work together through the network to conduct trans-national operations for clients as well as offering specialist knowledge and experience within their own national borders. Global specialists in various industry and market sectors are also available for consultation.

This detailed report providing key issues and information for investors considering business operations in Russia has been provided by the office of UHY representatives:

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UHY YANS-Audit provides accounting, auditing and consulting services for companies representing almost all of the major sectors of economic importance in the Russian Federation and specialises in tax planning and tax risk assessment. Audit & Consulting Group UHY YANS-Audit takes a stable place among 50 first-rate audit and consulting companies in Russia.

Information in the following pages has been updated so that they are effective at the date shown, but inevitably they are both general and subject to change and should be used for guidance only. For specific matters, investors are strongly advised to obtain further information and take professional advice before making any decisions. This publication is current at April 2009.

We look forward to helping you do business in Russia.



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2. Business environment

Political and legal system

The Russian Federation, or Russia, is a presidential republic (according to the Chairman of the Constitutional Court of the Russian Federation, it is a semi-presidential republic). It consists of 21 republics, 9 territories, 46 regions, 2 federal cities, 1 autonomous region and 4 autonomous areas, which are equal subjects of the Russian Federation. Republics have their own constitution and legislation. Territories, regions, federal cities, autonomous region and autonomous areas have their own charter and legislation. Delineation of competence between law-making entities is governed by the Constitution of the Russian Federation, treaties on delineation of competences and powers between the Federation and its entities as well as by the Federal Law "On principles and order of delineation of competences and powers between governmental authorities of the Russian Federation and governmental authorities of constituent entities of the Russian Federation".

Executive power in the Russian Federation is exercised by the President of the Russian Federation and the Government of the Russian Federation. The President is the head of state and defines the basic domestic and foreign policy guidelines of the state in accordance with the Constitution of the Russian Federation and federal laws. The President is elected for a term of four years and cannot hold the office for more than two terms in succession.

The Parliament of the Russian Federation is the supreme representative and legislative body of the Russian Federation. It consists of two chambers – the Federation Council and the State Duma. The deputies of State Duma are elected by the citizens of the Russian Federation for a term of four years. The Federation Council is formed by delegates of representative and executive bodies from each subject of the Federation.

Judicial power is exercised by the Constitutional Court of the Russian Federation (constitutional matters), the Supreme Court of the Russian Federation (civil, criminal, administrative and other matters tried by general jurisdiction), and the Supreme Arbitration Court of the Russian Federation (economic matters).

Local self-government is recognised and guaranteed in the Russian Federation. It operates independently within the bounds of its authority. The bodies of local self-government shall not be part of the state power

bodies. The structure of bodies of local self-government is determined by the population independently.

The domestic market

Area: 17,075,400 sq km

Population: 141 903 979 (as of January 1st, 2009)

79.3% of inhabitants live in the European part of Russia, 20.7% - in the Asian part. The large proportion of the population live in towns and cities - 73.1%.

Population density: 8.3 persons per square kilometre (average); differs from 56.9 inhabitants per square kilometre in the Central Federal District up to 1.2 inhabitants per square kilometre in the Far East Federal District.

Currency: Russian Ruble (RUB)

Language: Official language is Russian.

The main business areas are located in: Moscow region; St.-Petersburg region (North West district); Volga River industrial region (Povolzh'e); Ural region; Siberian oil and gas fields; regions of such Siberian cities as Novosibirsk, Omsk и Krasnoyarsk; Primor'e (Far East district). Sochi region (Black Sea Coast) has also developed recently.

The economy

According to the Ministry of Economic Development and Trade, GDP of Russia in total for the year 2008 grew by 5.6% vs. the year 2007. For the first quarter of the year 2009, GDP decreased by 9.5% vs. the corresponding period of the year 2008.

According to official estimations of the Ministry of Economic Development of the Russian Federation, GDP'2009 will decrease by 2.2%.

Per capita GDP (PPP) is estimated to have reached \$16,160 (2008 est. by International Monetary Fund).

Reserves of foreign exchange and gold: USD 385.0 billion (as of April 3rd, 2009).

National debt-external: USD 29.4 billion (as of December, 2009).

Economic structure

According to the Federal State Statistics Service of the Russian Federation, behaviour of the GDP structure on economic activity types (in current prices, in percentage to the total value) in 2008 was the following:

agriculture	4.9	transportation and communication	9.4
mining	9.2	financial activities	4.7
manufacturing	17.4	real estate operations	11
electric power, gas and water	3	public administration and security	4.9
construction	6.5	education	2.6
wholesale and retail trade; vehicles and household goods repair	20.6	healthcare and social services	3.1
hotels and restaurants	1	other municipal, social and personal services	1.7

Production

IPI'2008 (expressed in % to the year 2007) was 102.1%

IPI for the first quarter of the year 2009 expressed in % to the first quarter of the year 2008 is 85.7%.

Manufacturing activity sphere displays a marked weakening. IPI of this economy sector in the first quarter of the year 2009 vs. the corresponding period of 2008 was 79.2%.

