

The Russian Federation (Russia) is the world's largest country in terms of territory, with a consumer market of over 140 million people, vast natural resources, a highly educated workforce and technologically advanced research and production capabilities. The majority of investors surveyed believe that Russia's accession to the World Trade Organization (WTO) in July 2012, the formation of the Common Economic Space with Belarus and Kazakhstan, and a likely Eurasian Economic Union by 2015, will have a positive impact on Russia's attractiveness.

Dmitry Medvedev, Prime Minister of the Russian Federation says "We are going forward in all spheres: in the economy, in the implementation of large projects, in innovations and in humanitarian cooperation."

However, there are a number of issues which you must consider when you are looking to set up your business in Russia. This document takes you through some of the common questions we come across and gives you practical information about the issues you need to consider.

What type of Business Structure should we use?

There are advantages and disadvantages to all of them, and there is no one correct answer, it's all dependent on your specific business circumstances and needs. A brief overview of the main structures is below:

Establishment (a branch of your overseas business)

- Not a separate legal entity but an extension of the overseas parent company
- Can perform all or part of the parent company's functions, including (but not limited to) representation
- Because of the wide scope of their powers, branches are considered to engage in commercial activities for taxation purposes and are thus subject to profits tax
- Must file an annual report on the foreign entity's activities as well as a tax return

Open joint stock company — OJSC

- An unlimited number of shareholders
- Shares may be openly traded
- The minimum charter capital is set at RUB 100,000 (approximately USD 3,050)
- The shareholders are not liable for its obligations and accept the risks of losses within the limit of their respective stakes
- Have to file accounts for public view
- Accounts require auditing

Closed joint stock company — CJSC

- Limited to a maximum of 50 shareholders
- Shares are only distributed among its founders or another predetermined group of persons
- May not conduct an open subscription of shares to an unlimited group of persons
- The minimum charter capital may not be less than RUB 10,000 (approximately USD 310)
- Shareholders enjoy pre-emptive rights over any shares offered for sale by a withdrawing shareholder
- No obligation for accounts to be published
- Accounts require auditing if Revenues > RUB 400 m p/a (around USD 13 m) or Gross Assets > RUB 60 m (around USD 2 m)

Limited liability company — LLC

- Does not issue shares
- "Participants" contribute to its charter capital, financing is also possible in the form of contributions to the company's property
- The equity participation of the owners is determined by their capital contribution
- The minimum charter capital may not be less than RUB 10,000 (approximately USD 310)
- The number of participants may not exceed 50
- No obligation for accounts to be published
- Accounts require auditing if Revenues > RUB 400 m p/a (around USD 13 m) or Gross Assets > RUB 60 m (around USD 2 m)

Partnership:

- Minimum 2 partners
- Two types: a full partnership (the partners bear full liability for the partnership's obligations; a participant in a full partnership may not be a full partner in any other partnership) and a limited partnership (has both full partners and partners whose liability is limited to their contributions; a full partner in a limited partnership may not be a full partner in another partnership, and its liability is the same as for full partners as described above)

How much Corporation Tax will the business pay?

Current Corporation Tax rate in Russia is 20%. Taxable profit is calculated as income minus expenses.

(NB: rates are for the tax year to 31/12/2014)

Foreign legal entities (FLE) are liable for profits tax on their business income only if their business activities create a permanent establishment (PE). The Tax Code defines the term "permanent establishment" as a branch ("filial"), representative office, division, bureau,

office, agency or any other separate fixed place of activity, through which a foreign company regularly engages in business activities in Russia (the term is used exclusively for tax purposes and does not affect the legal status of an entity). Russia’s various double tax treaties (DTTs) may define a PE differently. Conducting business through an agent also may create a taxable PE in Russia. If no PE exists, foreign entities are exempt from Russian profits tax. An FLE receiving income from a source in Russia not connected with the activities of a PE is subject to withholding tax (at rates varying between 10% and 20%, depending on the type of income and the method used for calculations).

What if we use Russia to set up our holding company?

Tax rates for dividend income are:

0%	dividends payable to a Russian Legal Entity (RLE) if this RLE owns at least 50 percent of shares in the dividend payer for 365 consecutive days provided that the dividend payer is not a resident of an off-shore country (e.g., BVI, Guernsey, Jersey, Cyprus, or any other state indicated in the list established by the Ministry of Finance of the Russian Federation)
9%	for dividends received by an RLE from an RLE or FLE
15%	for dividends payable to an FLE by an RLE

What if we make cross-border transactions between group companies?

After many years of discussion, new transfer pricing rules came into effect in 2012. The new rules are substantially based on the OECD Transfer Pricing Guidelines.

The permitted transfer pricing methods are based upon the following:

- Comparable uncontrolled price
- Resale-minus
- Cost-plus
- Comparable profitability
- Profit-split

The law stipulates detailed guidelines on how to apply each method. The application of two or more methods combined is also permitted.

Transfer pricing controls may be applied to a single transaction or to a group of similar transactions belonging to the following types:

Cross-border transactions

- with related parties, including supply arrangements with third-party intermediaries
- with goods traded on commodity markets, e.g. crude oil or metals (the list of such goods is published by the Ministry of Industry and Trade, and those with offshore residents of certain “low tax” jurisdictions, if the transaction amount exceeds RUB 60 m (approximately USD 2 m). The parties in this case do not need to be related.

