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**C H A N C E**

Russia Update: Legal and  
market developments in Russia  
Spring 2012



Welcome to the first issue of **Russia Update: Legal and market developments in Russia**. The **Russia Update** is a new publication of Clifford Chance Moscow, and aims to summarise significant legal and market news relating to the Russian Federation which has taken place during the last quarter. You can access our key client briefings, alerters and other recent publications from this publication.

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# Russia Update: Legal and market developments in Russia

Spring 2012

## Macro Update

- Presidential elections took place on 4 March 2012, returning Vladimir Putin as President for a six year term. This is the third term of office for President Putin, who also served two consecutive terms as President in the period from 1999 to 2008. Mr Putin was Prime Minister of the Russian Federation from 2008 to 2012. Mr Putin officially took office on 7 May 2012. Turn out for the Presidential elections was reported at around 60% of the population.
- Former President Dmitri Medvedev has been nominated as Prime Minister by Mr Putin. The nomination for Prime Minister must be confirmed by the State Duma.
- In State Duma elections held on 4 December 2011, the largest party, United Russia, suffered electoral losses (and lost its two-thirds majority) but ultimately held an absolute majority with 238 (approximately 53%) of the seats available. The Communist Party (*KPRF*) now holds 92 seats in the Duma, the Just Russia party (*Spravedlivaya Rossiya*) 64 seats and the Liberal Democratic Party (*LDPR*) 56 seats.
- A programme for privatisation of state assets is expected to be a key focus for the office of the new President. In his post-election victory speech, Vladimir Putin expressed his intention to ensure state assets are sold at market prices.
- In December 2011, MICEX-RTS was created (from the merger of the MICEX and RTS stock exchanges) as the largest stock exchange in the Russian Federation. The merger is intended to simplify trading for both traders and investors and forms part of wider plans to develop Moscow as a global financial trading centre.

MICEX-RTS provides a platform for trading equities, bonds, derivatives and currencies.

- The Russian Federation acceded to the World Trade Organisation (WTO) in mid-December 2011 and will become a member of the WTO 30 days after the State Duma ratifies the accession package.
- At the end of 2011, Russia took up the chairmanship of the APEC (Asia-Pacific Economic Cooperation) organisation for 2012. The organisation's next summit will take place in September in Vladivostok. The Russian Federation has stated that its priorities as chairman of APEC will be the liberalisation of trade and investment activity and a deepening of economic integration in the region, cooperation for purposes of innovative growth, the improvement of transport and logistical systems, and food security.
- On 17 February 2012, Russia acceded to the Anti-Bribery Convention of the Organisation for Economic Co-operation and Development (OECD). Former President Dmitri Medvedev also spoke in 2011 of his intention for Russia to progress full membership of the OECD following accession to the WTO.

## Legal and Regulatory Update

### General

#### The Civil Code

In the first months of 2012 the hottest topic in the Russian legal world is the proposed amendments to the Civil Code. If adopted, these changes are expected to change significantly *'the rules of the game'* for all areas of business, from corporate relationships and M&A to the real estate

market, banking activities and structured finance products (securitisation).

There is much in the proposed changes that is potentially helpful, and some that is potentially alarming. Among other things, this draft bill focuses on the duty to act in good faith and provides specific consequences of the parties' failure to do so. It also introduces intercreditor agreements, pledge over bank account rights, irrevocable powers of attorney, escrow accounts and other long-awaited changes. For the first time, the concepts of indemnities, representations and warranties are introduced in the Russian law. The draft bill also reconsiders the concepts of security and its forms. It contemplates a wide range of changes in the corporate law field and real estate regulation.

The relevant draft bill was submitted to the State Duma by the Russian President on 2 April 2012. The draft bill passed the first hearing in the State Duma on 27 April while further readings are yet to be scheduled. If adopted in the current version, the majority of the amendments would enter into force as early as 1 September this year.

Clifford Chance issued a [Briefing Note](#) on the most salient of the proposed changes to the Civil Code in April 2012. As the Draft Bill passes the hearings in the State Duma, we will provide further updates and briefings aimed at unpacking these provisions and their potential impact on market activities more fully.

#### New Procurement Rules for State-Owned Companies

Federal Law No 223-FZ "On the Procurement of Goods, Works and Services by Certain Types of Legal Entities" dated 18 July 2011 (the "**Procurement Law**") has introduced a new regime for public procurement applicable to state and state-controlled companies, natural monopolies and utility companies.

The Procurement Law is more flexible than the pre-existing framework law on public procurement (Federal Law No. 94-FZ) as regards (i) the circumstances when tender procedures must be used, (ii) the procedures to be adopted for selecting participants in the tender process (which need not be a tender or auction) (iii) the requirements for participants in the procurement process and (iii) the timetable and documents needed for the procurement project.

Each company subject to the Procurement Law is required to adopt and publish details of the procurement procedure on its official website by 1 April 2012 (or a later date for certain types of companies) or otherwise conduct its procurement activities in accordance with the more restrictive Federal Law No. 94-FZ.

Companies subject to the Procurement Law must also adhere to certain principles during a procurement process. Key among these are: transparency of information; equal treatment of competitors and a lack of arbitrary requirements or restrictions; value for money, taking into account where necessary the life cycle of the relevant product; steps to minimise the expenses of the procuring entity; and equality of access to the process, including proportionate requirements for participation.

The penalties applicable for non-compliance are presently unclear. It is clear from the law that parties prejudiced by non-compliance can present a complaint to the court, but it is not certain whether the court has the power to re-open procurement processes.

Certain companies, including (a) those not having a significant proportion of their income from activities that represent natural monopolies, (b) subsidiaries (direct and indirect) of state-owned companies and (c) subsidiaries (direct and indirect) of natural monopolies, are not required to

comply with the Procurement Law until 1 January 2013.