Extractive industries are more stable, IPI for all of them in the first quarter of 2009 vs. the corresponding period of 2008 was 96.2%. Development of non-metallic construction materials and coal is more weakened. Development of particular metallic ores is standing out, i.e.: gold development grew significantly (150.8% vs. the first quarter of 2008), copper and molybdenum development also displays growth.

The above mentioned indices are not seasonally corrected and cannot show influence of the long January Holidays.

Consumer market

In the GDP structure calculated via the method of income use, final consumption ratio of households was significant - 48.1% for 2008.

Retail trade turnover in 2008 was 13853.2 bln rubles, which is more than for the year 2007 by 13.0% in the mass of commodity. Retail trade turnover

in the first quarter of 2009 was less than for the corresponding period of the previous year by 1.1% in the mass of commodity.

Consumer prices growth in Russia for the period January - March, 2009 was 5.4% (vs. December, 2008). According to the Federal State Statistics Service, consumer confidence index, which displays a public preparedness for making major purchases, decreased for the first three months of 2009 by 15 percentage points (pp) vs. the fourth quarter of 2008, and by 36 pp vs. the third quarter of 2008.

Personal income

Monthly average wages accrued (without social payments) in January - February 2009 were 17085 rubles, which is higher by 13.1% against the data for January - February 2008. At the same time, according to initial estimates, actual household disposable income (income less obligatory payments adjusted for the consumer price index) in the first quarter of 2009 decreased by 2.3% vs. the corresponding period of 2008.

Labour market and unemployment

According to the Federal State Statistics Service, economically active population amounted to 74.8 million people (53% of the total population of the Russian Federation) as of February 2009.

The average rate of general unemployment as of February 2009 was 9.5% (according to methodology of the International Labour Organization).

The lowest unemployment level is observed in Moscow, St. Petersburg as well as in a number of regions of the Central Federal District.

Prices and interest rates

At the end of 2008, beginning of 2009, the ruble significantly dropped against the US dollar and the euro. Then the ruble drop slowed and even changed for a slight growth. Currently, the situation is stabilised, and the exchange fluctuations are not too sizeable.

01 December 2008	1 USD =	27.60 RUB
01 January 2009	1 USD =	29.39 RUB
01 February 2009	1 USD =	35.41 RUB

01 March 2009	1 USD =	35.72 RUB
01 April 2009	1 USD =	33.90 RUB
01 May 2009	1 USD =	32.97 RUB

For the recent six months, refinancing rate of the Central Bank of the Russian Federation has been changed several times, and was raised from 11% (June, 2008) to 13% (was actual from December, 2008 - April, 2009) Currently, the refinancing rate is 12.5% (from April 24, 2009).

Foreign trade and the balance of payments

According to the Bank of Russia, Russian foreign trade turnover in January - February 2009 was \$60.5bln (56.5% against January - February 2008), including export - \$36.7bln (52.3% against January - February 2008), import - \$23.8bln (64.5% against January - February 2008). Trade surplus was \$13.0bln (in January - February 2008 it was \$33.4bln).

In the export structure, as in previous years, fuel and energy goods are predominating (66.4%), in imports, the major part is occupied by machinery, equipment and means of transport again (43.8%)

The key trade partners of Russia were countries of European Community (49.8% of the foreign trade turnover), CIS countries (13.6%) and China (9%).

The financial system

The bank system of Russia is regulated by Central Bank of the Russian Federation (Bank of Russia); issues and transferable securities and other activities in financial markets – by the Federal Financial Markets Service; and insurance undertakings – by the Federal Insurance Supervisory Authority.

As of April 1, credit companies registered with the Bank of Russia amounted to 1 210 in total, as of January 1 - 1 228 companies. From the total number of credit companies as of April 1, 1 157 were banks and 53 were non-banking credit institutions.

According to the Central Bank of the Russian Federation, the total number of operating credit companies in Russia decrease by 14 - from 1 108 to 1 094 for the first quarter 2009. From the total number of operating credit companies, 1 045 are banks and 49 are non-banking credit institutions. The total number of branches of the operating credit companies in Russia

decreased by 67 - from 3 470 to 3 403. The number of branches of Sberbank of Russia included into the state registration book for credit companies decreased from 775 to 739.

Licenses for banking operations of 114 credit companies were terminated or nullified, but have not been yet excluded from the state registration book as the liquidation has not been finalised.

In Russia, the number of credit companies with 100% foreign participation increased from 76 to 78 in January - March, number of companies with more than 50% foreign equity decreased from 26 to 25. The total number of Russian credit companies with various foreign equity increased from 221 to 223 for the first quarter.

It is important to note that branches of foreign financial institutions are not legally able to carry out their activity in Russia. Such institutions first have to register a legal entity in the territory of the Russian Federation in accordance with the legislation of the Russian Federation.

3. Foreign investment

Sovereign credit ratings:

On December 8, 2008, an international rating agency Standard & Poor's has lowered the sovereign rating of Russia for the first time for the past 10 years. As S&P announced, the main reason was sharp reduction in international reserves. The Agency has also given a poor prognosis concerning Russian economy, forecasting a growth reduction and budget deficit. Long-term and short-term credit ratings of Russia on foreign currency liabilities were lowered from "BBB+/A-2" to "BBB/A-3", on national currency liabilities - from "A-" to "BBB+".

