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Development of the Russian Tax System in 2011 and Prospects for 2012-2013

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PRACTICAL CHALLENGES OF THE NEW TRANSFER PRICING LAW – SUMMARY OF AEB RESPONSE

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New Russian TP & Tax Consolidation Law

STATUS AND KEY CHANGES

December 15th, 2011

TP Reform: Status

- New law #227-FZ signed 18 July 2011
- More OECD alignment than in previous drafts
- Introduction date – 1 January 2012
  - with 2012-2013 being transition years

TP Reform: Key Changes

- Introduction of the arm's length principle
- Substance-over-form approach
- Arm's length range
- Five TP methods
- TP documentation / reporting requirements
- Dedicated TP audits, TP penalty
- Corresponding adjustments
- APA

Tax Consolidation Law: Key Changes

- New law #321-FZ signed16 November 2011
- Tax consolidation can be formed as of 2012
- Criteria for entrance
  - Russian companies, 90% equity share
  - Taxes 10bn RR, Sales 100bn RR, Assets 300bn RR
- No transfer pricing control for transactions between the participants

New Russian TP Law

AEB RESPONSE

Key issues of concern (1)

- No aggregation for TNMM / PSM
- No retrospective TP adjustments
- Intangibles – no clear definition
- APA and correlative adjustments – not for foreign legal entities
- No cost allocation

Key issues of concern (2)

- Burdensome requirements for regulated prices
- No clear mechanism for attribution of profits to a PE
- No clear correlation with general tax rules
- Interest deductibility rules not aligned with new law
- TP and customs conflict

Progress and Next steps

- Business breakfast with the Ministry of Finance on 15 October 2011
- TP working group is working on key issues
- Proposed amendments to the TP law to be presented to the Ministry of Finance and the Parliament beginning of 2012

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Preparation to the Law: practical aspects

Svetlana Stroykova, PwC

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Preparation to the Law: practical aspects (1 of 2)

- Rules are expected to be clarified but not changed significantly
- 30 days is quite short period, to be smart does not mean to be quick
- Margins in Russia – any surprises?
- Business people in your organization – is there clear understanding of what is required
- Your department profile – new challenges or opportunities?

Preparation to the Law: practical aspects (2 of 2)

- Transfer pricing function
- Group transfer pricing policy vs. Russian specifics
- TP documentation: value added vs routine elements
- Staged approach (compliance only? ERP systems tailoring?)
- Internal controls

Step	Comments
1. Verification of controlled transactions	List of transactions which are subject to control
2. Diagnostics	Validation of TP model, its efficiency and sustainability, methods to be applied Understanding of changes to current TP methods / operating model to decrease TP risks (if any)
3. Conducting Russian benchmarking studies, work out TP methodology	2008-2010 arm's length profit margins - to be used for planning purposes
4. Monitoring of profit margins	Financial analysis, understanding of changes / additional measures required to sustain targeted profit margins in inter-company arrangements
5. Drafting Russian TP documentation - proposed timeline	TP methodology , changes to contracts – end of 2011 Draft TP documentation report – first half of 2012 Benchmarking studies update for 2011 data – end of 2012 Final documentation set - beginning of 2013

Questions?

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December 15th, 2011

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VAT questions

Stanislav Tourbanov

15 December 2011

New document – adjusting VAT invoice

- To be issued when there is a change in the price of goods, works, services, and property rights in the following cases:

✓ change in the price or tariff

✓ specification of the quantity (volume) of goods

- VAT may be deducted based on an adjusting invoice only when there is a document confirming that the buyer has been notified of the change in the price of goods.
- An adjusting VAT invoice must be issued by the seller within 5 days of the date of the buyer being notified (receipt of consent) of the change in the price of goods.
- Use of an adjusting VAT invoice is regulated by Letter No. ED-3-3/3608@ of the Federal Tax Service “On the procedure of filing an adjusting VAT invoice” dated 2 November 2011, and by Letter No. ED-4-3/15927@ of the Federal Tax Service “On applying an adjusting VAT invoice” dated 28 September 2011.

Electronic VAT invoices

- Introduced by Federal Law No. 229-FZ dated 27 July 2010. The application of electronic VAT invoices is regulated by Order No. 50n of the Ministry of Finance dated 25 April 2011 (effective as of 3 June 2011).
- The Order contains the following main provisions:

✓ Sending and receiving invoices in electronic form over telecommunication channels must be carried out through the Operator of the electronic document circulation.

✓ Invoices must be made in electronic form by mutual consent of the parties to the transaction and upon the availability of compatible means and the possibility to receive and process such invoices by the parties to the transaction.

✓ An invoice in electronic form must have the electronic digital signature of the authorised person.

✓ The seller and the buyer must carry out electronic document circulation separately for each invoice.

- There are still no formats for the electronic VAT invoices, purchase ledgers and sales ledgers.

Extension of the list of grounds for VAT restoration

The list has been extended to the following cases when:

•A buyer reduces the price of goods, works, services, and property rights (cf. adjusting VAT invoice).

•Goods, works, services, and property rights, including fixed assets and intangible assets, are used in operations taxed at 0% VAT. Restoration must be made in the period of shipment.

•The taxpayer receives a subsidy from the federal budget to reimburse expenses for the payment of goods, works, and services, including tax and the reimbursement of expenses for the payment of tax when importing goods to Russia and other territories under Russian jurisdiction (pending issue: partial financing).

•Goods, works, and services are bought to carry out construction-and-assembly works for one's own consumption; but fixed assets are later used in non-VATable activities.