#### **Law on Electronic Signatures**

The law on electronic signatures has recently been updated to clarify the circumstances in which electronic signatures can be used in cross-border transactions. Onerous requirements concerning encryption and regulatory permits, which cast doubt on whether messages sent via instant messaging systems such as those operated by SWIFT, Bloomberg and Reuters would comply with the law, have been relaxed.

The basic position is now that any electronic message with a simple electronic signature will meet the requirements of the law on electronic signatures where the parties have previously agreed to use an electronic signature when using the relevant messaging system and the parties have expressly agreed to keep the means of generating the electronic signature confidential.

Clifford Chance issued a [Briefing Note](#) on changes to the law on electronic signatures in April 2011.

#### **Corporate**

##### **New Law on Business Partnerships**

In December 2011, a new law on business partnerships was adopted by the Russian parliament and will enter into force on 1 July 2012. The law was originally intended to facilitate venture capital projects but the potential scope for its application may be even broader.

Business partnerships are introduced into Russian law as a new form of legal entity for the first time. According to the new law, they must have at least two and no more than 50 participants and at least one of them must be an individual who will serve as the CEO of the business partnership. Other than the CEO, whose role is prescribed by the law, the structure of the management bodies may be agreed between the participants.

Business partnerships may engage in any type of business activities as long as they comply with the following prohibitions: no issues of bonds or other mass securities, no advertising of their activities and they may not own any shares of or participate in other companies (which means that they cannot serve as any holding companies).

The law allows the participants to agree in the partnership management agreement on a broad range of matters relating to the activities of the partnership including: management of its affairs, composition of its management bodies, rights of the participants etc.

Although the law creates rather flexible rules for the constitution and operation of a business partnership, a few provisions in it (such as the requirement for the CEO to be a participant, restrictions on the partnership's activities and others) raise concerns as to the potential use of this new form of entity in practice.

##### **Restriction on foreign ownership of land close to the Russian border is effective**

20 January 2012 was the deadline for foreign individuals and legal entities to comply with restrictions on foreign ownership of land in certain territories close to the Russian border. The list of particular territories close to the border was approved in 2011 and included, for example, some areas in the St. Petersburg region. The framework restriction on foreign ownership of land close to the state border was in place for many years before 2011; however, it was not effective until the list of specific areas was approved.

#### **Regulatory**

##### **Competition Update**

The so-called "Third Antimonopoly Package" was adopted in late 2011 and entered into force on 6 January 2012. From the merger control perspective this third major set of amendments to federal competition laws introduced a new local



presence criterion for foreign targets, brought the method of calculation of the target's assets in line with other jurisdictions, granted the Federal Antimonopoly Service ("**FAS**") a right to impose conditions precedent to closing of share purchase transactions and set other changes.

- Local presence criterion: at present, foreign-to-foreign transactions fall within the Russian merger control regime where the target entity directly or indirectly controls any Russian entities, owns substantial assets located in Russia or has turnover exceeding RUB 1 billion (approx. EUR 25 million) from operations in Russia in the year preceding the transaction (directly or through a foreign subsidiary). The introduction of the RUB 1 billion threshold excluded transactions where the target's turnover in Russia was insignificant from merger control.
- Method of calculation of the target's assets: generally, under the Competition Law the target group includes the group of its controlling shareholder (often acting in the capacity of the seller). However, for the assessment of the asset-based threshold (combined value of assets of the acquiring group and the target

group) for pre-transfer notifications the assets of the seller's group are not aggregated with the target's assets if the seller loses its controlling rights over the target further to the implementation of the transaction.

- Right to impose conditions precedent to closing: for share purchase transactions which may result in a restriction of competition (the most frequent example is the creation or strengthening of a dominant position) in addition to the right to impose post-closing conditions the regulator also obtained a right to impose conditions precedent to closing and set a term for their fulfillment (up to nine months).

#### **Strategic Investments Law Amended as of 18 December 2011**

The "Law on Foreign Investment in Strategic Sectors" (the "**Strategic Investments Law**") was amended with effect from 18 December 2011.

The principal aim of the amendments was to ensure that "real" Russian deals are exempt from the Strategic Investments Law. As such, the acquisition of Russian assets by a foreign company will no longer require prior approval, provided that the ultimate beneficiaries of the seller and the buyer are the Russian Federation, Russian nationals and Russian tax payers.

In addition, the scope of the Strategic Investment Law was limited such that:

- Where the target of an acquisition is a bank operating with encryption licenses, the Strategic Investments Law will not apply as long as the Russian state is not a shareholder in the target bank.
- On the acquisition of a strategic subsoil target, a request for prior

approval will only be required if the acquirer will control 25% of the target post-closing, raising the previous threshold from 10% control.

Some of the key points to note about the Strategic Investment Law are set out in our *Russian Law Focus* column below.

## **Finance**

### **Changes to the Enforcement Regime for Russian Security**

- New legislation was recently enacted which affects the enforcement of various types of Russian security. Federal Law No 405-FZ "On amendments to certain Russian laws in relation to the improvement of procedures for the enforcement of security" dated 6 December 2011 (the "**Security Enforcement Law**") came into force in March 2012 and introduced wide-ranging changes to the enforcement of various types of security interests, in particular, the enforcement rules relating to Russian pledges and mortgages.
- The new regime, while clearer and more detailed, is arguably more cumbersome than before and it seems likely that out-of-court enforcement over most Russian pledges and mortgages will only be possible with a notarial executory endorsement on the security documents or with the cooperation of the security provider. This means that, from March 2012, security documents must be executed before a notary if they are to provide for out-of-court enforcement.
- In our [Briefing Note](#) published in December 2011, we expressed concern that the new law creates uncertainty for security holders, particularly in relation to the application of the new law to pre-existing security



interests. Any pre-existing security documents affected by the new rules may need to be re-executed before a notary in order to be eligible for out-of-court enforcement through a notarial procedure. Re-execution of the documents may give rise to new hardening periods which may prejudice the security holder's interest in the event of the security provider's insolvency, unless this issue is clarified by the Supreme Arbitrazh Court. Enforcement of existing security through the courts will still be available, without the need to re-execute the relevant security documents.