In the meantime, in December 2008, an international rating agency Moody's changed the forecast of Russian rating on foreign and national currency debt "Baa1" to "stable" from "positive". The forecast change displays the increased pressure on liquidity position of the country amidst the global credit crisis escalation. At the same time, a "stable" forecast shows that Russian credit indices are still advantageous in comparison with other countries of the "Baa" rating category.

Volume of foreign investments:

According to the Federal Statistics Service, volume of foreign investments into Russian economy in 2008 decreased by 14.2% against the previous year data. Total inflow into Russian economy amounts to \$103.8bln. Direct investment volume was \$27.027bln, portfolio investments amounted to \$1.415bln. The rest of funds were credits.

Portfolio investment volume decreased more dramatically. Reduction of this index was 66.3% against the indices of the year 2007. Credit volume decreased by 15.3%, direct investment volume - by 2.8%. Accumulated foreign capital in Russian economy has reached \$264.6bln. This index raised by 19.9% against the previous year data.

The major part of foreign investments flew to manufacturing activity, wholesale and retail trading and immovable property operations. These spheres received \$33.9bln, \$23.9bln and \$15.4bln respectively. The key investors in these industries are Germany, Great Britain and Cyprus.

The major volume of accumulated investments was received from Cyprus, the Netherlands and Luxembourg. These countries have invested \$56.9bln, \$46.3bln, \$34.4 respectively.

Restriction on foreign investments into strategically important industries

The Russian Government is endeavoring to have control over foreign investments into strategically important industries; in this context, the Federal Law No 57-FZ dated 29.04.2008 "On the order of performance of foreign investments into economic societies that have strategic importance for providing defense support and security of the State" was passed. This law established the restrictions for foreign investors when they participate in charter capitals of the economic societies that have strategic importance for providing defense support and security of the State as well as in the course of settlement of transactions that lead to establishing control over the mentioned economic societies. Transactions, in consequence of which foreign countries or organisations that are under their control obtain the right to dispose a particular number of votes that fall on voting shares or stakes of the charter capital, are subject to reconciliation with specialised government commission. The law provided the detailed regulation on types of strategically important activities, characteristics that indicate the fact that the economic society is under control, other concepts used by the law as well as on procedures of transaction approval. The law is not applied to relations that are connected with performance of foreign investments and regulated by other Federal Laws.

4. Setting up a Business

Any legal issues relating to business organisation and conducting in the Russian Federation are determined by the Civil Code of the Russian Federation and a number of other documents (the Federal law on Joint-Stock Companies, the Federal Law on Limited Liability Companies etc.).

In order to obtain a status of a participant in civil matters as prescribed in the Russian Federation Civil Code, foreign companies should legalise their status in the Russian Federation through participation in a legal entity of the Russian Federation (for business activity), or through opening up of a representative office of a foreign company in the Russian Federation.

Forms of investment activity in the Russian Federation.

Opening of a branch or a representative office of a foreign legal entity

Creation of separate structural unit of a foreign legal entity registered in the home country of the branch or the representative office is subject to accreditation in the order established by the Government of the Russian Federation. Moreover, responsibilities for activities of the branches and representative offices shall be borne by the legal entity that created them.

A foreign legal entity creates its branch on the territory of the Russian Federation so it could perform the activities, which are conducted by the head office outside the Russian Federation. The branch may be liquidated upon the foreign legal entity's – the head office – decision.

A foreign company's branch is not a legal entity; it is vested with the foreign company's property and acts on the basis of the provision approved by the authorised body of the foreign legal entity. Head of the branch is appointed by the foreign company and acts on the basis of the letter of attorney. A foreign company's branch executes all activities or part of them including activities of representative office of the foreign company on the territory of the Russian Federation.

Registration of a representative office or a branch of a foreign legal entity includes the following stages:

- Opening (accreditation) of a branch or a representative office of a foreign legal entity in the State Registration Chamber under the jurisdiction of the Ministry of Justice of the Russian Federation

- Receipt of the information letter from the Russian Federation State Statistics Committee
- Registration of the foreign legal entity with tax authorities
- Registration of the foreign legal entity with the Social Insurance Fund
- Registration of the foreign legal entity with the Obligatory Health Insurance Fund
- Registration of the foreign legal entity with the Pension Fund
- Opening of operating and/or foreign currency account of the branch (representative office) of the foreign legal entity at the bank at the choice of client.

In-force period of the accreditation of a branch is 1, 2, 3 or 5 years. The State Duty for the accreditation is 60,000 rubles is to be paid as well as an additional duty depending on the in-force period of the accreditation: from 500 to 2,000 conventional units.

In-force period of the accreditation of a representative office is 1, 2 or 3 years and can be prolonged, if necessary. The State Duty for the accreditation of a representative office in the amount of 1,000 – 2,500 conventional units is to be paid. The amount of the State Duty depends on the in-force period of the accreditation. Procedure of accreditation of a branch (representative office) takes up to 21 working days.

