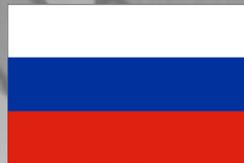




PrimeGlobal

*An Association of
Independent Accounting Firms*

DOING BUSINESS IN RUSSIA





COMPANY FORMATION IN RUSSIA

MAIN FORMS OF COMPANY/BUSINESS IN RUSSIA

Currently, the following forms of commercial legal entities (for-profit) may be incorporated in Russia:

- Full partnerships;
- Limited partnerships ("kommandit" partnerships);
- Limited liability companies;
- Additional liability companies;
- Production cooperatives;
- Joint-stock companies

Of the above, only the joint-stock company resembles a corporation, but the limited partnership also limit the liabilities of investors, as described below. These are the more popular forms of doing business.

SPECIFIC TAX CONCERNS RELATED TO ESTABLISHING A COMPANY

There are several systems of taxation in Russia. The most frequently encountered include the following:

General system of taxation - may be applied by all types of legal entities. All taxes and appropriate tax rates will be applied.

Simplified system of taxation - was implemented specifically for SMEs and can be applied by legal entities where the total annual revenue does not exceed RUB 60 million (this number is not fixed and may vary from year to year). There are several other limitations including one that prevents a corporate shareholder from owning more than 25% of the shares (i.e. a 100% subsidiary of foreign legal entity does not qualify). The tax rate is 6% (if tax basis is revenue) or 15% (if tax basis is profit). Revenue and expenses are to be calculated on a cash basis.

Taxes and tax rates applied under the General system of taxation are:

- Value Added Tax (VAT): General tax rate is 18%; for certain groups of goods 10%; export operations 0%.
- Corporate Profit Tax: Tax rate is 20%.
- Property Tax: The tax rate depends on the region of Russia, but cannot exceed 2.2%.
- Personal Income Tax: This is the employee's personal obligation; the tax rate is a flat 13% for residents and 30% for nonresidents.
- Social Insurance Payments: This is the employer's only obligation; the rate is approx 30%. There is also an additional 10% for employees that earn over a certain threshold.

LEGAL ISSUES RELATED TO ESTABLISHING A COMPANY

In terms of a company's registration process the first thing to do is to find a reliable lawyer, who will guide you through the information and paper work. There is no need to look for a big attorney firm, one could find suitable assistance by following advice from friends, partners, embassies or associations. After finding the lawyer it takes about a month or even just three weeks to obtain the registration.



It can be difficult for a new comer to find complete information about the process of registration and subscribing to the full range of state insurances and tax institutions. That's why it should be addressed to a lawyer, instead of doing it yourself. The registration procedures works fast. It takes only 15 minutes to hand over the registration documents in the respective offices. You get the registration and tax certificates within 5 working days.

It is important from the very beginning to set up proper bookkeeping and to arrange for the secure receipt of state authorities' correspondence. The post does not work correctly, letters are delayed, and often not delivered at all. One of the main secretarial tasks is to deal with the post! And it takes time!

CULTURAL CONCERNS RELATED TO ESTABLISHING A COMPANY

HR Issues

Twenty years ago staffing was not a problem; instead the issue was a shortage of skills. Now we almost have the reverse situation where in today's market there is generally not a problem with skills, but there is an issue in finding available staff.

It is generally accepted that Russia has a very well-educated work force and that many young people are innovative. One successful owner told us recently that in his view "Russia is a laboratory of ideas." We therefore find that many SMEs succeed in attracting good people by offering a good working environment, consensual decision-making, attention to training and development, and maybe some form of ownership participation. What we have also been told by successful owners of SMEs is not to underestimate the importance of treating people well, being appreciative and having a good working environment. Also, be open with people and let them know what is happening and treat them with the respect that they deserve. With regard to talent retention and motivation, salary is still the biggest factor. However, job satisfaction and career growth are becoming more significant. With regard to additional employee benefits, private medical insurance has become the norm, even for SMEs.