- The amendments introduced by the Security Enforcement Law also clarify the circumstances in which pledges over shares can be enforced out of court. Certain other important amendments have been made regarding the creation of mortgages over real estate, as well as clarifying the methods of out-of-court enforcement available to mortgagees.
- The rules for out-of-court enforcement of Russian pledges and mortgages will be amended further upon the

adoption of the amendments to the Civil Code, which is expected to occur later this year.

## **Capital Markets and Securities**

### **Insider Trading Law**

- During the final six months of 2011 the Federal Service for Financial Markets of the Russian Federation (the "**FSFM**") adopted the orders and other secondary legislation necessary to bring into force Federal Law No. 224-FZ "On the prevention of illegitimate use of insider information and market manipulation and on certain amendments to the laws of the Russian Federation" (the "**Insider Trading Law**"). Although in force in part since July 2011, certain compliance deadlines for issuers were postponed and the Insider Trading Law was, finally, substantially in force by 31 December 2011.
- The introduction of an insider trading law in the Russian Federation is a landmark event and represents the development of Russia as a maturing jurisdiction for the trading of shares

and other securities. Like similar legislation in other jurisdictions, the Insider Trading Law regulates accurate and precise information relating to, among others, an issuer of financial instruments or financial instruments per se that has not been made public and if made public could materially affect the price of financial instruments trading (or subject to an application to trade) on an exchange. The Insider Trading Law is different, however, as (unlike other jurisdictions where inside information is determined by the issuer) the types of information constituting "inside information" are listed exhaustively for specific groups of issuers (these being "**primary insiders**") in the "List of Inside Information". As such, insiders have little or no discretion in determining what information is inside information. It is likely that this approach has been taken in order to assist domestic issuers in adapting to a regime for disclosure of inside information, to develop understanding of the disclosure obligations and also to promote the obligation to disclose.

- The general rule imposed by the Insider Trading Law is that inside information must be disclosed by a primary insider to the market by 10am on the day immediately following (i) the event constituting inside information or (ii) the inside information becoming known to the issuer. Disclosure is made pursuant to new disclosure rules applicable to public companies, adopted in April 2011 (the "**Disclosure Rules**") and includes an obligation to disclose material facts relating to the event or matter constituting the inside information. Significantly for issuers, although board decisions are generally treated as inside information, certain



non-routine board decisions that are classified by the issuer as confidential information do not have to be disclosed under the Disclosure Rules. As such, some board decisions can remain inside information for an indefinite period of time.

- The Insider Trading Law also regulates the transfer of information between primary insiders and their “secondary insiders”, such as legal and financial advisers. The general rule is that a person possessing inside information is prohibited from transferring that information other than to other persons on the list of insiders. The information may only be transferred pursuant to obligations or rights created by Federal Law or contract or by virtue of an employment relationship. The FSFM has recently made steps to clarify some ambiguities in the law regarding the transfer of inside information, however, clear and detailed rules are yet to be published and until they are it is important for market participants and advisers to think carefully about the processes adopted for the exchange of information.
- Once further regulation is adopted, professional participants in the securities market and banks will have obligations to notify the FSFM about “suspicious” transactions of their clients that may be caught by the Insider Trading Law.

Our [Briefing Note](#) published in July 2011 looks in more detail at some key features of the Insider Trading Law.

#### Deposits of Up to 100% of Shares into Depository Receipt Facilities

The FSFM adopted several amendments to the Regulation on the placement and circulation of securities of Russian issuers

abroad (the “**Securities Regulation**”) in August 2011. When implemented, these amendments will potentially allow Russian issuers greater freedom to trade their shares on foreign markets.

More specifically, when the adopted amendments enter into force:

- Russian issuers that are not subject to the Strategic Investments Law and have shares included in quotation list A or B of MICEX-RTS will be able, with FSFM consent, to circulate up to 100% of their securities on foreign markets as shares or foreign securities such as depository receipts. Previously, the circulation of securities on foreign markets was limited to 25% of share capital.
- Russian companies subject to the Strategic Investments Law and operating in strategic sectors other than subsoil will be able to circulate their securities on foreign markets either (i) up to an amount of 25% of share capital with FSFM consent or (ii) up to another amount specifically authorised in any pre-approval decision made under the Strategic Investments Law on the application of that company.
- Russian subsoil companies will be able to circulate their securities on foreign markets either (i) up to an amount of 5% of share capital with FSFM consent or (ii) up to another amount specifically authorised in any pre-approval decision made under the Strategic Investments Law on the application of that company.
- The “**50-50 rule**”, under which Russian issuers had to first offer shares for sale in Russia before being able to offer up to half of such shares for sale overseas, will be abolished.

The amendments to the Securities Regulation are expected to enter in force when all the provisions of the law on the central depository enter into force and the central securities depository is created.

Clifford Chance issued an [alert](#) on the Regulation in August 2011.

#### New Law on Central Depository

In December 2011, the Russian Parliament adopted Federal Law No. 414-FZ “On Central Depository” (the “**Central Depository Law**”) and Federal Law No. 415-FZ “On Incorporation of Amendments to Russian Legislative Acts in Connection with the Adoption of the Federal Central Depository Law” (the “**Amendment Law**”).

For the first time ever, the Central Depository Law introduced the concept of a central securities registration institution in the Russian securities market. Although the FSFM is yet to adopt quite a few regulations implementing the new rules, the amendments will be relevant for operations of a broad range of parties, including Russian issuers, holders of depository receipts and many more.

Some of the key features are as follows:

- The new legislation establishes regulatory framework for the operations of the central depository. It also provides material changes to the existing regulation of depository and registrar activities, stricter disclosure and related obligations for the market participants.
- The Central Depository Law introduces new types of securities accounts that custodians and registrars can open. Also, foreign nominee holders and international custodians are allowed to open accounts with the Russian custodians. However, the regulation for opening

and maintaining of such accounts is yet to be established by the FSFM.