Acquisition of stakes and shares of a Russian legal entity

In this case, a foreign investor purchases stakes (shares) of a Russian commercial organisation so that the Russian organisation has a status of a commercial organisation with foreign investments.

At the same time, a foreign investor, commercial organisation with foreign investments that is created on the territory of the Russian Federation, in which the foreign investor (investors) holds (hold) not less than 10% stake, stake (contribution) in the authorised (share) capital of the mentioned organisation, in full measure enjoy a legal protection, guarantees and benefits established by the Law “On foreign investments in the Russian Federation”.

Acquisition of stakes (shares) of a Russian organisation shall be executed in due course and includes the following main stages:

- conclusion of purchase and sale contract¹
- introduction and registration of alterations to the constituent documents of a legal entity
- obtaining new codes at the State Committee of the Russian Federation for Statistics
- making announcement to the funds about registration of alterations to the constituent documents of the legal entity.

Setting up a legal entity with foreign investments

In this case, a foreign investor establishes an organisation with foreign investments, which is registered in accordance with the Russian legislation; and the foreign investor holds the 100% interest in the organisation.

Registration of organisations with foreign investments executes in due course and includes the following main stages:

- State registration of a legal entity
- Registration of the legal entity with the tax authority
- Obtaining codes at the State Committee of the Russian Federation for Statistics
- Registration of the legal entity with the Social Insurance Fund
- Registration of the legal entity with the Obligatory Health Insurance Fund
- Registration of the legal entity with the Pension Fund
- Opening of operating and/or foreign currency account of the foreign legal entity at the bank at the choice of client.

Types of commercial organisations

Joint stock company

A joint stock company is a company, the authorised capital of which is divided into a certain number of shares. Members of a joint stock company (shareholders) are not liable for its obligations and bear a risk of losses connected with the company business activity within the value of shares in their ownership.

¹ According to recent amendments made to the Federal Law "On Limited Liability Companies", a contract for purchase and sale of shares in the authorised capital of a Limited Liability Company is subject to notarial certification

A joint stock company in which members may dispose of their shares without the consent of other shareholders is an open joint stock company. Such joint stock companies may sell their shares openly and freely. A joint stock company in which shares are distributed only among subscribers of its Memorandum or another predetermined circle of persons should be recognised a closed joint stock company. Such companies may not have public subscription of its shares or in any other manner offer its shares for acquisition by an undefined circle of persons. The number of shareholders of a closed joint stock company should not exceed fifty.

The authorised capital of a company is made up by par value of company shares purchased by shareholders. A company's authorised capital determines a minimum size of company property, which guarantees the interests of its creditors. The company's profits gained as a result of its entrepreneur activities shall be distributed among the shareholders. The minimum authorised capital of an open joint stock company should be not less than a thousand-fold amount of minimum wage established by the Federal Law as of the date of the company registration, while the authorised capital of a closed joint stock company should be not less than a hundred-fold amount of minimum wage established by the Federal Law as of the date of the company registration.

The state duty for registration of company incorporation is 2,000 rubles.

Limited liability Company

A limited liability company is a company incorporated by one or more persons (individuals or legal entities), the authorised capital of which is divided into equity stakes of a certain size. Members of a limited liability company are not liable for its obligations and bear a risk of losses related to the company business activity within value of stakes they have in the authorised capital.

The number of company members should not exceed fifty.

Payment for stakes in a company's authorised capital can be made in the form of money, securities, other property or property right or other rights, which have money value. A company's authorised capital is made up by par values of its members' equity stakes. A company's authorised capital determines a minimum size of company property, which guarantees the interests of its creditors.

Company profit gained as a result of its business activity should be distributed among company members in proportion to their equity stakes

in the authorised capital. The minimum authorised capital of a limited liability company should be not less than ten thousand rubles.

The state duty for registration of company incorporation is 2,000 rubles.

General partnership

A general partnership is a commercial company, the members of which, in accordance with the agreement concluded between them, carry on business on behalf of the partnership and are liable for its obligations with their property.

The partners of a general partnership are called members and conclude transactions on behalf of the partnership and carry on business in any other manner.

A general partnership is incorporated and operates under the Memorandum, which establishes the size and composition of the share capital and sizes of members' shares in the share capital.

The state duty for registration of company incorporation is 2,000 rubles.

Any profits and losses of a general partnership are divided among its members in proportion to their shares in the share capital.

Types of not-for-profit organisations

Funds

A fund is a non-profit organisation without membership, founded by citizens and (or) legal entities on the basis of voluntary property contributions, which pursues social, charitable, cultural, educational or any other purposes.

Any property transferred to the fund by its founders (or founder) is property of such fund. Founders are not liable for obligations of the fund set up by them and the fund is not liable for obligations of its founders.

A fund may carry on business which is necessary to achieve its socially useful purposes, for which the fund has been set up, and which is in accordance with such purposes. To carry on business, funds may set up business companies or participate in them.

The state duty for registrations as a legal entity is 2,000 rubles.

When a fund is liquidated all its property which is left after all claims of creditors are settled should be directed for purposes specified in the articles of association of the fund.

Associations and unions

Associations and unions are non-profit organisations set up by profit organisations to co-ordinate their business activity and also to represent and defend their common property interests.