•Modernisation (reconstruction) of real estate (fixed asset) has resulted in the change of its initial cost.

Restoration of VAT in the case of shortage and/or theft is still not provided.

Exchange and sum differences for VAT purposes

- In the case of payments in a currency, the tax base must be determined in roubles at the exchange rate of the Central Bank of the Russian Federation as at the date that corresponds to the time to determine the tax base during the sale (transfer) of goods (works and services). Previously, operations taxed at 0% VAT were determined as at the date of payment; however, as of 1 October 2011, they are determined at the date of shipment.
- VAT deductions must not be adjusted if a follow-on payment in roubles for the price of goods, works, services, and property rights is set in a foreign currency or in standard units. VAT related to sum differences must be reported as non-operating expenses or non-operating income.

Latest trends in taxation of bonuses (1/2)

"Leroy Merlin" case

The case has been sent to the Presidium of Supreme Arbitration Court for consideration.

The issue under consideration is as follows.

•The Company has received bonuses from its suppliers for ensuring the presence of their goods in the Company's shops and has not charged VAT, given that bonuses are not services. The tax authorities have challenged this approach. The decisions of the courts, except for that of the first instance, have been in favour of the Company (i.e. the taxpayer).

Latest trends in taxation of bonuses (2/2)

The judges of Supreme Arbitration Court have disagreed with the lower instance courts on the following grounds:

- The Company has included bonuses in revenue from the sale of goods (works and services) in tax and accounting reporting. However, the Company has not charged VAT on these sums.
- The suppliers are interested in concluding contracts on the terms proposed by the Company; therefore, there is an indirect economic effect connected to the increase of sales, since the Company entices individuals to buy more of a supplier's products.
- The supply contracts have provisions on bonuses as an integral part of the contracts.
- In the Court's opinion: "the suppliers also may not refuse to pay the bonuses to the Company while preserving other provisions of the contract. Therefore, the Company's obligations to accept goods and allocate them in the shops correspond to the obligations of suppliers to pay bonuses".
- No consistent court practice.

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Development of the Russian Tax System in 2011 and Prospects for 2012-2013

Orlov Mikhail

15th December 2011

Contents

Federal law №. 245-FZ dated 19.07.2011 "On modifying the first and second parts of RF Tax Code"

- **General 0% VAT issues:**
  - Documents confirming 0% VAT rate;
  - Services subject to 0% VAT rate;
  - Realization of goods (works, services) for international organizations;

- **0% VAT rate on transportation services within Customs Union**

- **'Adjusting' VAT-invoices**

- **Other VAT issues:**
  - Sales of quotas on emission of greenhouse gases under Kyoto Protocol to the UN Framework Convention on Climate Change
  - Realization of goods (works, services) on the continental shelf

15 December 2011

General 0% VAT issues

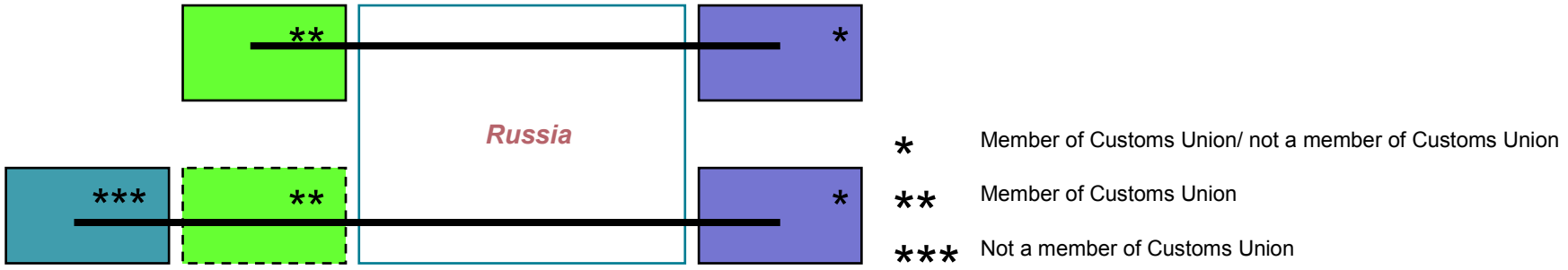
- List of documents confirming 0% VAT rate was shortened – no need to present payment documents (i.1 art.164, art.165);

- List of services subject to 0% VAT rate was extended – provision of railway rolling stock and containers as well as rendering forwarding services from ports on the territory of Russia to destination point on the territory of Russia was added (s.2.1 i.1 Art.164 of RF Tax Code);

- Realization of goods (works, services) for international organizations is also subject to 0% VAT rate
  (s.11 i.1 Art.164 of RF Tax Code);

0% VAT rate on transportation services within Customs Union (1/2)

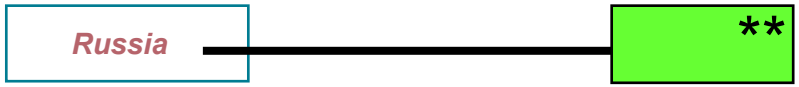
- **Services provided by organizations or by individual entrepreneurs** (s.3.1 i.1 Art.164 of RF Tax Code):
  - Services on **provision of railway rolling stock and containers** for transportation of goods as well as **freight forwarding services** rendered under a freight forwarding agreement via territory of Russia from a foreign country which is not a member of Customs Union through the territory of the country – member of Customs Union, or from the territory of country - member of Customs Union to the territory of a foreign country, including the territory of a member of Customs Union;