- If a Russian issuer is subject to mandatory ongoing disclosure rules under the Russian Securities Market Law, only the central depository will be allowed to open a nominee account in the register of such issuer.
- Russian issuers will have to prepare lists of holders of depository receipts representing the shares of such issuer on a quarterly basis. Interim nominee holders (i.e. depository banks) are required to provide the Russian issuer with the necessary information. The exact procedure and scope of such disclosure is to be established by FSFM. The new laws provide sanctions for failing to comply with the disclosure rules such as prohibition on payment of dividends in certain cases.
- The Central Depository Law also provides new rules and limitations for voting with shares deposited under a DR program. Complying with the new rules may require extra effort for the market participants.
- The Amendment Law also provides that for the purpose of any enforcement procedures only securities recorded in owner (proprietary) accounts are subject to seizure.

Most of the new rules will become effective from 1 July 2012 and the rest will follow with effect from 1 January 2013.

## Litigation and Dispute Resolution

### Arbitration of Corporate Disputes – Recent Cases in the Russian Courts

Two recent Russian court decisions have considered the issue of whether

corporate disputes relating to Russian companies can be resolved by arbitral tribunals. These rulings may have implications for the enforcement of Russian and international arbitral awards in Russia.

The term “corporate disputes” is a defined term in Russian legislation and covers a range of different types of disputes relating to Russian companies, including (by way of example) disputes between shareholders, disputes over the exercise of rights attached to shares, and disputes connected with the establishment, re-organisation or liquidation of a legal entity.

Until recently, arbitrazh courts have not taken a uniform approach to the arbitrability of corporate disputes. One view is that the Arbitrazh Procedure Code of the Russian Federation (the “**APC**”) gives special jurisdiction to the arbitrazh courts and that disputes between participants of companies and those relating to company operations cannot be considered by arbitral tribunals. The other approach is that the special jurisdiction of arbitrazh courts over corporate disputes provided for in the APC does not exclude the possibility of corporate disputes being heard by an arbitral tribunal.

The two recent decisions both appear to be predicated on the position that corporate disputes are not arbitrable. However, we are of the view that these decisions do not definitely settle the point.

We consider the two cases more fully in our [Briefing Note](#) issued in February 2012.

## Employment

### Share schemes for Russian employees

Usually under international share schemes, employees of local subsidiaries are awarded shares in foreign group companies. However, this was not generally possible in Russia as foreign

shares not listed in Russia could only be offered to employees who are “qualified investors by recognition”. Furthermore, “qualified investors by recognition” may acquire foreign securities only via a broker who has recognised them as qualified investors.

However, FSFM has made it possible, via an order which came into force on 19 June 2011, for foreign shares not admitted to public placement and/or public circulation in Russia to be directly acquired by certain other categories of Russian citizens. These categories include, *inter alia*, individuals acquiring foreign shares (i) under their employment contracts; or (ii) in connection with their employment; or (iii) in their capacity as a director of the company. This exemption should make it easier to implement international share schemes in Russia.

## Tax

### Re-thinking Thin Cap

Two recent court cases appear to mark a significant shift in the approach of the Russian tax authorities and courts to thin capitalisation. These changes may require taxpayers and lenders to restructure existing financings, as well as review plans for future financings.

Russia’s thin capitalisation rules impose limitations on the deductibility of interest by Russian companies with significant overseas shareholdings and have been in force since 2002.

Due to drafting deficiencies it was not clear if the rules covered intra-group debt financing provided by a foreign group company to a Russian group company, and market practice has been to treat this type of loan as outside the scope of the rules. Russian courts have also ruled on a number of occasions that the thin capitalisation rules are incompatible with the non-discrimination clauses contained in most Russian double tax treaties.



However, the Naryanmarneftgaz case has cast doubt on financing via a foreign group company, finding that an intra-group loan made to Naryanmarneftgaz (a Russian company) by a foreign group company was, despite appearances, instead a loan from the company's foreign shareholder, ConocoPhillips.

In addition, in the case of Severny Kuzbass heard by the Russian Supreme Arbitrazh Court the tax authorities argued that interest on controlled indebtedness is not deductible for tax purposes. Ruling in their favour, the court found, contrary to previous practice, that "non-discrimination" clauses in double tax treaties do not overrule Russian thin capitalisation rules.

We consider the two cases more fully in our [Briefing Note](#) published in November 2011.

### Taxation of Eurobonds

The Finance Ministry announced at the end of 2011 that off-shore SPVs used to issue Eurobonds would not qualify as beneficial owners of the interest paid under the bonds. Russian borrowers would be obliged to pay a 20% withholding tax on any interest paid to the SPV unless they could demonstrate that the ultimate bondholders were residents of a jurisdiction with a double tax treaty with Russia under which they were exempt Russian withholding tax (please see our client briefing "[Beneficial Ownership in the Context of Eurobond Transaction: New Reality?](#)"). It was proposed that the changes should have retrospective effect from 2008.

The announcement marked a significant change in approach and caused significant uncertainty in the market in relation to the taxation of future issuances, and calls for a re-assessment of the policy from issuers as well as underwriters led to consultations between the Finance Ministry and market

participants. These consultations culminated in an announcement on 20 February that the proposals would be amended to allow withholding tax in Eurobonds to be avoided subject to certain technical conditions being met.

We elaborate on this matter in our [Briefing Note](#).

### Taxation of Interest on Russian Listed Bonds

Amendments to the securities market law and the introduction of a common depositary concept into Russian law have led to certain changes in the tax regime for income from Russian domestic bonds. Thus, in respect of bonds kept with a common depositary, the depositary will now act as a tax agent and withhold Russian corporate income tax from amounts payable to foreign bondholders and personal income tax.