Members of an association (or union) maintain their independence and rights of a legal entity. No association (or union) is liable for obligations of its members. Members of an association (or union) bear subsidiary liability for its obligations in the amount and in accordance with the procedure as specified by constitutive documents of such association.

The state duty for registering the incorporation of an organisation is 2,000 rubles.

Other aspects

State registration procedure is conducted within the period of less than 5 working days from the date of submission of the documents to the registering authority.

It is important to note that legal regime of foreign investments as well as foreign investors' activities on effectuation of foreign investments cannot be less advantageous than the regime for property, property rights and investment activities of legal entities and citizens of the Russian Federation. Limitations in foreign investors' activities on the territory of the Russian Federation may be established by Federal Laws only.

Russian legislation provides foreign investors with a number of advantages for purposes of stabilisation and legal protection of their business in Russia. The following advantages may be qualified as the most essential:

- A foreign investor has a right to compensation of losses, incurred as a result of illegal actions (non-act) of state bodies, local self-governing bodies or officials of these bodies, in accordance with the Civil legislation
- Property of a foreign investor or a commercial organisation with foreign investments is not subject to compulsory taking including nationalisation, seizure

- In the case of adverse change to Tax or Customs legislation, these changes shall not be applied to foreign investors within the recoupment period of the investment project
- Foreign investor has a right to unimpeded transfer of incomes, profits and other received amounts of money outwards the Russian Federation
- Presence of international agreements on avoidance of double taxation, which allow not paying a tax on one income twice; and its legal force that more significant than legal force of national legislation.

Relations concerning foreign investments in the Russian Federation are also governed by other Russian statutes in force and international agreements. If an international agreement, which is applicable on the territory of the Russian Federation, establishes provisions other than those provided by legislative acts of the Russian Federation, the provisions of the international agreement are applicable.

5. Labour

Employment Agreements

The population of the Russian Federation is almost 100% literate with a large share of specialists with university degrees.

The main provisions regulating employer-employee relations arising in the Russian Federation are the Labour Code of the Russian Federation adopted by December 30, 2001.

Labour relations between an employee and an employer arise by virtue of an Employment Agreement concluded between them.

An Employment Agreement is a written agreement between an employee (an individual) and an employer (an individual who represents a company), which establishes:

- the nature of the employee labour function (i.e. the job for a certain profession, office, specialty)
- their labour conditions (including, the length of a working-day, the salary and the period of paid leave)
- the rights and obligations of the employee and the employer.

In addition to the Employment Agreement, the employer and the employee are governed by the Labour Code of the Russian Federation.

In accordance with the general rule, the terms and conditions of the Employment Agreement shall not aggravate the employee's situation as compared with the Labour Code of the Russian Federation. In other words, the legal norms of the Labour Code of the Russian Federation, which determine the minimum level of social guarantees and labour conditions (including minimum salary and minimum paid leave), should be unconditionally used in relation to employees and employers, which concluded an Employment Agreement in the Russian Federation.

The terms and conditions of an Employment Agreement may only improve the situation of an employee as compared with the terms guaranteed by the Labour Code of the Russian Federation; that is to increase the salary, the period of paid leave, etc.

The minimum period of paid leave - 28 calendar days – is guaranteed by the Labour Code of the Russian Federation. The terms and conditions of an

Employment Agreement may increase the length of paid leave on any terms and conditions as agreed by the employee and employer.

An Employment Agreement may be concluded:

- without date
- for a specified period not exceeding five years (fixed-term employment agreement).

To conclude an Employment Agreement, the employee should present her/his:

- passport
- retirement insurance certificate
- military registration documents (for men)
- document that confirms the employee's education, qualification or special skills (for work that requires special knowledge or specialised education).

To employ foreign citizens, the employee is obliged to obtain a permit from the Migration Service for engaging of foreign labour power; such permit is valid for one year.

If a foreign person acts as a founder of a Russian legal entity only, no work permit is required.

At the same time, regardless the fact of presence of labour relations between a Russian company and a foreign citizen, the foreign citizen is obliged to observe a residence regime in the Russian Federation and obtain a permit to reside for that purpose.

The following regulation is applied to foreign citizens, who concluded a contract of hiring work with a Russian company: they are not obliged to obtain a work permit but are obliged to obtain a permit to reside.

In order to protect employees' rights and interests, they may unite in trade unions, which, in addition to the protection function, have the right to represent an employee in the course of concluding an Employment Agreement or in case of a strike (when employees refuse to perform their labour duties for the purpose of labour dispute settlement).

Social Security

In accordance with the Labour Code of the Russian Federation, an employer is obliged to provide its employees with a social insurance, which means that the employee shall receive insurance compensations at a

certain rate of 60% to 100% of their salary depending on the insured event (disease, maternity, disability, loss of breadwinner, etc.). The insurance compensations shall be paid by social welfare authorities from the monthly social tax paid by the employer at a rate of 26% of the salary of each employee.

Social insurance of foreign citizens who are heads or officials of a Russian legal entity is provided in accordance with the rules established for Russian citizens.