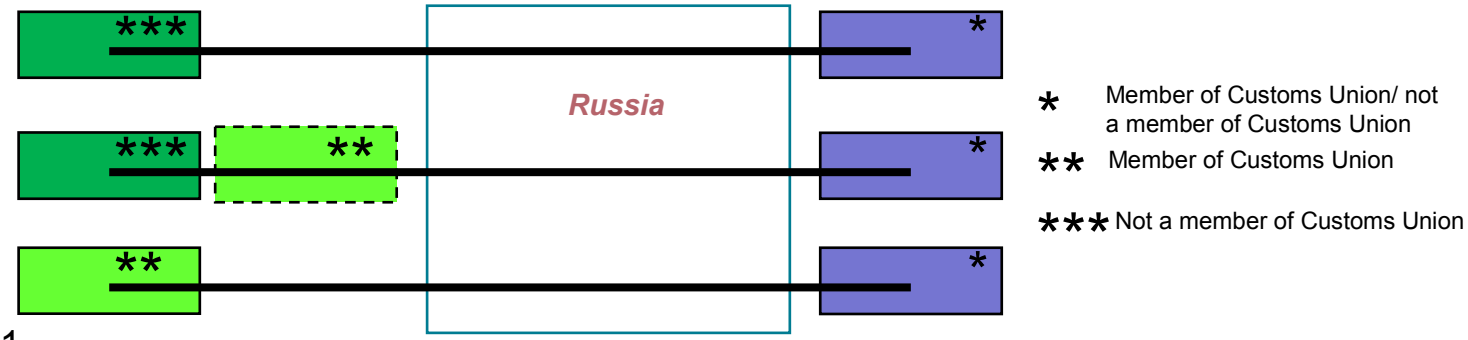
0% VAT rate on transportation services within Customs Union (2/2)

- **Services provided by Russian carriers on railway transport** (s.9.1 i.1 Art.164 of RF Tax Code):

  – Works (services) on transportation of goods exported from Russian territory to the territory of a foreign country which is a member of Customs Union and works (services) directly connected with transportation of such goods which price is indicated in transportation documents;

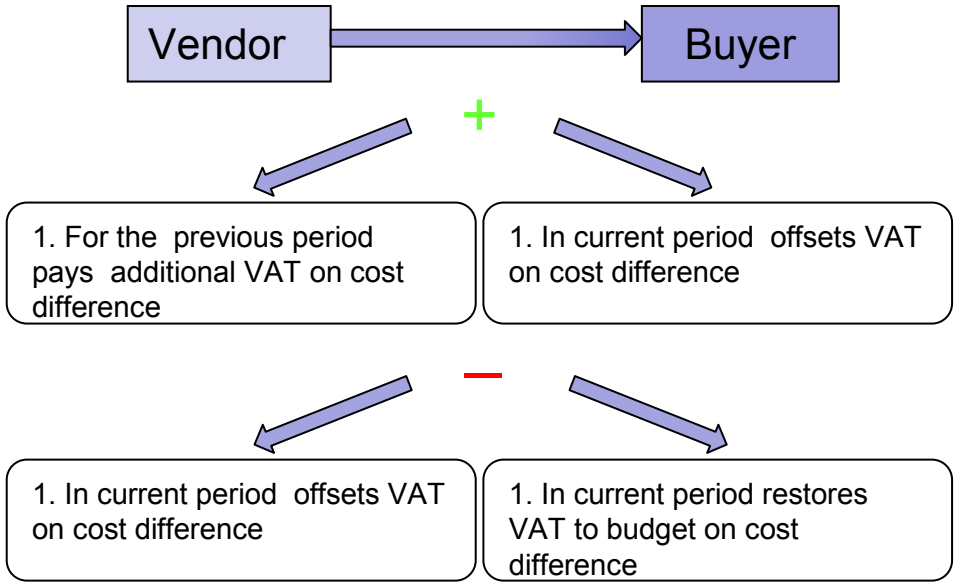


  – Works (services) on transportation of goods transferred via territory of Russia from a foreign country which is not a member of Customs Union through the territory of the country – member of Customs Union, or from the territory of country - member of Customs Union to the territory of a foreign country, including the territory of a member of Customs Union and works (services) directly connected with transportation of such goods which price is indicated in transportation documents;



‘Adjusting’ VAT-invoices

- New document is introduced - ‘adjusting’ ’VAT-invoice
- ‘Adjusting’ VAT-invoice is issued if cost of goods (works, services), property rights is changed
- Contract (other agreement), other primary documents confirming agreement of a buyer on change of cost of realized goods (works, services) – ground for issuance of ‘adjusting’ VAT-invoice



Draft Decree of the Government of the Russian Federation

"On VAT-invoices and recognition of becoming invalid certain regulatory legal acts"
(planning to come in force since 01.01.2012)

- Form of VAT-invoice
- Form of adjusting VAT-invoices
- Form of log book containing obtained and submitted VAT-invoices
- Form of purchases book
- Form of sales book

15 December 2011

Other VAT Issues

- Sales of quotas on emission of greenhouse gases under Kyoto Protocol to the UN Framework Convention on Climate Change
- Realization of goods on the continental shelf
- Rendering of services (works) regarding exploration and production of raw hydrocarbon on the continental shelf