Domestic related party transactions

- if the transactions between two related parties in 2013 exceed RUB 2 b (approximately USD 66.6 m; with the threshold decreasing to RUB RUB 1 b from 2014)
- if the transactions between two related parties in a calendar year exceed RUB 60 m and one of the following applies:
 - Mineral Extraction Tax is being paid at the ad valorem rate by one of the parties
 - one of the parties is exempt from, or pays profits tax at a rate of 0%
 - one of the parties is a resident of a special economic zone
- if transactions between two related parties in a calendar year exceed RUB 100 m (approximately USD 3.3 m) in value and one of the parties pays unified tax on imputed income or unified agricultural tax

Transfer pricing rules do not apply to transactions between companies that are members of a consolidated group of taxpayers.

Transfer Pricing Documentation

Companies must retain specific transfer pricing documentation if the total amount of revenue from all controlled transactions with the same counterparty in 2013 exceed RUB 80 m (approximately USD 2.6 m, no limitation applies from 2014). Furthermore, such companies must file a notification with the tax authorities concerning their controlled transactions during a calendar year no later than the 20 May of the following year. All documentation should be prepared in Russian.

What Employment Taxes and Social Security will need to be paid?

Both Russian tax resident and non-resident individuals are subject to Russian income tax. Neither the individual’s domicile nor citizenship is relevant. Russian tax residency is established if an individual is physically present in Russia for at least 183 calendar days during a 12-month rolling period. This 12-month period is not interrupted by brief trips outside Russia (i.e. lasting less than six months) for the purposes of medical treatment or study. A final determination of an individual's tax residency status is made based on whether 183 or more days have been spent in Russia in the calendar year.

Current Personal Income Tax rates in Russia are:

Russian tax residents:

13% rate	most types of income
9% rate	dividends received from Russian or foreign corporations
35% rate	certain prizes, interest that exceeds specific limits on bank deposits, and income deemed to be received from low-interest loans (except loans used to acquire real estate)

Non-residents:

30% rate	all types of Russian-sourced income
15% rate	dividends paid by Russian organisations

Highly-qualified specialists are eligible for the standard personal income tax rate of 13% on remuneration from their employment even before they become Russian tax residents.

(NB: rates are for the tax year to 31/12/2014)

Social contributions are payable in respect of individuals engaged under employment or civil contracts, to the following three funds:

- State Pension Fund
- Social Insurance Fund
- Federal Obligatory Medical Insurance Fund

The obligation to pay insurance contributions falls wholly on the employer, irrespective of an individual's tax status.

Current Social Security rates are:

Band of income (RUB)	Rate (%)
Up to 624,000 RUB (approximately USD 18,350) per employee	30%
Over 624,000 RUB (approximately USD 18,350) per employee	Additional 10%

NB: (rates are for the tax year to 31/12/2014)

From 1 January 2012, Russian employers (including foreign companies with a registered presence in Russia) are required to pay pension contributions, including the additional 10%, for remuneration paid to foreign employees who are temporarily staying in Russia and working under an employment contract concluded for more than 6 months. Nevertheless, foreign employees are not eligible to claim any pension or other payment (for example, on leaving Russia) relating to contributions paid.

Foreign employees working in Russia on the basis of a Highly-Qualified Specialist work permit are excluded from the requirement to make pension contributions.

What is Value Added Tax (VAT) and should the business be registered?

VAT is a "goods and services tax" on supplies made, the standard rate of which is 18% (with a lower rate of 10% applicable for certain basic foodstuffs, children's clothing, medicines and medical products, printed publications, etc. and a 0% rate applicable for the sale of goods exported outside the Russian Federation).

There is no separate VAT registration in Russia. When foreign companies with a presence in Russia register with the Russian tax authorities, they register for all taxes, including VAT.

Taxpayers follow a "classical" input-output VAT system, whereby the VAT payer generally accounts for VAT on the full sales price of the transaction and is entitled to recover input

VAT incurred on inventory costs and other related business expenses.

Can we provide Share option plans to our staff?

Many companies see Share Option plans as being an important way of attracting, motivating and retaining key staff.

However this is a very technically complex area and careful planning needs to be undertaken.

The process of setting up an incentive scheme in the form of a share-option plan in Russia brings to light certain difficulties relating to Russian securities regulation. As a matter of practice, share-option plans in Russia are structured through the acquisition of foreign securities. However, Russian law prevents offering foreign securities (unless they are listed in Russia) to non-qualified investors, which employees generally are.

A further difficulty is that Russian labour law does not recognize share-option plans. As a result, share-option plans are usually deemed to constitute bonus payments. This leads to the imposition of certain restrictions upon payments made pursuant to share-option plans.

How else can we compensate our employees?

Russia has a very comprehensive range of compensation and benefit options available for companies to offer their employees.

Pensions, private medical insurance, life and disability cover are now commonplace benefits provided by many Russian businesses to their workforce.

To discuss your requirements please contact the International Office on +44 (0) 1245 449266 or [email](#) us directly.

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Setting up your Business in Russia

Issues to consider



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