### Capital Gains Tax Exemption

Russia has recently introduced a number of exemptions in respect of capital gains tax on a transfer of shares in Russian companies.

The first exemption is available both to individuals and legal entities and applies to transfers of shares (or participatory interests in LLCs) acquired after 1 January 2011 and held for at least 5 years provided that such shares:

- were not traded on a stock exchange upon acquisition or during the 5-year period; or
- were traded on a stock exchange during the 5-year period and are recognised as shares in companies operating in the advanced technology (innovation) field; or
- become traded on a stock exchange and recognised as shares in

companies operating in the advanced technology (innovation) field upon their further sale after the 5-year period.

Under the second exemption, capital gains upon a disposal by a foreign company of shares in so-called Russian real estate-rich companies (i.e. companies more than 50% of whose assets comprise real estate located in Russia) will not be subject to Russian withholding tax, provided such shares are traded on a stock exchange. Together with the obvious benefits for developers, this exemption also gives comfort to foreign investors trading Russian blue chips.

### New Transfer Pricing Regulations and Fiscal Unity Rules

On 1 January 2012, a new section of the Russian Tax Code dealing with transfer pricing in transactions between related parties came into force, replacing existing regulations.

Going further than the previous regulation, the new rules broaden the list of controlled transactions and circumstances in which parties are treated as related.

Comprehensive rules are set out in the revised Tax Code for determining whether prices used in controlled transactions comply with market prices, and the new rules limit and prohibit the use of transfer prices as means for reducing tax payable.

Under the new rules, a taxpayer is obliged to notify the tax authorities of any controlled transactions as well as to submit to the tax authorities, on demand, documents and information relating to the calculation of the price for a controlled transaction. Penalties may be imposed by the tax authorities for failure to pay the correct amount of tax arising from a controlled transaction, failure to notify the tax authorities of a controlled transaction and making notifications containing false information.

Rules introducing a concept of “fiscal unity” to the Tax Code also came into force on 1 January 2012. The rules allow members of a “consolidated group” of taxpayers to account for corporate income tax on an aggregate basis and to avoid the transfer pricing rules in relation to intra-group transactions, subject to certain exceptions.

A “consolidated group” of taxpayers is a group meeting the following criteria:

- one member of the group directly or indirectly participates in the capital of another member for at least 90%;
- the aggregate amount of assets as of 31 December in the year prior to the creation of the group is not less than RUB 300 billion (USD 10,26 billion) under the Russian Accounting Standards;
- the aggregate amount of VAT, excises, corporate income tax and mineral extraction tax (save for taxes payable upon export/import of goods) paid by the members in the year prior to creation of the consolidated group is not less than RUB 10 billion (USD 342 million); and
- the aggregate amount of sales revenues for the year prior to creation of the consolidated group is not less than RUB 100 billion (USD 3,4 billion) under the Russian Accounting Standards.

#### **Employment taxes: Social insurance contributions**

As of 2012, the general rate of social insurance contributions (which are paid in respect of the capped annual payroll of RUB 512 000) was reduced from 34% to 30%. At the same time, the overall level of contributions was increased due to the introduction of a new 10% contribution payable on the payroll in the excess of the capped amount.

Social insurance contributions are payable in respect of Russian citizens as well as foreign citizens who reside in Russia permanently or temporarily (i.e., those who have residence permit or permission to temporarily reside) excluding foreign citizens recognised as “highly qualified personnel”. Payments to foreign citizens that are temporarily staying in Russia and work on the basis of visa and work permits are exempt from social insurance contributions.

#### **Double Tax Treaties: Update**

##### **Luxembourg**

On 21 November 2011, Luxembourg and Russia signed an amendment to the 28 June 1993 double tax treaty (the “**Luxembourg Tax Treaty**”). The amendments came into force on 1 January 2012 and include the following key changes:

- Dividends: Withholding tax on dividends is reduced from 10% to 5%, and now applies to ownership interests meeting the minimum threshold of 10% participation and EUR 80,000 (lowering the earlier threshold of 30% participation and EUR 75,000).
- New regime for taxation of Undertakings for Collective Investment (UCIs):



- Income derived from units in Russian UCIs that invest in Russian real estate becomes subject to real estate income tax treatment in Russia.
- Income from UCI units (other than Russian real estate UCI units) is treated as a dividend.
- Capital Gains: Gains realised upon the disposal of shares deriving, directly or indirectly, more than 50% of their income from real estate will be taxed in the country (Russia or Luxembourg) where the real estate is located. The rule on capital gains does not apply to listed shares, company reorganisations or to gains realised by pension funds or governments.
- Other Income: Any income not otherwise specifically dealt with in the Treaty that is sourced or derived from one country will be taxable in that country. In addition, Luxembourg residents will now receive a tax credit for Russian tax paid.

Our **Briefing Note** published in December 2011 provides more detailed information about the amendments to the Luxembourg Tax Treaty.

##### **Switzerland**

On 24 September 2011, Switzerland and Russia signed a Protocol which amends the 15 November 1995 double tax treaty. The Protocol is subject to ratification by both countries and provides for the following key changes:

- Interest: the current withholding tax on interest is abolished (the current levels are 10% for corporate and 5% for banking loans). Once the Protocol is effective, interest will not be taxed