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Changes to the Russian Social Security System

effective 2012

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Legislative Framework

✓ Federal Law №. 379-FZ of 03.12.2011, effective 1 January 2012

Main changes

- Draft Law №. 607164-5 of 30.09.2011
- Decision of the Council of the Federation of the RF №. 455-SF of 25.12.2011
- Federal Law №. 379-FZ – signed by the President of the RF on 06.12.2011
- Official publication, "Rossiyskaya Gazeta", release №. 5654 of 09.12.2011

✓ Decision of the Government of the Russian Federation №. 974 of 24.11.2011

Annual earnings' cap for 2012 year - RUB 512,000

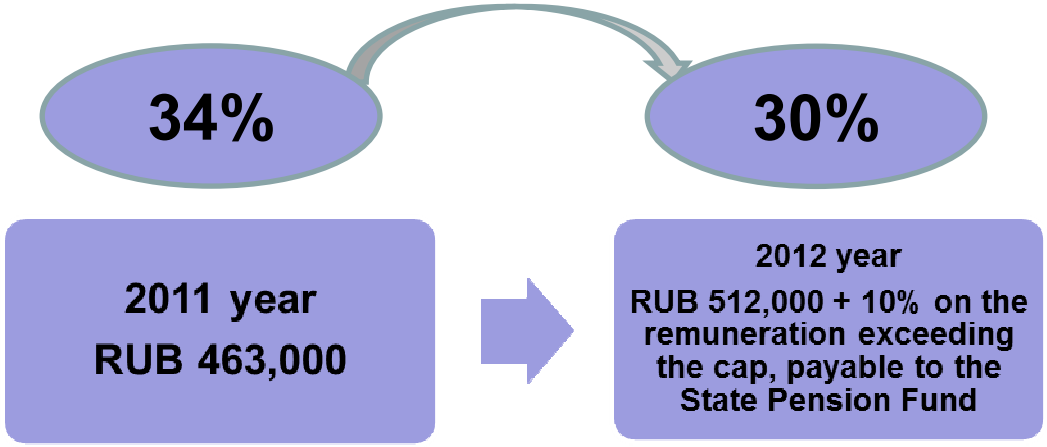
✓ Federal Law №. 313-FZ of 29.11.2010, effective 1 January 2012

Administration of social security system, allocation procedures

Changes in rates and the cap

Rate of insurance contributions applied to the cap stated:

The cap:



- The additional contributions of 10% → Federal Pension Fund of the RF as part of the individual's pension funding obligation (insurance part);
- Certain limited categories of taxpayers → rate decreases from 26% to 20% on the established cap (Simplified Tax System, etc.)

Social security contributions rates

	2010	2011	2012 - 2013
State Pension Fund	**20%**	**26%**	**22% + 10%** (above the cap)
Social Insurance Fund	**2.9%**	**2.9%**	**2.9%**
Federal Obligatory Medical Insurance Fund	**1.1%**	**3.1%**	**5.1%**
Local Obligatory Medical Insurance Funds	**2%**	**2%**	**0%**
Total	**26%**	**34%**	**30%+ 10%** (above the cap)
Annual Cap in RUB	**415,000**	**463,000**	**512,000***
Maximum liability per employee in RUB	**107,900**	**157,420**	**unlimited**

* **2013 year – RUB 563,000**

List of insured individuals - foreign nationals back in

Current rules

Foreign nationals → Accident Insurance contributions only (0.2 – 8.5%)

Rules effective 1 January 2012

Foreign nationals → Insured individuals (foreign employees who are temporarily staying in Russia and working on the basis of employment contracts concluded for more than 6 months)

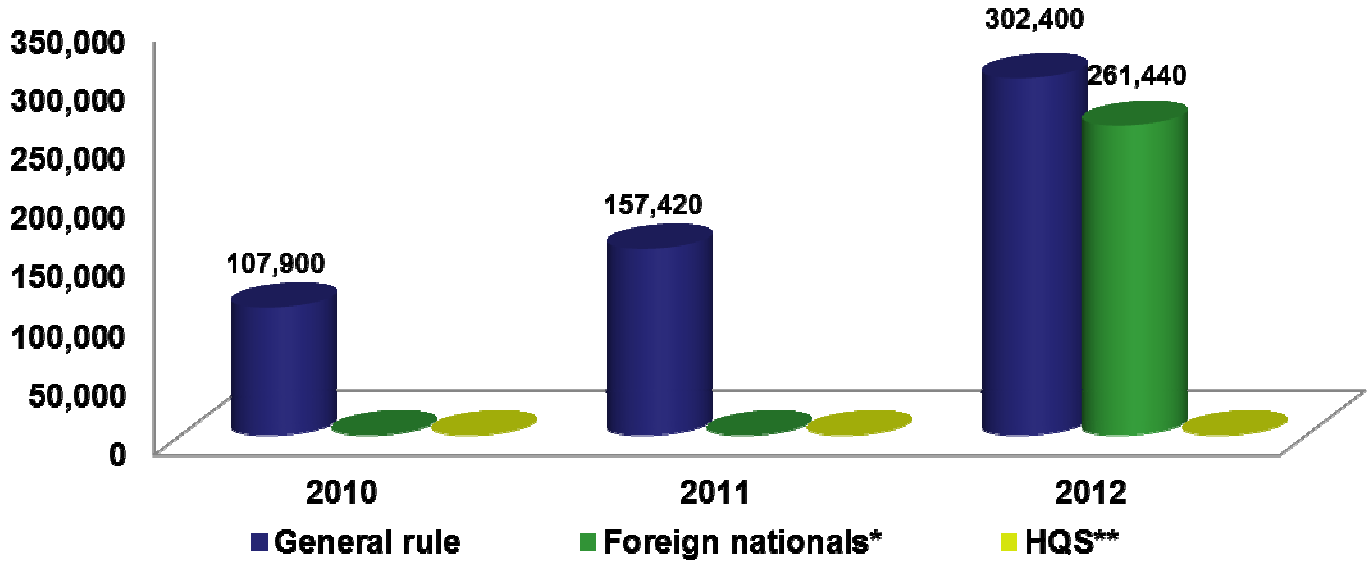
↓

State Pension Fund + Social Insurance Fund

Pension contributions (insurance part) will be due (22% of earnings up to RUB 512,000 + 10% of earnings exceeding the cap)