Social insurance of foreign citizens who are heads or officials of a representative office of a foreign legal company is provided in accordance with laws of the state where the legal entity is incorporated.

6. Taxation

Taxes and Dues laws of the Russian Federation is represented by the Tax Codes and federal laws, normative legal acts of constituents of the Russian Federation and municipal authorities adopted in accordance with the Tax Code.

All the taxes imposed in the Russian Federation within the framework of this legal system may fall into the following categories:

- Federal taxes: Value Added Tax, Corporate Profits Tax, Individual Income Tax, Unified Social Tax
- Regional taxes: Corporate Property Tax, Tax on Gambling Industry, Transport Tax
- Local taxes: land tax, individual property tax.

The main taxes, which are most considerable in amount and most complicated in accrual, are the VAT, the profits tax, and the unified single social tax - from the federal taxes, the Corporate Property Tax - from the regional taxes. The local taxes are not really important except when owning large land plots.

Important sources of budgetary receipts are excise duties and the Severance Tax.

The applicable tax system also has special taxation regimes, which mean that one special tax should be paid instead of all the taxes prescribed by the law. Such special regimes mean considerable reduction of taxation load for small business (simplified tax system), agriculture (Unified Agricultural Tax), or obligation to transfer separate types of activity into a taxation system in the form of Unified Tax on Imputed Income (Unified Tax on Imputed Income).

The applicable tax system of the Russian Federation concerning international relations has established the priority of international treaties signed by the Russian Federation, which refer to tax computation, over internal laws.

Corporate Profits Tax

Taxpayers are Russian organisations and foreign organisations which have registered representative offices in the Russian Federation and (or) which gain income from sources in the Russian Federation.

The tax base is earned revenue less reasonable expenses, which are documentarily proved. As for foreign organisations which do not have registered representative offices in the Russian Federation, but which gain income from sources in Russia, the tax is imposed on the income received from the source of payment.

The profits tax rate is generally 20%. However, special tax rates are stipulated for separate types of income:

- For dividend income received by a Russian company from another Russian company - 9%
- Dividend income received by a Russian company from abroad is taxed at 9%
- Tax at the rate of 15% is withheld from dividends payable abroad by a Russian company
- Income in the form of interest on state and municipal securities - 15%
- Withholding tax on income from the operation, maintenance, or rental (freight) of vessels, aircraft, or other mobile means of transport or containers in international traffic - 10%.

Income Tax in the form of dividends received by a Russian company may be calculated at 0% given that the terms and conditions (i.e. period of share ownership in the authorised share capital - not less than 365 days, share size in the authorised share capital - not less than 50%, cost of the share - not less than 500 million rubles etc.) established by the legislation are observed.

Tax rate on other incomes of foreign companies not related to activities in the Russian Federation via a representative office (including income in the form of interests) - 20%.

The procedure for calculation of taxable income in accordance with the Tax Code differs from the procedure established for accounting. First of all, this is because a taxpayer cannot take into account all types of expenses in the structure of expenses for the Profits Tax calculation (for example, insurance expenses are accepted for the Profits Tax in accordance with exhaustive list of classes of insurance). Some expenses are accepted for the Profits Tax not in the full amount but within the normal range (entertainment, advertising etc. ones). Therefore, such difference requires keeping separate tax ledgers.

Value Added Tax

Taxpayers are Russian or foreign organisations or individual entrepreneurs.

Taxable items are operations of selling goods (works, services) and property rights, including those without charge, in the Russian Federation. In addition, VAT is imposed on transfer of goods on the territory of the Russian Federation (performance of works, rendering of services) to own needs, expenses for which are not accepted for deduction when calculating Organisation Income Tax, construction and mounting works for own use, and importing goods in the customs territory of the Russian Federation (VAT on import).

Particular types of activity, including bank transactions and securities transactions, are fully exempted from VAT.

VAT is imposed as of the earliest of the following dates:

- Date of goods shipment (delivery of works, services) and transfer of property
- The date of payment (full or partial) against future shipment (delivery) and transfer of property (date of advance payments receipt).

Set-off method of VAT calculation is a specific feature of calculation of this tax in the Russian Federation: the VAT for payment to the budget is the difference between the tax calculated on the basis of cost of goods sold and amounts of the VAT given by the suppliers of goods (works, services) that used by the taxpayer in the course of operations that are subject to taxation with the VAT. Moreover, VAT amounts calculated on advance payments, are subject to tax deduction upon shipment of goods (works, services) or return of advance. When transferring an advance to a supplier of goods (works, services), property rights, the buyer has a right to accept VAT for deduction provided that the supplier issues an invoice on the advance amount for him.

Given that the taxpayer implements the transactions that are not subject to taxation with the VAT, the amounts of the VAT given by the suppliers shall be included into cost of goods (works, services) purchased and shall not be returnable from the budget but shall reduce the tax base in the course of the Income Tax calculation.

The general VAT rate is 18%.

A reduced VAT rate is 10% and is applied to particular lists of medical goods, books, paper-printed periodicals, foodstuffs and goods for children.

VAT rate with regard to export of goods is 0%.