## Russian Law Focus: The Strategic Investment Law

- *The Russian Law Focus* column in each new issue of our **Russia Update** will focus on a selected area of Russian law or regulation. The choice of themes will not necessarily be linked to the news of the relevant quarter but rather provide a general overview on a particular legal matter that we are frequently asked to advise on.
- The Foreign Investments Control Regime (the “**Regime**”) was introduced in May 2008 setting out a procedure for prior control of foreign investments in sectors of strategic importance for national security and state defence.
- The Regime extends to Russian companies involved in any of 42 categories of “strategic activities”, e.g. the exploitation of major subsoil plots, TV and radio broadcasting, encryption, printing and publishing, and natural monopolies (airports, ports). A company holding licences or permits for these activities but which does not actually perform them may also be considered strategic for the purposes of the Regime.
- The acquisition of a certain level of control (usually over 50%) over strategic companies by a foreign investor requires prior clearance by a Government Committee chaired by the Prime Minister. The clearance process is complex and usually takes from three to six months. The review process is coordinated by FAS which consults the Federal Security Service, the Ministry of Defence and, in some cases, the relevant sector regulators.
- Special rules apply to acquisitions in the subsoil sector (e.g. the level of control at which the clearance requirement is triggered is 25%) and those made by a foreign public investor (e.g., generally, a foreign public investor cannot exercise sole control over a strategic company).
- Sanctions for failure to comply with the Regime are very serious. Transactions entered into without clearance are null and void and attract the usual consequences of invalidity under the general law including an obligation on each party to return to the other property or money transferred under the transaction.

In the event that such civil sanctions cannot be applied for any reason, the Russian courts may strip the relevant shares of all voting and quorum rights. The courts can also declare any decisions made by shareholders and management bodies of the relevant strategic company following the transaction null and void. Furthermore, the infringing company and its officers can be held administratively liable as well as liable to fines.

See also our update on the recent amendments to the Strategic Investment Law described on [page 5](#) above.

provided that the recipient is a beneficial owner of such income.

- Capital gains: capital gains on a disposal of shares in companies whose assets mostly consist, directly or indirectly, of immovable property are now taxable in the country where such immovable property is located. Capital gains are however exempt from tax if:

- The shares are listed on a stock exchange; or
- Where a real-estate rich company uses real estate to carry on business.

- The Protocol now explicitly provides that payments on units in real estate investment funds or mutual investment funds deriving more than 50% of their income from shares are considered as dividends. Payments on units in mutual investment funds deriving less than 50% of their income from shares are considered as interest.

- Exchange of information and anti-conduit provisions are introduced to the Treaty

In light of the recent court practice in relation to the Russian thin capitalisation rules (please refer to section *Re-thinking Thin Cap* above) it is worth mentioning that in relation to Articles 10 (Dividends)

and 11 (Interest) of the Treaty the Protocol allows for the application of domestic thin capitalisation rules.

### Cyprus

The Protocol to the Russia-Cyprus Double Tax Treaty, which was signed on 7 October 2010, has been finally ratified by the Russian Parliament on 15 February 2012 (Cyprus had previously ratified the Protocol). Most of its provisions are due to come into force in 2013, while those provisions relating to the taxation of capital gains will not come into force until 2017.

Like the Swiss Protocol, the Protocol to the Russia-Cyprus Double Tax Treaty allows for the application of domestic thin capitalisation rules.



Our **Briefing Note** published in April 2009 provides detailed information about the amendments made by the Protocol to the Cyprus Tax Treaty.

### **Chile**

The Russia-Chile Double Tax Treaty, which was signed on 19 November 2004, has been finally ratified by the Russian Parliament.

The Treaty is similar to the OECD Model Tax Convention, and provides for reduced tax rates for dividends (5% and 10%) and royalties (5% and 10%), and a 15% tax rate on interest. Capital gains from financial instruments as well as other income not mentioned in the Treaty is subject to taxation in the country of origin.

### **United Arab Emirates**

Russia and the United Arab Emirates signed a tax treaty on 7 December 2011.

The Treaty is not based on the OECD Model Tax Convention. It excludes dividends, interest and capital gains (except those derived from disposals of real estate and shares in real estate-rich companies) from taxation at source. Other income is subject to taxation in the country of origin. The Treaty will apply only to investments made on behalf of the state and fully state-owned investment vehicles.

## **Sector Update**

The *Sector Update* looks at certain key deals and other developments in the sectors most relevant to the Russian market.

### **Energy, Metals and Mining**

#### **Announced Deals**

- Russian oil giant Rosneft and independent natural gas producer Itera signed a strategic agreement to jointly develop gas fields in Russia. The two companies will set up a joint venture to manage the gas assets of

Itera and Rosneft in the gas-rich Yamalo-Nenets autonomous region in Russia's Arctic. (March 2012)

- VTB Bank OAO bought a 20% stake in Metalloinvest, the iron ore miner part owned by Alisher Usmanov. The deal was valued at about \$2.5 billion. The stake was bought from Vasily Anisimov's Coalco Metals, which will use the proceeds to repay a US\$1.5 billion loan to VTB made in 2008. (December 2011)

- UC RUSAL completed its US\$4.75 billion syndicated pre-export refinancing of the international financial indebtedness. The deal has been named a Trade Finance Deal of the Year. (November 2011)

- SUEK, the Russian coal company, acquired 24.91% ordinary shares (18.68% stake) in Murmansk Commercial Seaport (MMTP). The value of the deal was about US\$100 million. (February 2012)

- Following the acquisition of the rolling business of Steel Invest and Finance (formerly a joint venture between NLMK and Duferco Group) in July 2011 – one of the largest deals in the sector – NLMK announced the creation of its new business divisions – NLMK Europe and NLMK USA. (August 2011)

- Russia's state-owned oil company Rosneft teamed up with the U.S. corporation ExxonMobil in a multibillion-dollar deal to develop offshore oil fields in the Russian Arctic – one of the last regions with large and untapped hydrocarbon deposits – in return for access to resources in the Gulf of Mexico. The partnership agreement relating to development of the Arctic's untapped reserves was signed in April 2012. (August 2011, April 2012)