! Exception – Highly-Qualified Specialists → Accident Insurance contributions only

Social security burden on RUB 2,000,000 - visual



* Foreign nationals who are temporarily staying in Russia and working on the basis of employment contracts concluded for more than 6 months

** Foreign nationals holding Highly Qualified Specialist (HQS) work permits

Conclusions

- The amendments announced will have no impact on the actual employees' earnings (both Russian and foreign nationals), at the same time there is no enhancement in their level of benefits as insured individuals;
- Additional social security contributions are payable as a part of of the individuals' pension funding obligation (insurance part);
- Amendments introduced will apparently involve significant increase in the fiscal burden on the employers;
- Extra costs in relation to contributions on foreign employees' earnings (not HQS) should be taken into account calculating total cost of assignments and HR budgeting;
- HQS regime implies the most effective cost-saving opportunity from the standpoint of immigration, tax and social security legislation of the RF.

Questions and Answers

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Deloitte.

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Key changes to the double tax treaties with Switzerland and Luxembourg

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Protocol to the Double Tax Treaty between Russia and Switzerland

- The Protocol introducing the amendments to the Double Tax Treaty signed between Russia and Switzerland (the "**DTT**") was signed on 24 September 2011.
- The Protocol will come into force after its ratification by Russia and Switzerland and will become effective as of 1 January of the year following the year of ratification by Russia and Switzerland.
- *The most significant changes introduced by the Protocol to the DTT are the following:*
  - 10% withholding tax on interest income has been abolished;
  - it was agreed that the Contracting States may apply domestic "thin capitalisation rules";

December 15, 2011

Protocol to the Double Tax Treaty between Russia and Switzerland

- capital gains of a resident of a Contracting State from the alienation of shares in a company deriving more than 50% of their value from immovable property situated in another Contracting State could be taxed in that other state. However, this rule will not apply to capital gains derived from the alienation of certain quoted shares or shares of a company if the company carries out its business in this immovable property;
- the term "dividends" has been extended;
- a new article on "Exchange of information" has been introduced;
- a new article on "Anti-conduit" rules has been introduced in respect to dividends, interest and royalties to prevent conduit arrangements whose main purpose is to obtain tax benefits under the treaty.

Protocol to the Double Tax Treaty between Russia and Luxembourg

- The Protocol introducing the amendments to the Double Tax Treaty signed between Russia and Luxembourg (the "**DTT**") was signed on 21 November 2011.
- The Protocol will come into force after its ratification by Russia and Luxembourg and will become effective as of 1 January of the year following the year of ratification by Russia and Luxembourg.
- *The most significant changes introduced by the Protocol to the DTT are the following:*
  - Reduction of the minimum withholding income tax rate on dividends from 10% to 5% (the minimum rate applies provided (i) the beneficial owner of the dividends is a company which (ii) holds not less than 10% of the capital of the company paying the dividends; and (iii) invested not less than EUR 80 000 in the capital of the company paying the dividends);

Protocol to the Double Tax Treaty between Russia and Luxembourg

- capital gains of a resident of a Contracting State from the alienation of shares in a company deriving more than 50% of their value directly or indirectly from immovable property situated in another Contracting State could be taxed in that other state. However, this rule will not apply to capital gains from the alienation of certain shares listed in the Protocol, in particular, to capital gains derived from the alienation of certain quoted shares and from shares alienated in the course of reorganisation;
- the term "dividends" has been extended;
- the Article on "Exchange of information" has been amended;

Protocol to the Double Tax Treaty between Russia and Luxembourg

- amendments have been introduced to Article 29 of the DTT to limit benefits from the provisions of the DTT of a tax resident of Russia or Luxembourg if the main purpose or one of the main purposes of the creation or existence of such tax resident was to obtain benefits under the DTT;
- the Article “Other income” has been amended;
- the definition of a permanent establishment has been extended.

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Attribution of Profits and Expenses to a Permanent Establishment (CMS Case)

