

Doing Business in Russia

2008



Contents

1. Introduction.....	2
2. Business environment.....	4
3. Foreign investment.....	11
4. Setting up a Business.....	13
5. Labour	20
6. Taxation.....	23
7. Accounting & reporting.....	30
8. UHY firms in Russia.....	32
9. UHY offices worldwide	33

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:

Nikolay Litvinov
UHY YANS-Audit LLC
2-y Volkonsky per., d.3
Moscow, RUS-127473
Russian Federation
Tel: +7 495 925-5751
Email: n.litvinov@uhy-yans.ru
Web: www.uhy-yans.ru

Vladimir Petrenko
UHY Eccona LLP
Shaumyana pr., h.18, office 310
St. Petersburg, RUS-195112
Russian Federation
Tel: +7 812 622 12 13
Email: petrvlad@sp.ru
Web: www.eccona.spb.ru

Alexander Tildikov
UHY Atomic Audit
Narx Street 14
Obninsk, RUS- 249035
Russian Federation
Tel: +7 484 3940440
Email: tildikov@obninsk.com
Web: www.uhy-atomic.ru

You are welcome to contact any of these firms directly for any inquiries you may have.



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 August 2008.

We look forward to helping you do business in Russia

UHY YANS-Audit LLC, UHY Eicona LLP and UHY Atomic Audit are members of UHY, an international association of independent accounting and consultancy firms, whose organising body is Urbach Hacker Young International Limited, a UK company. Each member of UHY is a separate and independent firm. Services described herein are provided by UHY YANS-Audit LLC, UHY Eicona LLP, UHY Atomic Audit and their subsidiaries and not by Urbach Hacker Young International Limited or any other member of UHY. Neither Urbach Hacker Young International Limited nor any member of UHY has any liability for services provided by other members.

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, 6 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 recognized 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: 141 888 900 (as of June 1st, 2008)

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** in January – June, 2008, grew by 8.0% vs. the corresponding period of 2007.

Per capita GDP (PPP) is estimated to have reached \$14,700 (2007 est.).

Reserves of foreign exchange and gold: USD 568.286 billion (as of July 1st, 2008).

National debt- external: USD 41.0 billion (as of June 1st, 2008).

Economic structure

According to the Federal State Statistics Service of the Russian Federation, the service sector (trade, transport, restaurants, hotels, communication, financial activities, real estate operations, government management, security service, education, public health, and other services) was predominating and amounted to 58% of GDP. The non-production sphere also provides 60.9% of employment.

In 2007, the production sphere provided 43% of GDP, including agriculture - 4.4%; mining industry - 10.1%; manufacturing industry - 18.5%; construction - 5.7%.

The Russian economy still remains very dependent on energy and other extractive sectors, such as timber, precious metals, non-ferrous metals and

steel, despite the Russian government's efforts to change the situation including implementation of government programmes on support of hi-tech industries.

Other specific feature of the Russian Government's economic policy is its determination to strengthen the state control, both direct and indirect, over the economy, first of all in strategic sectors such as energy, aluminium, steel, automotive, machine tools and aerospace.

Production

Russia's industrial production grew by 5.8% for the period January – June 2008, compared to 7.1% for the corresponding period of 2007. Analysis of the sectoral behaviour for the year 2007 and the beginning of the year 2008 displays restoration of cumulative influence of such traditionally significant industries as machine building, construction materials producing, food industry on the general behaviour of production against the backdrop of decreasing influence of fuel and energy sector on economic (although it undoubtedly remains very high). The key contribution into dynamics of productivity progress was made by manufacturing activity. As of the first six months of 2008, growth in manufacturing activity was 8.4%, in primary sector - 0.6%. Output of the construction materials with decrease of machinery and equipment production is marked by the maximum growth in comparison with the corresponding period of 2007.

Construction industry boom, which had been observed for a number of years, demonstrates some deceleration first of all in Moscow and St. Petersburg. However, construction companies actively develop their expansion into regions.

Consumer market

Consumer market is continuing its significant influence on general economic behaviour. For the period of the year 2007, trade provided 20.2% of GDP, surpassing the rest of the types of economic activities.

According to data for the first and the second quarters of 2008, retail trade turnover increased in all federal districts and in almost all constituent entities of the Russian Federation. Moreover, according to data for the first quarter of 2008, growth behaviour also surpassed the data of 2007.

At the same time, regional structure of the Russian retail trade turnover is highly erratic. Seven constituent entities of the Russian Federation account for 43.4% of total retail trade turnover, including Moscow (19.9%).