### **Sector News**

- The Russian government has announced its intention to sell its stake in OJSC Apatit, one of the world's largest producers of apatite and nephelitic concentrates, in a privatisation auction at the starting price of RUB10.5 billion. The government currently owns 26.6% of Apatit's ordinary shares, or around 20% of its total charter capital. Some parties, including Russia's leading mineral fertilizer producer PhosAgro, have already filed their bids. (April-May 2012)
- The supervisory board at OJSC Alrosa approved the privatisation of 14% of the diamond miner's shares. (March 2012)
- A potential merger between Russian gold miners Polyus and Polymetal has been quashed, following resistance from shareholders. The deal, which would have created an entity controlling more than a quarter of Russia's gold production, was rejected by shareholders of both companies in February 2012. (February 2012)
- World number one nickel and palladium producer Norilsk Nickel is investing heavily in new and existing mines. The Russian mining conglomerate announced in December 2011 it plans to spend US\$10.9 billion to expand its mineral resource base including development of existing mining assets and construction and commissioning of new mines. It will also spend US\$632 million to explore the Norilsk and Murmansk regions until 2025. (December 2011)
- In November 2011, operations began to lay the first of two pipelines, comprising the important Nord Stream project which will transport natural gas from Russia to Europe under the Black Sea. The project is considered vital to future energy security for Europe. (November 2011)

## Transport and Infrastructure

### Announced Deals

- Globaltrans completed the acquisition of 100% of LLC Metalloinvesttrans, the captive freight rail transportation operator of Metalloinvest, a leading global iron ore and HBI producer based in Russia. The acquisition, for USD 540 million on a cash and debt free basis, includes a three-year contract to provide freight rail transportation and logistics services to Metalloinvest.
- FESCO transportation group has selected Neftetransservice as the winning bidder for the sale of railway operator LLC Transgarant. FESCO will only sell the non-container transport division of Transgarant. The deal is scheduled to be completed in the second quarter of 2012.

### Sector News

- Russian Railways (RZhD) expects to privatise various subsidiaries in 2012, including Vagonremmash, Zheldorremmash, BetEITrans, RZDstroy, Pervaya Nerudnaya Company, as well as 25% of its 50% stake in Central Suburban Railway Company. (March 2012)
- The Russian government will channel at least RUR400 billion (US\$13 billion) from federal resources into the development of shipping in the next 10 years. In November 2011, former Russian President Dmitry Medvedev signed a federal law that offers tax breaks and other incentives to domestic shipbuilding and shipping companies to stimulate their development. Russian shipyards will be exempt from land and property tax for 10 years while ship owners will also be tax-exempt from profits received from the operation or sale of



Russian-built vessels. The new law will also exempt domestic shipbuilding and shipping companies from insurance payments to Russia's Pension, Social Insurance and Compulsory Medical Insurance Funds. (November 2011)

## Financial Services

### Announced Deals

- VTB, Russia's second largest bank, completed a buy-back of its publicly listed shares for a total of ca. 11 bln Roubles. VTB acquired about 83.3 billion shares (ca. 0.008% of its share capital) from minority shareholders. (April 2012)
- Sberbank acquired 100% of Volksbank International (VBI), an Eastern European subsidiary of Austria's Oesterreichische Volksbanken AG banking group, for €505 million in order to further expand into Europe. (February 2012)

- Sberbank and Troika Dialog completed their merger, creating the largest universal banking institution in the Russian Federation. The businesses of Troika Dialog will be integrated into new business divisions of Sberbank focused on Corporate Investment Banking and Wealth Management (including asset management and private banking). The Troika Dialog brand will cease to be used once the merger is fully implemented. (January 2012)
- In December 2011 MICEX and RTS finalised their merger creating the new MICEX-RTS. The deal, estimated at US\$1 billion, is aimed at establishing an integrated exchange and developing Moscow as an international financial centre. (December 2011)
- EBRD and Russian Direct Investment Fund (RDIF), a US\$10 billion investment fund, acquired stakes of 6.29% and 1.25%, respectively, in MICEX-RTS, the recently merged Russian stock-exchange. (February-March 2012)
- VTB increased its stake in Bank of Moscow to 80.57% (from 46.48%) paying about US\$3.4 billion. The additional share issue is part of a broader state bailout plan to shore up Bank of Moscow, where almost half of its loan book was found to be doubtful after VTB took over control of the bank earlier in 2011. (October 2011)

### Sector News

- The Central Bank, Sberbank's controlling shareholder, is planning the sale of a 7.6% stake in Sberbank. However on 16 March Sberbank Chief Executive German Gref announced the bank is not currently planning to conduct an SPO (secondary public offering), as market conditions at



present are unfavourable. According to Gref, the SPO could happen in the first half or in the second half of this year. (March 2012)

- Barclays Bank disposed of its high street assets despite having invested heavily into the Russian business. Barclays sold its banking operations in Russia to banker Igor Kim (who intends to restore the lender's former name of Expobank), while retaining its presence in the investment market. (October 2011)

## Real Estate

### Announced Deals

- One of the landmark transactions in the Russian real estate market was the sale of Lesnaya Plaza, a Class A office building, by VTB Capital to O1 Properties. The acquisition was financed by a mezzanine facility made available to the buyer by VTB Capital. (January 2012)

- The largest real estate deal in 2011 was the purchase by Morgan Stanley of the 191,000 square meters Galleria shopping centre in St. Petersburg in December, for an estimated US\$1.1 billion. The bank's Morgan Stanley Real Estate Fund VII purchased the Galleria Mall from Meridian Capital CIS Fund, a private investment fund backed by a group of Kazakh investors. (December 2011)

### Sector News

- Last year saw record investment volumes into Russian commercial real estate with growth of over 200% above the level reached in 2010 (according to the latest research by CBRE). There were 43 investment deals last year compared to 27 investment deals in 2010 and 50 deals closed in the record 2008. Investment rose to €4.55 billion and the average deal size was approximately €105.6 million.