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Partner, Baker & McKenzie

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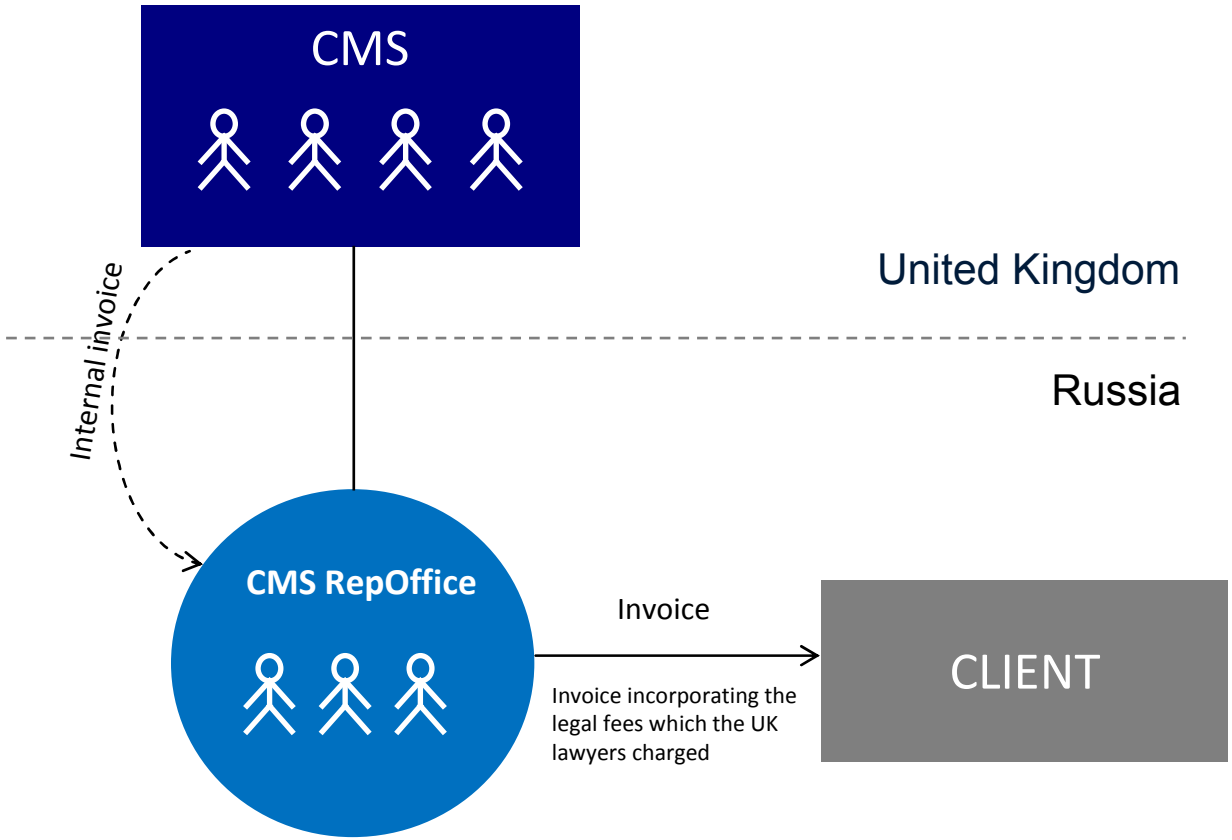

FACTS:

UK and Russian lawyers worked on the same project for Russian clients (single contract for the works performed by both the Moscow office and the UK head office)

The CMS Moscow office included entire revenues under the contract into the taxable base of the permanent establishment, including the revenue attributable to the UK lawyers

The Moscow office reflected the revenues attributable to the UK lawyers and invoiced internally as deductible expenses of the Russian permanent establishment (and not as a portion of direct and indirect expenses of the head office)

The CMS Case – Issues

- Whether:
  - the entire revenue stream should be deemed related to the Russian permanent establishment and taxed in Russia;
  - the branch could deduct fees the UK lawyers would charge based on their hourly rates (and invoiced internally by the head office to the Russian branch) as expenses under Article 307 of the TC;
  - the UK-Russia double tax treaty provide for any extra protection than domestic rules do;
  - the UK-Russia double tax treaty could apply given that the entity is a partnership, a “flow-through” entity;
  - the Russian VAT should be withheld on the internal money transfer;
  - the branch could be taxed as if it were a functionally separate and independent enterprise;
  - And many other ……...

The CMS Case – Trend or Incident?

- Why important?
- Position of the courts
- The *Bloomberg* case
- Recent attitude and focus of the Russian tax authorities

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Thin Cap Rules: New Approaches Resulted from the Severniy Kuzbass Case