Personal income

In June 2008, cash earnings (per capita in average) amounted to 15552 roubles (124.9% of the data of June 2007; actual disposable cash income

had grown by 6.6% for this period), monthly average nominal wage amounted to 17808 roubles, (nominally - 128.6% of data of June 2007; actually (taking inflation into account) - 111.7%).

High inflation in the end of 2007 and the beginning of 2008 as well as intensive growth of consumer expenditures discouraged the citizens from money saving. Only 4.9% of monetary incomes for savings in the form of deposit and securities were used by the citizens within the first six months of 2008 vs. 6.6% for the corresponding period of 2007.

Labour market and unemployment

According to the Federal State Statistics Service, economically active population amounted to 75.5 million people (53% of the total population of the Russian Federation) as of June 2008.

The average rate of general unemployment as of June 2008 was 6.2% (as of June 2007: 5.85%).

However, disproportions of salaries between industries in combination with reduction of population conduce to shortage of specialists and qualified workers in most of manufacturing industries, which hinders development of these industries. In some regions, against the backdrop of intensive development of trade, industrial production and service sectors, problems related to skilled and unskilled labour shortage occur in other industries as well.

A number of social programmes are being put into effect to solve such problems, among them a birth-rate growth programme, programme for promotion of working specialty (education) and Russian-speaking labour intake for permanent residence in the Russian Federation, primarily from the CIS countries.

According to methodology of the International Labour Organization, the lowest unemployment level – which amounted to 1.0% - is observed in Moscow vs. the other constituent entities of the Russian Federation. Unemployment level in St. Petersburg does not exceed 4% as well as in a number of regions of the Central Federal District (Moscow region, Tula region, Lipetsk region, Ryazan' region, Belgorod region, Yaroslavl' region, Kostroma region, Ivanovo region), in the Republic of Mordovia (Povolzh'e), in Tumen' and Chelyabinsk regions (Siberia) (as of February 2008).

Prices and interest rates

During the past 2 years the Rouble has strengthened against the dollar, but:

01 January 2007	1 USD = 26.53 RUB
01 June 2007	1 USD = 25.82 RUB
01 January 2008	1 USD = 24.48 RUB
01 June 2008	1 USD = 23.46 RUB

However, in August 2008, dollar began to display its tendency to growth; and as of 15.08.08 its rate amounted to 24.32 RUB per USD.

Since July 2008, the refinancing rate of the Central Bank of the Russian Federation is 11% PA.

In the light of the world's financial crisis, credit interest rates of Russian banks have risen recently, so, as of the August 2008, the average rouble credit rate with a credit period of 1 - 2 years is amounting to approximately 20% PA, foreign currency credit rate is approximately 18% PA.

Inflation rate (consumer prices): 8.7% (2008 estimate).

Foreign trade and the balance of payments

According to data of the Federal Custom Services, Russian foreign trade turnover was 359.6 USD billion (increased by 50.2% vs. the first six months of 2007), which includes trade turnover with non-CIS countries amounting to 305.4 USD billion (increased by 50.8%) and the one with CIS countries amounting to 54.2 USD billion (increased by 47.0%).

Export trade balance (the first six months of 2008):	USD 103.0 billion (USD 59.9 billion for the corresponding period of 2007)
Exports (the first six months of 2008):	USD 238.0 billion (153.1% to the first six months of 2007)
Imports (the first six months of 2008):	USD 135.0 billion (141.3% to the first six months of 2007)

In the first six months of 2008, ratio of fuel and energy goods in the commodity composition of export to far abroad countries was 73.1% of the total export volume (vs. 66.8% in the corresponding period of 2007). In the commodity composition of import to far abroad countries, the key position was occupied by machinery and equipment (56.2%).

The financial system

The present-day financial system of the Russian Federation has been developing since 1991 and was considerably reformed after the economic and bank crisis of 1998. As a result it is mostly analogous to financial systems of European countries.

The main tasks of the Russian financial system, as stipulated by national regulators, are: strengthening of rouble exchange rates, inflation rate decrease, bank equity capital enlargement, and control system improvement.

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.

According to Bank of Russia, 1124 credit companies, including 1079 banks, were registered in Russia as of August 2008. The number of credit companies with foreign participation in charter capital increased by 17 for the period January-July and currently it amounts to 219. The number of credit companies with 100% foreign participation registered as of August 1st 2008 amounts to 71. The number of banks with over 50% foreign participation in the capital has reached 25.

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: Moody's – Baa1, S &P – BBB+/A- (as of March 2008)

According to the Federal State Statistic Service of the Russian Federation, in the first half of the year 2008 foreign investment inflow to the Russian economy amounted to USD 46.5 billion, which is 23% lower than the inflow in the corresponding period of 2007. Decrease in investment volume was directly related to development of international financial crisis.