## Technology, Media and Communications

### Announced Deals

- VimpelCom, one of Russia's top three cell phone operators, closed a \$6.5 billion merger deal with Wind Telecom, owned by Egyptian billionaire Naguib Sawiris. The combination of Vimpelcom and Wind Telecom creates one of the world's largest mobile telecoms provider in terms of subscribers, with operations in 20 countries. The deal will cut the share of Norway's Telenor, a VimpelCom shareholder, which opposed the merger, to 25% of the voting stock from the current 36.03%, and the share of Altimio, the telecoms arm of Russian billionaire

Mikhail Fridman's Alfa Group, to 31% from 44.65%. (April 2012)

### Sector News

- Russian billionaire Alexander Mamut may sell his 50.01% stake in Euroset, the country's largest mobile phone retailer, to mobile phone operator MegaFon and the country's long-distance operator Rostelecom. The deal is likely to be completed within two or three months. (March 2012)
- After years of intense corporate disputes, shareholders of MegaFon, one of the three largest Russian mobile phone network operators, seem to have reached a solution. Together with an agreement on payment of dividends, it has been decided that AF Telecom (controlled by Mr Alisher Usmanov) will get majority control in MegaFon, Altimio (Alfa Group's telecoms arm) will exit and Sweden's TeliaSonera will reduce its ownership whilst keeping a long term strategic ownership. Also, MegaFon may be going public in 2012, seeking to raise ca. \$4bn (April 2012)

## Consumer Goods and Retail

### Announced Deals

- On 20 June 2011 DIXY Group, one of Russia's leading retailers of foods and everyday products, announced the completion of a deal to acquire 100% of the shares of its market competitor – Victoria Group. The deal was valued at RUR25.6 billion, including Victoria Group's financial debt, cash and cash equivalents. As a result of this transaction, the DIXY Group increased turnover by more than 50%. (June 2011)



- Russia's largest sparkling wine producer Abrau Durso has gone public placing a 10% stake on the Russian MICEX-RTS (April 2012)

## Forthcoming Events

This summer there will be a number of investor conferences and other sector-specific events in Russia, including:

- Russia & CIS Airfinance Conference - the biggest event dedicated to aircraft finance in Russia and CIS (28 - 29 June 2012, Moscow)
- Russian Ports (26 - 27 June 2012, St. Petersburg)
- St. Petersburg International Economic Forum (21 - 23 June 2012, St. Petersburg)
- Antitrust Regulation and Competition Law in Russia (20 - 21 June 2012, Moscow)
- Preventing Fraud: Latest Strategies (18 - 19 June 2012, Moscow)
- Project Finance 2012 in Russia and CIS (14 - 15 June 2012, Moscow)
- Annual Russian Securities Forum (6 - 7 June 2012, Moscow)
- All Russia Tax Congress (31 May - 1 June 2012, Moscow)
- Russian Real Estate Summit (30 May - 1 June 2012, Moscow)
- Business Forum "1520 Strategic Partnership" - the biggest event dedicated to railway transport in Russia (30 May - 1 June 2012, Sochi)
- Aircraft Finance in Russia (31 May 2012, Moscow) - annual event held by Clifford Chance
- World Leasing Convention (29 - 30 May 2012, St. Petersburg)
- Tax Strategy in Russia (29 May 2012, Moscow)
- Russian Power (24 - 25 May 2012, Moscow)
- Syndicated Loans Russia & CIS Conference (24 - 25 May 2012, Moscow)
- CIS Coal Summit (22 - 24 May 2012, Moscow)
- Russian Pharmaceutical Forum (22 - 24 May 2012, Moscow)

## CC Moscow Update: News and People

### Clifford Chance celebrates 20 years in the Russian Federation

In the Autumn 2011, Clifford Chance celebrated the 20th anniversary of its operations in Russia. Reflecting on the firm's 20 years in Russia, Jan ter Haar (Managing Partner, Moscow Office) comments: "Our anniversary is a very special celebration for our entire team and it allows us to thank our clients for the part they have played in our success. When we opened our office in Moscow in 1991 we did so with a small group of lawyers and the ambition to become a major player in the Russian legal market. Today, we have a team of almost 100 lawyers and one of the most well-known law practices in

Russia. Our evolution has gone hand in hand with the changes happening in Russia. We have witnessed how the Russian economy opened its doors to the rest of the world. Being able to participate in this process has been, and continues to be, an exceptional opportunity for all of us at Clifford Chance and we thank our clients for making that possible."

### Clifford Chance triumphs at IFLR Europe Awards 2012

We are proud to announce that the following awards have recently been received by Clifford Chance Moscow such as:

- 'Russian Law Firm of the Year' by IFLR Europe Awards in 2012
- 'International Law Firm of the Year' by IFLR Europe Awards in 2012
- CRE Award 2012 for The Best Investment Transaction of the Year: acquisition of the Galeria Shopping Centre in St Petersburg
- 'Structured Finance and Securitisation Team of the Year' by IFLR Europe Awards in 2012
- 'Restructuring Team of the Year' by IFLR Europe Awards in 2012
- IFLR Europe Award 2012 for the Project Finance Deal of the Year: Nord Stream pipeline: Phase II
- Trade Finance Magazine Deals of the Year 2011: UC RUSAL, Uralkali, TANECO

### People and Promotions

Effective 1 May 2012, Alexander Anichkin is promoted to Partner at Clifford Chance Moscow. Alexander joined the firm in

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1999 and has since gained extensive experience focusing on Tax and Regulatory matters but also actively participating in our Banking, Corporate and Capital Markets deals.

We are also very proud to announce that effective 1 May 2012, Adam Fadian (Banking & Finance), Alexei Konovalov (Corporate), Julia Popelysheva (Litigation & Dispute Resolution) and Evgeny Soloviev (Capital Markets) are promoted to Counsel at Clifford Chance Moscow.

Julian Traill joined Clifford Chance Moscow as Counsel in March 2012. Julian is an experienced M&A lawyer, having practised corporate law with Freshfields, Bruckhaus & Deringer in London (2004-7) and Moscow (2007-12). He began his career with Minter Ellison in Australia. We are delighted to welcome Julian to our corporate group.