Rustem Akhmetshin
Senior Partner for Pepeliaev Group

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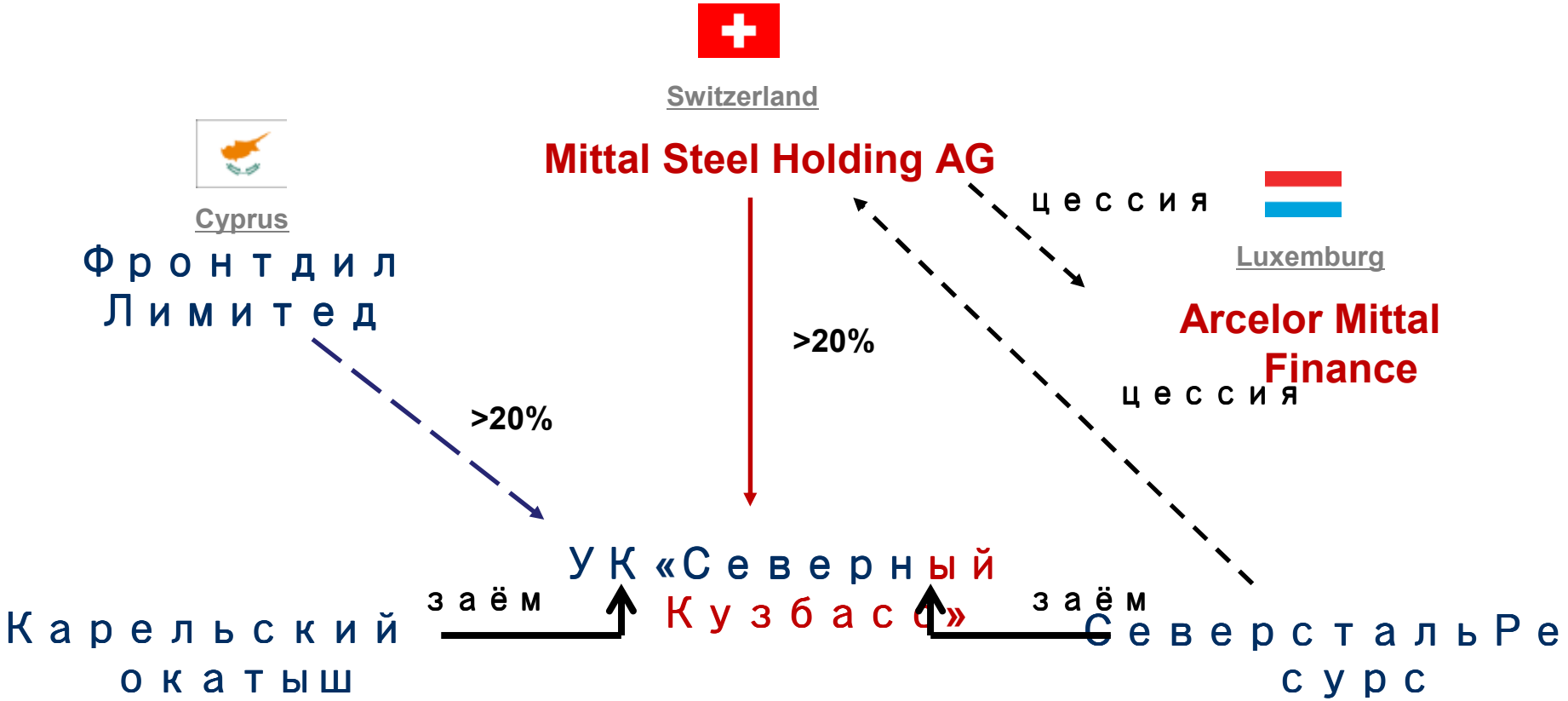
Switzerland
Mittal Steel Holding AG
Cyprus
Фронтдил Лимитед
цессия
Luxemburg
Arcelor Mittal Finance
>20%
>20%
цессия
УК «Северный Кузбасс»
заём
заём
Карельский окатыш
Северсталь Ресурс

In lower courts opinion, Russian thin cap rules should not be applied because of non-discrimination provisions of relevant DTTs (with Cyprus and Switzerland)

Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected (Art.24 (4)) .

15.11.11 Supreme Arbitration Court overturned lower courts' decisions. Which might be grounds for that?

Option 1

DTTs and specifically Art.24 are applicable when the income is paid **from one State to another State**, not within the same State:

Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected (Art.24(1))

Option 1

BUT Art.24 (4) directly stipulates:

Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the **other** Contracting State, **shall not be subjected in the first-mentioned State** to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

Option 2

Art.24 prohibits discrimination for **similar** enterprises only:

Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other **similar enterprises of the first-mentioned State** are or may be subjected.

All Russian enterprises owned or controlled by foreign entities are treated in the same way.

BUT the purpose of Art.24 is to provide the same treatment of non-residents and residents.

Option 3

Definition of «dividends» in DTTs allow the application of the national thin cap rules:

The term «dividends» as used in this Article means income from shares… or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights **which is subjected to the same taxation treatment as income from shares** by the laws of the State of which the company making the distribution is a resident (Art.10 (3)).

Option 3

BUT those definitions stipulate just the opposite:

The term «dividends» as used in this Article means income from shares… **or other rights, not being debt-claims, participating in profits**, as well as income from other **corporate** rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident (Art.11(3)).

Option 4

DDTs provide with special regulation of the interests paid between related parties, so national thin cap rules may be applied:

Where, by reason of a **special relationship** between the payer and the beneficial owner … the amount of the interest, having regard to the dept-claim for which it is paid, **exceeds** the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, t**he excess part of the payments shall remain taxable according to the laws of each Contracting State**... (Art.11(5))

But Tax authority must **prove** arm's length principle breakage, and only **excessive** amount of interests may not be recognised for tax purposes.

Option 5

DDTs with Cyprus and Switzerland always assumed priority of the national thin cap rules, new Protocols just “specify” that

It is understood that the provisions of Articles 10 and 11 do not prevent the application by a Contracting State of the generally applicable “thin capitalisation” rules set forth in its domestic legislation (Protocol with Switzerland from 25.09.11, cl.4(a))

BUT actually Protocols have no retroactive force and therefore confirm just the opposite.

Option 6

Expenditures may not be recognised for tax purposes until the interests are paid.

BUT former decision of the Court in SaNiVa Case (24.11.2009) was criticized by experts and even Minfin.

Option 7

The failure to pay interest is an evidence of an unjustified tax benefit, so protective DTTs provisions may not be applied.

BUT the Supreme Arbitration Court has no right to determine the facts that have not been determined by lower courts.

Summary

The Court's grounds can hardly be predicted.

They may relate to

- all DTTs
- specific DTTs, i.e. with Cyprus and Switzerland
- specific details of the case

Consequences will depend on the grounds the Court will chose in it's written decision.