Almost each and every provision concerning VAT contains complications and numerous nuances. The most complicated aspects of VAT calculation are as follows:

A complicated system of confirmation of the right to tax deduction (sums, which reduce payments to the budget). In order to confirm tax deductions, a number of requirements needs to be met; one of such requirements is a strict observance of rules on filling in an invoice.

Failure to fill in or incorrect filling-in of at least one detail in this document may result in failure to grant a deduction on the VAT.

It is necessary to keep separate accounting for operations which are taxable with the VAT from those operations and those which are not taxable with the VAT.

The most complicated aspect in the VAT accrual is VAT refund in the case of export of goods (works, services) beyond the Russian Federation. When goods (works, services) are sold to a foreign buyer, the VAT is not imposed to him; and the seller may require from the budget refunding of the VAT paid to the Russian supplier. Russian tax authorities are not too willing to refund the VAT from the budget. It is connected with the cases of fraudulent export, which are becoming more and more frequent; fraudulent export means situations, i.e. when an operation is performed only to demand refunding of the VAT from the budget and not for actual export. A considerable part of exporters claims to refund the VAT amounts results in submitting such cases in the Arbitration Court. Such situation hinders activity of real exporters, which work within the frameworks of foreign trade contracts.

Order of acceptance of the VAT for deduction in cases when, on the results of the taxpayer's activities for the taxation period, the VAT amounts are subject to return to the taxpayer from the budget but not to payment to the budget, has become more complicated. In this case, the tax authority is obliged to conduct in-house tax audit within three-month period; and only after that to make the decision on refund the VAT amounts from the budget.

Unified Social Tax

Unified Social Tax payers are any persons (companies or entrepreneurs) that make payments to individuals within the framework of employment or civil law contracts and agreements (agreements on performance of works or rendering of services).

The tax base for companies and individual entrepreneurs is the amount of payments and other remunerations accrued by taxpayers in the favour of individuals for the tax period.

The Unified Social Tax is assessed on the gross payroll and remunerations of each physical person and is payable by the employer to the Federal Budget, Social Insurance, Pension and Medical Insurance Funds.

The applicable laws have a regressive rate scale for the unified social tax (the rate is gradually reducing from 26% to 2%):

Tax base	Tax rate (%)
Less than 280,000 RUR	26%
From 280,000 RUR to 600,000 RUR	72,800 RUR + 10% from an amount over 280,000 RUR
Over 600,000 RUR	104,800 RUR + 2% from an amount over 600,000 RUR

Companies that make payments to individuals are required to pay compulsory pension insurance (14%) on payments made to insured individuals. Pension insurance contributions paid to the Pension Fund of the Russian Federation are tax deductions and they reduce the amount of the Unified Social Tax payable to the Federal budget.

In addition to the Unified Social Tax, contributions are paid to the Social Insurance Fund (for injury and professional illness). Rates of the contributions are established by the Federal Law for the corresponding year. The rates depend on a risk category, which is determined depending on a type of an insurer's economic activity (legal entity or individual that hires employees). The minimum contribution is 0.2% of payroll accrued (on all grounds), and the maximum contribution is 8.5%.

When making payments to a physical person under civil law contract, payments: 2.9% (with incomes less than 280 thousand rubles) as part of the Unified Social Tax, and payments on injuries and professional diseases (from 0.2% to 8.5%) shall not be compounded to the Social Insurance Fund.

The legislation contains the list of payments that shall not be taxable for the Unified Social Tax purposes (welfare payments, compensation payments established by the legislation etc.). The Unified Social Tax shall not be applied to those payments to individuals that are taken into account by the organisation for the Profits Tax purposes.

Besides, some organisations are exempt from the Unified Social Tax from out payments and other remunerations that do not exceed 100 thousand rubles per individual for the tax period: public organisations of disabled persons, organisations with participation of public organisations of disabled persons and other similar organisations.

Corporate Property Tax

The Corporate Property Tax is paid by any Russian and foreign companies that own property in the Russian Federation. The tax base is assessed by the historical cost in accordance with the accounting standards applicable in the Russian Federation. The tax base is capital assets of the balance sheet. The tax rate is established by regional authorities and does not exceed 2.2%.

The legislation established some privileges for particular organisations (religious organisations, all-Russia public organisations of disabled persons etc.) and for particular types of property (space devices, particular vessel types etc.)

Individual Income Tax

Payers of the income tax are defined as both tax residents of Russia and non-resident individuals who receive income from Russian sources.

Russian tax residents are currently recognised as individuals who actually spend in Russia not less than 183 days within 12 consecutive months. Accordingly, non-residents shall be understood as those who actually spend less than 183 days of the mentioned period in Russia.

Russian tax residents are taxed in Russia on their worldwide income. Individuals who are not tax residents in Russia are taxed on their Russian source income, which includes for example:

- Remuneration for the performance of employment duties, services and actions in Russia
- Dividends and interests paid by a Russian organisation

- Insurance payments made by a Russian organisation
- Income from the sale of property in Russia.

The basic Personal Income Tax rate is 13%.