As of the first half of the year 2008, direct investment inflow into the Russian economy was USD 11 billion, which is 30% less than the inflow in the corresponding period of 2007. The volume of portfolio investments increased by 4.4% to USD 1.2 billion. The volume of other types of investments decreased by 21% to USD 34.3 billion.

The highest volume of foreign investments was observed in wholesale and retail trades, the second highest volume - in investments into manufacturing activities (approximately 30% of the total volume of investments). Activities of the economy sector are the fastest growing. The third position is occupied by companies related to real estate projects (15%). The fourth position is occupied by investments into mining operations (about 10%).

As of the end of June 2008, accumulated foreign capital in the Russian economy amounted to USD 242 billion, which is 35.6% more than the amount for the corresponding period of the previous year.

The highest ratio in accumulated foreign capital was observed in the other types of investments made on return basis (credits of international financial organizations, trade credits etc.) was 49%, direct investments ratio was 48%, portfolio investments ratio was 3.0%.

The key countries-investors as of the first half of the year 2008 were the following: Cyprus (almost 25%), the Netherlands (18%), the United Kingdom (13%), and also Germany, Switzerland, the USA, France, Ireland. The above countries account for 71.2% of the total volume of accumulated foreign investments and for 84.3% of the total volume of accumulated direct foreign investments.

As of the date of preparation of this review, official statistics data for August 2008, when in the light of the Caucasian conflict increase in capital outflow from Russia occurred, was absent. However, the vice-president of the Central Bank is convinced that Russia will receive approximately USD 40 billion of foreign investments in total for 2008.

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-ФЗ 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 organizations 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 specialized 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 organization 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 legalize 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 on the territory of 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 authorized 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 roubles 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 organization so that the Russian organization has a status of a commercial organization with foreign investments.

At the same time, a foreign investor, commercial organization 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 authorized (share) capital of the mentioned organization, 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 organization shall be executed in due course and includes the following main stages:

- conclusion of purchase and sale contract;
- 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 organization with foreign investments, which is registered in accordance with the Russian legislation; and the foreign investor holds the 100% interest in the organization.

Registration of organizations 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 organizations

Joint stock company

A joint stock company is a company, the authorized 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.

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 recognized 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 authorized capital of a company is made up by par value of company shares purchased by shareholders. A company's authorized 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 authorized 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 authorized 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 authorized 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 connected with the company business activity within the sizes of contributions made by them.

The number of company members should not exceed fifty.

Contributions to the company's authorized 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 authorized capital is made up by par values of its members' equity stakes. A company's authorized 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 authorized capital.

The minimum authorized capital of a limited liability 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.

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 non-profit organizations

Funds

A fund is a non-profit organization 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 registration 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 organizations set up by profit organizations 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 registration of organization incorporation is 2,000 rubles.

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 stabilization 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 organization with foreign investments is not subject to compulsory taking including nationalization, 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, speciality);
- 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 specialized 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 obligatory transfer of separate types of activity to the simplified taxation system (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 organizations and foreign organizations 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 organizations 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 24%. 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 15%.
- Dividend income payable by a Russian company abroad attracts withholding tax of 15%. This is subject to any applicable relief.
- 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%.
- Withholding tax rate for other types of Russia-sourced income (including interest income) – 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 are normalized (entertainment, advertising etc. ones). As a result, such difference requires keeping of separate tax ledgers.

Value Added Tax

Taxpayers are Russian or foreign legal entities or individual entrepreneurs.

The main tax base is operation of selling goods (works, services) and property rights, including those without charge, in the Russian Federation. In addition, VAT is imposed on auxiliary works, construction and mounting works, and importing goods in the customs territory of the Russian Federation (VAT on import). A peculiar feature in computation of VAT in the Russian Federation is the offset method of tax calculation: the VAT payable to the budget is a difference between the tax calculated for the gross value of sold goods minus VAT sums submitted by the supplier of goods (works, services), which are used in the taxpayer's activity

VAT is imposed when the earliest of the following dates occur:

- The date of shipment of goods (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).

Advance payments are included in the VAT tax base at the time of money receipt.

Setoff VAT calculation procedure 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, amounts of the VAT, that are calculated on advance payments, are subject to tax rebate as well upon shipment of goods (works, services) or return of the advance.

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 profits tax.

The general VAT rate is 18%. A reduced VAT rate of 10% applies to medical goods, books, periodicals, foodstuffs and children's clothes. The export of goods is subject to VAT at 0%. Certain spheres of business, including banking and transactions with securities, are exempt from VAT altogether.