One peculiarity about compensation in Russia is that all employees think in terms of "net salary". Therefore if a potential candidate says he is looking for 100 roubles in salary, that means 100 roubles in his pocket, with the tax grossed up and paid by the employer.

OTHER COUNTRY-SPECIFIC ISSUES RELATED TO ESTABLISHING A COMPANY

The only other consideration is choosing your bank. In Russia the bank is more an agent of the state – ensure all regulations are met – rather than "your bank" acting in your interest. Therefore expect them to be bureaucratic.

That said, while there are some currency regulations related to documenting cross border movement of funds, getting currency in and out of Russia is not a difficult task and no unusual taxes apply.



PERMANENT ESTABLISHMENT IN RUSSIA: BRANCH OR SUBSIDIARY?

DEFINITION OF A PERMANENT ESTABLISHMENT

A 'permanent establishment' (PE) is not an organizational form of business structure, but rather a taxable status of a foreign business operation in another country, in this case in Russia. The term is defined in the Russian Tax Code (art. 306) and in many double taxation treaties. A business may be considered as a permanent establishment when activities in Russia are carried out by a foreign firm through any fixed place of doing business: the office, branch, headquarters, business partner or agent of a foreign company.

The concept of a permanent establishment is often confused with the concept of representative Office (RO), as the Russian terms for them are very similar. Representative office in Russian is 'predstavitelstvo' and permanent establishment is 'postoyannoye predstavitelstvo'. However, the existence of a RO does not determine if the business is taxable or not.

DEFINITION AND MAIN DIFFERENCES BETWEEN A BRANCH AND A SUBSIDIARY

Russian Legal Entity (Subsidiary) - A separate legal entity, registered under Russian law, that bears its own liabilities.

Branch/Rep Office (B/R O) - An extension of the a foreign legal entity accredited to carry out activities in Russia. Liability is borne by the Head Office or Parent company.

Representative and Branch Offices are not independent legal entities, but rather "sub-divisions" of a parent company. A Rep Office should not engage in commercial activity, but a Branch may.

TAX AND ACCOUNTING OBLIGATIONS

In general the accounting requirements are bit more burdensome for Russian Legal Entity as quarterly financial statements must be prepared (in certain circumstances) as well as full tax accounting, including VAT.

B/R Os are allowed to file and pay quarterly profit taxes. This is an opportunity for tax planning. No value added tax (VAT) accounting is necessary if there is no commercial activity and VAT is recognized as a cost. It should be noted that if a BO or RO engages in commercial activity then full tax accounting and reporting is mandatory.

The accounting requirements are not as burdensome – there are no quarterly financial statements, but an annual report on activities (includes quasi-financial statements) is made.

Rep Offices which do not carry out commercial activities are exempt from VAT on their rent payments.

REGISTRATION FORMALITIES

The "accreditation" process as it is called in Russia can take much longer for a Rep/Branch office compared to a LLC or JSC, typically 6 to 8 weeks.



In contrast to Russian legal entities, the process of registering a branch or representative office of a foreign company involves several federal and local authorities. To register, branches and representative offices need to take the following steps:

- accreditation with federal bodies. Accreditation is mandatory, since the local banks and administrative authorities may not recognize the branch/representative office without it;
- tax registration;
- registration with state statistic authorities, obtaining statistics codes;
- registration with social (pension, medical and social security) funds;
- opening bank accounts.

For the accreditation of a representative office, accreditation bodies charge a processing fee ranging from USD 2,000, depending on the period of accreditation.

STANDARD LEGAL OBLIGATIONS AND FORMALITIES FOR A BRANCH

There are some advantages of doing business via a Rep/Branch office, such as the ease of moving currency out of Russia and obtaining work visas for staff. However, some activities may be limited or more troublesome such as the import of goods or certain licensed activities.

An accredited representative office is not a Russian legal entity, but an officially recognized subdivision of a foreign legal entity. Although Russian law suggests that the scope of an accredited representative office's activity would be limited to auxiliary representational functions, in practice many foreign firms conduct commercial activities that, according to a strict interpretation of the law, should only be conducted through a registered branch or a Russian company.