However, other rates are also applied for particular types of income:

- Income in the form of dividends from business participation in Russian organisations' activities received by individuals who are not tax residents of Russia - 15%
- All other types of income received from Russian sources by individuals who are not tax residents of Russia - 30%
- Income from a share holding in organisations received by individuals - tax residents of Russia - in the form of dividends - 9%
- Cost of any winnings and prizes received in any competitions, games and other events for the purpose of promotion of goods, works and services to the extent that the amount exceeds 4000 rubles - 35%
- Material benefits in the form of interest savings on loans (credits) received to the extent that the sums exceed prescribed amounts - 35%
- Income in the form of interest on mortgage-backed securities issued before 1 January, 2007 - 9%.

In the course of determination of taxable base, there are some tax deductions that reduce the taxable base for the tax:

- Social (for each employee and their children)
- Property (expenses for building or purchase of a house, apartment that reduce taxable incomes per annum, or expenses for purchase of property in the course of selling a house)
- Social (expenses for medical services, purchase of medicines, education and pension insurance)
- Social (income transferred for charitable purposes)
- Professional (intended for individual entrepreneurs, notary officers, lawyers etc.).

Organisation, which makes payrolls and remunerations under agreements on performance of works and rendering of services, is considered as a tax agent. It withholds the tax paid on incomes and transfers it to the budget. A tax agent bears all responsibilities for submission of all reports to a tax inspectorate.

Individuals apply to tax authorities if this tax has not been deducted from their salary for some reason (for example, in cases of receiving income in a

foreign state or receiving income in kind), or in order to obtain corresponding tax deductions, certificates and proofs.

Moreover, regarding the number of persons, the organisation that makes the payment is not considered as a tax agent; and these persons are obliged to calculate and pay the tax as well as to submit the tax declaration themselves. In particular, individual entrepreneurs, attorneys, notary officers and persons that derive revenue from selling of their property fall into this category.

7. Accounting & reporting

Accounting and Reporting Requirements

The Law on Accounting applies to all organisations located in the Russian Federation and to branches and representative offices of foreign companies, unless otherwise is stipulated in the international treaties of the Russian Federation. However, the Law on Accounting and Reporting allows representative offices of foreign companies to conduct accounting in accordance with their home country accounting regulations, if these regulations do not contradict International Financial Reporting Regulations (IFRS).

The Law on Accounting consists of the Law of Accounting, other federal laws, Russian Federation Presidential Edicts and Decrees of the Russian Federation Government. Accounting is executed under the Russian Accounting Standards (Principles). The RAS have been greatly influenced by IFRS and mostly follow their provisions. At the same time Russian law-makers did not adopt the IFRS completely and left a number of old provisions in the applicable RAS (such as accounting by historical cost; there is no practice of recognition of reserves and contingent liabilities). The fact that Russian Accounting Principles do not fully conform to international standards hinders attraction of foreign investments, therefore, complete transfer to the IFRS is planned for the near future. Companies in Russia should use the accrual method for financial accounting purposes.

The statutory Annual Financial Reports in Russia consist of the following statements:

- Balance Sheet
- Profit and Loss Account
- Addendums to the above mentioned Statements provided by statutory acts (Cash-Flow Statement, Addendums to Balance Sheet, Statement of Changes in Equity, Statement on Proper Use of Funds Received)
- Explanatory notes
- Audit opinion.

Interim (quarterly) financial statements shall include a balance sheet and profit and loss account.

The reporting year for all companies is from January 1 to December 31. Quarterly reports should be submitted within 30 days after close of the quarter.

Audit Requirements

Auditing activity in the Russian Federation shall be performed on the basis of the corresponding Federal Law. The regulatory authority is the Ministry of Finance of the Russian Federation.

An individual shall be trained at an educational institution authorised by the Ministry of Finance of the Russian Federation and pass examinations to be granted an auditor's certificate to become an auditor. An auditor should attend refresher courses for 40 hours every year to confirm their auditor's certificate.

Certified auditors may set up companies. Auditing activity in the Russian Federation will not be licensed since January 1, 2010. Instead of a license, an audit company shall have a membership to one of the accredited self-regulated audit organisations as well as comply with a number of requirements to ownership structure and structure of regulatory bodies established by law. In addition, a company shall have not less than 3 licensed auditors.

Audit examinations are either of obligatory and initiative nature. Obligatory audit examinations are established by the Law and conducted for:

- Open joint stock companies
- Banks, insurance companies, stock exchanges and investment funds
- State municipal and unitary enterprises
- Companies with revenues and/or total assets exceeding a certain limit during a reporting year (currently, revenue exceeding approximately 50,000,000 rubles and total assets exceeding approximately 20,000,000 rubles)
- Other cases when federal laws stipulate mandatory audit.

Obligatory audit examinations shall be conducted in accordance with the standards approved by the Russian Federation Government.

Initiative audits may be conducted pursuant to the decision of a company owner or management in the process of company merger and acquisition. Audit examinations are often conducted to obtain comprehensive consultative assistance in matters of accounting, especially possible tax problems.

The market of auditing services in Russia is expanding. Audit services conducted in accordance with international standards as well as on transferring accounting statements to international standards are becoming more and more popular.

8. UHY firms in Russia

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