Almost each and every provision concerning VAT has complications and many nuances. The complexity of VAT calculations is compounded by the factors noted below.

A complicated system, which confirms the right to tax deduction (sums, which reduce payments to the budget). It is necessary to satisfy a number of requirements in order to confirm tax deductions; one of such requirements is strict observance of rules relating to issuance of invoices. Failure to fill or incorrect filling-in of at least one requisite 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. The VAT is not accrued when goods are sold to a foreign citizen, and the seller may require from the budget refunding of the VAT which has been 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 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 amounts to deduction in cases when, on 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 which have been accrued by the employer in favor of an individual 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 till 600,000 RUR	72,800 RUR + 10% from amount over 280,000 RUR
Over 600,000 RUR	104,800 RUR + 2% from 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 to the Social Insurance Fund (for injury and professional illness) shall be paid. The rate of contributions varies depending on the risk category into which the employer falls as determined by the fund. The current minimum contribution is 0.2% of payroll and the maximum is 8.5%.

When making payments to a physical person under civil law contract, payments: 2.9% (with incomes less than 280 thousand roubles) 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 organization for the Profits Tax purposes.

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

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 organizations (religious organizations, all-Russia public organizations of disabled persons etc.) and for particular types of property (space devices, ships etc.)

Individual Income Tax

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

Russian tax residents are currently defined as individuals who spend not less than 183 days of a calendar year in Russia. Accordingly, non-residents are those individuals who spend less than 183 days of a calendar year 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 organization.
- Insurance payments made by a Russian organization.
- Income from the sale of property in Russia.

There are currently four flat rates of 9%, 13%, 30% and 35% applicable to different types of income:

- Russian-sourced income received by non-residents – 30%;
- Income from a share holding in organizations received in the form of dividends – 9%;
- Winnings from lotteries and other games of chance as well as winnings paid out by bookmakers – 35%;
- Certain insurance payouts; material benefits in the form of interest savings on loans received; interest income on bank deposits that exceeds prescribed amounts – 35%;
- Income in the form of interest on mortgage-backed bonds issued before 1 January, 2007 – 9%;
- Other income for which a special rate is not stipulated – 13%.

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, which 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 and education) in the amount of 38 000 rubles for each type of expenses;
- Professional (intended for notary officers, lawyers etc.).

Organization, 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 a number of persons, the organization 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.

7. Accounting & reporting

Accounting and Reporting Requirements

The Law on Accounting applies to all organizations 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 itself and adopted 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 report in Russia consists of the following statements:

- Balance sheet;
- Profit and loss statement;
- Other supplementary information such as cash flows statement, statement of changes in shareholder's equity, summary of accounting policy;
- Explanatory notes to the financial statements;
- Audit opinion.

Quarterly financial reports should include a balance sheet and profit and loss statement.

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 should have training in an educational institution authorized 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 is licensed. A company should have not less than 5 licensed auditors to obtain a license to auditing from the Ministry of Finance.

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

- Open joint stock companies.
- Banks, insurance companies, stock exchanges and investment institutions.
- 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 should be conducted in accordance with the standards approved by the Russia Federation Government.

Initiative examinations 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 is growing in Russia. The services of conducting audit in accordance with international standards and also transferring accounting statements to international standards are becoming more and more popular.

It is planned to cancel licensing of auditing activity and to transfer all the functions connected with control over auditing services to self-regulating auditing associations.

8. UHY firms in Russia

Nikolay Litvinov
UHY YANS-Audit LLC
2-y Volkonsky per., d.3
Moscow, RUS-127473
Russian Federation
Tel: +7 495 925-5751
Email: n.litvinov@uhy-yans.ru
Web: www.uhy-yans.ru

About UHY YANS-Audit LLC

UHY YANS-Audit LLC 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 LLC takes a stable place among the top 50 first-rate audit and consulting companies in Russia.

Vladimir Petrenko
UHY Eccona LLP
Shaumyana pr., h.18, office 310
St. Petersburg, RUS-195112
Russian Federation
Tel: +7 812 622 12 13
Email: petrvlad@sp.ru
Web: www.eccona.spb.ru

Alexander Tildikov
UHY Atomic Audit
Narx Street 14
Obninsk, RUS- 249035
Russian Federation
Tel: +7 484 3940440
Email: tildikov@obninsk.com
Web: www.uhy-atomic.ru

9. UHY offices worldwide

For contact details of UHY offices worldwide, or for details on how to contact the UHY executive office, please visit www.uhy.com