HOW TO HIRE MY FIRST EMPLOYEE IN RUSSIA

MAIN LEGAL STEPS TO FOLLOW TO HIRE A FIRST EMPLOYEE

After the company registration (accreditation), you can hire your first employee. In general case, your first employee is the General Manager of the company or Head of the Rep office.

While registering the legal entity with the support of the local lawyer, he will prepare all the necessary papers to appoint a General Manager and you don't need to worry about the legal aspects of it. Your task will be to choose a candidate for this job before the registration starts and inform the lawyer.

The registration authorities don't require to provide a signed employment contract of the General manager during the registration (accreditation) process, but it is the first thing to do after getting the registration certificates and opening a bank account.

Due to the large number of legal requirements related to the accounting payroll calculation and HR administration, we recommend to subcontract a local accounting outsourcing provider to guarantee the full compliance.

Should you hire a local (Russian) manager with a clear understanding of the local culture and business ethics? He or she may be well connected, making it easier to solve problems when they arise. The disadvantage of this option is that the talent pool for managers is still relatively small in Russia, and as an SME, you will be competing with the big firms and be expected to pay top dollar to good managers.

Another option is to find an expat already settled in Russia, ideally, with a Russian family and looking to stay for a while. These candidates usually speak Russian and have a good understanding of the Russian culture and values. They may have good connections and have worked for start-ups before, and so understand the needs of SMEs on a tight budget. The downside of this group of candidates is that they tend to be entrepreneurial and looking to set up their own business and may not be a long-term solution.

One option that has become more popular is bringing a young expat over from the home country. Usually unmarried, ambitious, and looking for international experience, they are generally willing to give 2-3 years with relatively low pay to gain this type of experience.

DESIGN AND CONTENTS OF AN EMPLOYMENT CONTRACT

Employment Contracts

A written employment contract setting out the terms of employment must be concluded with every employee and drawn up in two copies, each of which is signed by both parties. The employer must draw up the employment contract within three business days after the day the employee started work.

The Labour Code establishes mandatory requirements for the content of employment contracts. As a general rule, employment contracts are concluded for an indefinite term. A fixed-term employment contract (no more than five years) may also be concluded, but only in those circumstances specifically prescribed by the Labour Code.

An employee's job responsibilities must be defined in the employment contract. An employee cannot subsequently be required to perform tasks outside the scope of duties described in the contract. Employers are required to issue an internal order each time an employee is hired, transferred to a new job, granted a



vacation, disciplined or dismissed, as well as in other situations. Moreover, employers should adopt a certain set of internal regulations compliant with Russian law.

Working Hours

- Employers are required to keep a record of all time worked by each employee, including overtime;
- The standard working week in Russia is 40 hours over a five- or six-day week. For certain categories of employees, the number of working hours should be reduced (for example, for employees aged from 16 to 18, disabled employees);
- The law strictly defines the minimum payment for overtime and holiday/weekend work;
- On the eve of public holidays, the working day should be one hour shorter.

Paid Holidays

All employees are entitled to a minimum of 28 calendar days of paid leave annually. Normally, employees may begin taking vacation time for the first year of their work after they have worked at a company for six months continuously.

Wages and Salaries

Salary must be paid in Russian roubles twice a month. Salaries may not be lower than the minimum monthly salary established by Russian law. The minimum wage is regularly adjusted.

CAN SOMEBODY DO BUSINESS FOR ME AND NOT BE AN EMPLOYEE?

Yes, you can hire an individual as a consultant on a fixed term contract. However if there is no clear reason for this kind of employment (seasonal project, for example) then relationship can be classified as a regular employment. It should be noted that in this arrangement the social taxes are almost the same and are also borne by the employer.



HOW TO READ FINANCIAL STATEMENTS IN RUSSIA

The basic Russian financial statements always consists of:

- Balance Sheet
- Profit and Loss statement (statement of comprehensive income)
- Footnotes to the financial statements



BALANCE SHEET

as at _____ 20__

Organization _____

Tax identification number of taxpayer _____

Type of economic activities _____

Incorporation form/proprietary form _____

Measurement unit: thousand rubles (million rubles)

Location (address) _____

OKUD classifier #

Date (day, month, year)

OKPO
classifier #

TIN

OKVED
classifier #

OKOPF/OKFS #

OKEI #

Codes

0710001

384 (385)

Пояснения/ Notes 1	Наименование показателя 2	Item name 2	As at _____	As at 31 December	As at 31 December
			20 _____ 3	20 _____ 4	20 _____ 5
	АКТИВ	ASSETS			
	I. ВНЕОБОРОТНЫЕ АКТИВЫ	I. NON-CURRENT ASSETS			
	Нематериальные активы	Intangible assets			
	Результаты исследований и разработок	Research and development results			
	Нематериальные поисковые активы	Intangible development assets			
	Материальные поисковые активы	Tangible development assets			
	Основные средства	Fixed assets			
	Доходные вложения в материальные ценности	Income bearing lease investments			
	Финансовые вложения	Long-term investments			
	Отложенные налоговые активы	Deferred tax assets			
	Прочие внеоборотные активы	Other non-current assets			
	Итого по разделу I	Total under section I			
	II. ОБОРОТНЫЕ АКТИВЫ	II. CURRENT ASSETS			
	Запасы	Stock			
	Налог на добавленную стоимость по приобретенным ценностям	Value Added Tax on purchased goods			
	Дебиторская задолженность	Accounts receivable			
	Финансовые вложения (за исключением денежных эквивалентов)	Short-term investments (except for cash equivalents)			
	Денежные средства и денежные эквиваленты	Cash and cash equivalents			
	Прочие оборотные активы	Other current assets			
	Итого по разделу II	Total under section II			
	БАЛАНС	TOTAL ASSETS			



Пояснения/ Notes 1	Наименование показателя 2	Item name 2	As at ____	As at 31 December	As at 31 December
			20 ____ 3	20 ____ 4	20 ____ 5
	ПАССИВ	EQUITY AND LIABILITIES			
	III. КАПИТАЛ И РЕЗЕРВЫ 6 Уставный капитал (складочный капитал, уставный фонд, вклады товарищей)	III. SHARE CAPITAL AND RESERVES РЕЗЕРВЫ 6 Share capital (charter capital)			
	Собственные акции, выкупленные у акционеров	Treasury shares	() ⁷	()	()
	Переоценка внеоборотных активов	Revaluation of non-current assets			
	Добавочный капитал (без переоценки)	Additional capital (except for revaluation)			
	Резервный капитал	Reserve capital			
	Нераспределенная прибыль (непокрытый убыток)	Retained profit (uncovered loss)			
	Итого по разделу III	Total under section III			
	IV. ДОЛГОСРОЧНЫЕ ОБЯЗАТЕЛЬСТВА	IV. LONG-TERM LIABILITIES			
	Заемные средства	Loans (borrowed assets)			
	Отложенные налоговые обязательства	Deferred tax obligations			
	Оценочные обязательства	Estimated liabilities (contingencies)			
	Прочие обязательства	Other obligations			
	Итого по разделу IV	Total under section IV			
	V. КРАТКОСРОЧНЫЕ ОБЯЗАТЕЛЬСТВА	V. SHORT-TERM OBLIGATIONS			
	Заемные средства	Loans (borrowed assets)			
	Кредиторская задолженность	Accounts payable			
	Доходы будущих периодов	Deferred revenues			
	Оценочные обязательства	Estimated liabilities (contingencies)			
	Прочие обязательства	Other obligations			
	Итого по разделу V	Total under section V			
	БАЛАНС	TOTAL EQUITY AND LIABILITY			

General Manager
(Director)

_____ (signature)

_____ (name)

“ ____ ” _____ 20 ____



Remarks

1. Put the reference number to corresponding Note of the Balance sheet and Profit and Loss statement.
2. In accordance with the Accounting standard «Accounting (financial) statements PBU 4/99» approved by the Ministry of Finance of Russian Federation, the information (indicators) on separate assets, liabilities can be shown in total amount with disclosure of this information in the Notes to the financial statements, if each indicator individually is not material for the estimations of financial position by the interested users.
3. Reporting date is indicated here.
4. Previous year is indicated here.
5. Year preceeding the previous one is indicated here.
6. Not for profit entity nominates this section «Special purpose fundung». Instead of the items «Share capital», «treasury shares», «Additional capital», «Reserve capital» and «Retained profit (uncovered loss)» not-for-profit entity uses «Mutual fund», «Special purpose capital», «special purpose funds», «real estate fund», «Reserve fund and other special purpose funds».
7. Here and in other reporting firms deducted and negative indicators are shown in round brackets.

PROFIT AND LOSS STATEMENT

(Statement of comprehensive income)

for _____ 20 ____

Organization _____	OKUD classifier #	Codes	
Tax identification number of the taxpayer _____	Date (day, month, year)	0710002	
Type of economic activities _____	OKPO #		
Incorporation form/proprietary form _____	TIN		
Measurement unit: thousand rubles (million rubles)	OKVED #		
	OKOPF/OKFS #		
	OKEI #	384 (385)	

Пояснения/ notes ¹	Наименование показателя ²	Item name ²	For _____ 20 ____ ³	For _____ 20 ____ ⁴
	Выручка ⁵	Revenues ⁵		
	Себестоимость продаж	Cost of sales	()	()
	Валовая прибыль (убыток)	Gross margin (loss)		
	Коммерческие расходы	Selling expenses	()	()
	Управленческие расходы	Administrative expenses	()	()
	Прибыль (убыток) от продаж	Operational profit (loss)		
	Доходы от участия в других организациях	Investment income		
	Проценты к получению	Interest income		
	Проценты к уплате	Interest expense	()	()
	Прочие доходы	Other income		
	Прочие расходы	Other expenses	()	()



	Прибыль (убыток) до налогообложения	Profit (loss) before tax		
	Текущий налог на прибыль	Current profit tax	()	()
	в т.ч. постоянные налоговые обязательства (активы)	Inclusive permanent tax obligations (assets)		
	Изменение отложенных налоговых обязательств	Change of deferred tax obligations		
	Изменение отложенных налоговых активов	Change of deferred tax assets		
	Прочее	Other		
	Чистая прибыль (убыток)	Net profit (loss)		

Пояснения/ notes ¹	Наименование показателя ²	Item name ²	For _____ 20 ____ ³	For _____ 20 ____ ⁴
	Результат от переоценки внеоборотных активов, не включаемый в чистую прибыль (убыток) периода	Result of revaluation of non-current assets which is not included in net profit (loss) of the period		
	Результат от прочих операций, не включаемый в чистую прибыль (убыток) периода	Result of other operations which is not included in the net profit (loss) of the period		
	Совокупный финансовый результат периода ⁶	Comprehensive income for the period ⁶		
	Справочно Базовая прибыль (убыток) на акцию	For information only : Basic earnings (loss) per share		
	Разводненная прибыль (убыток) на акцию	Diluted earnings per share		

General Manager
(Director)

_____ (signature) _____ (name)

“ ____ ” _____ 20 ____

Remarks

- Put the reference number to corresponding Note of the Balance sheet and Profit and Loss statement.
- In accordance with the Accounting standard «Accounting (financial) statements PBU 4/99» approved by the Ministry of Finance of Russian Federation, the information (indicators) on separate assets, liabilities can be shown in total amount with disclosure of this information in the Notes to the financial statements, if each indicator individually is not material for the estimations of financial position by the interested users.
- Reporting date is indicated here.
- Period of the previous year comparable to current reporting period.
- Revenues are recognized net of Value Added Tax.
- Comprehensive income is calculated as the sum of the following line items «Net profit (loss)», «Result of revaluation of non-current assets which is not included in net profit (loss) of the period» and «Result of other operations which is not included in the net profit (loss) of the period».