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New Practice: Thin Cap Rules on Sister Company Loans (Naryanmarneftegas Case)

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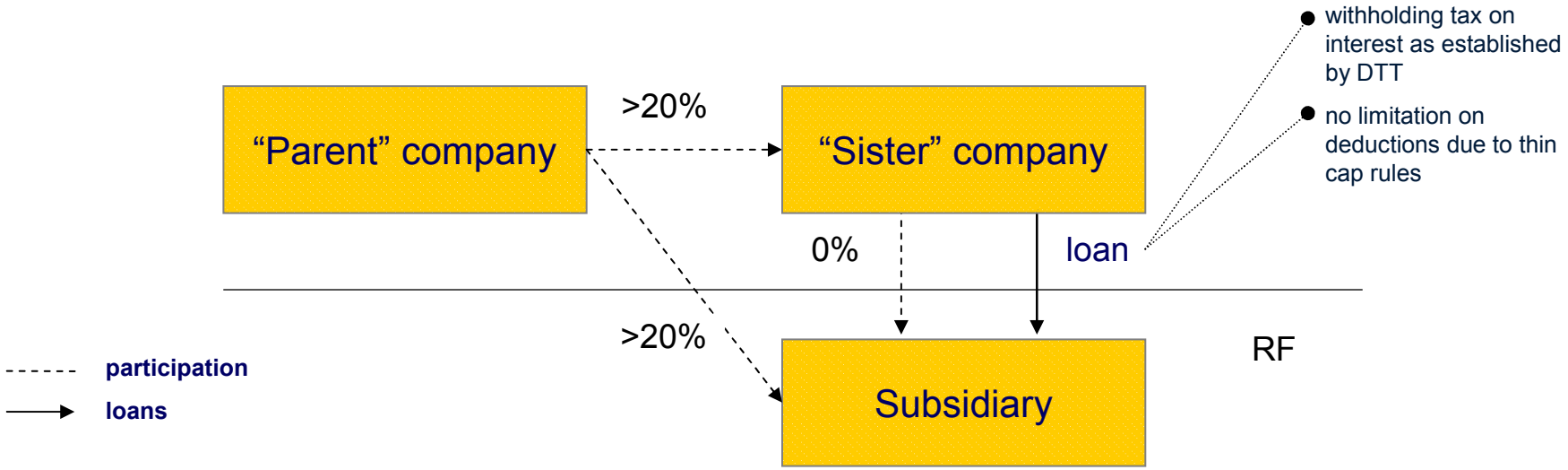
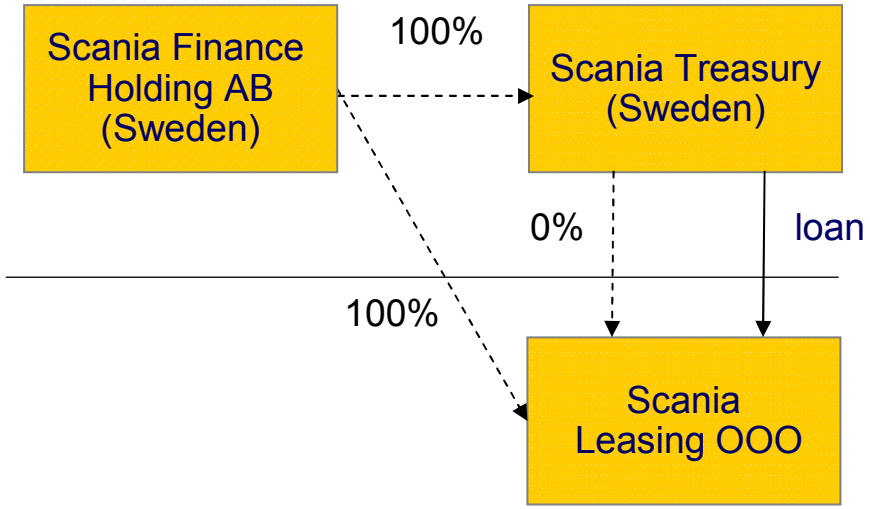
Financing Through a Foreign “Sister” Company



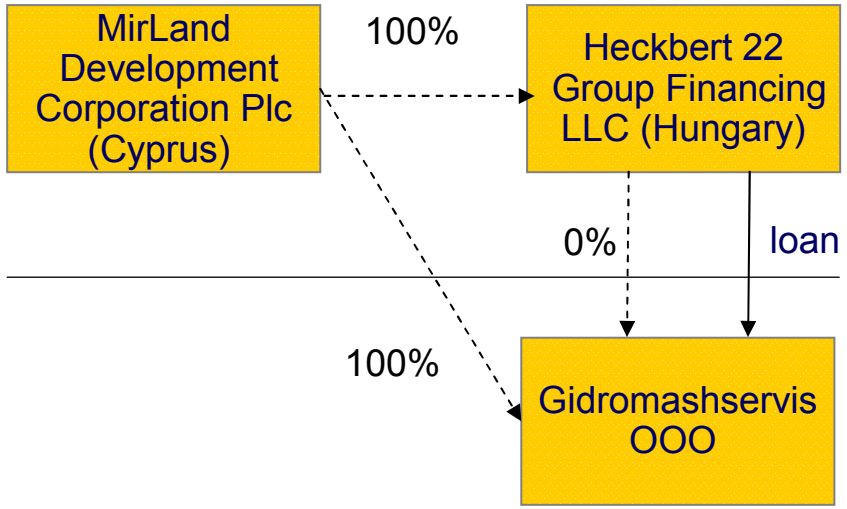
- Form over substance: Russian thin cap rules are not applicable to loans from a foreign “sister” company
- Substance over form: “Sister” company loans are controlled by the “Parent” company

Before 2011: Positive Court Practice

Scania Leasing OOO Case (2010)



Gidromashservis OOO Case (2010)



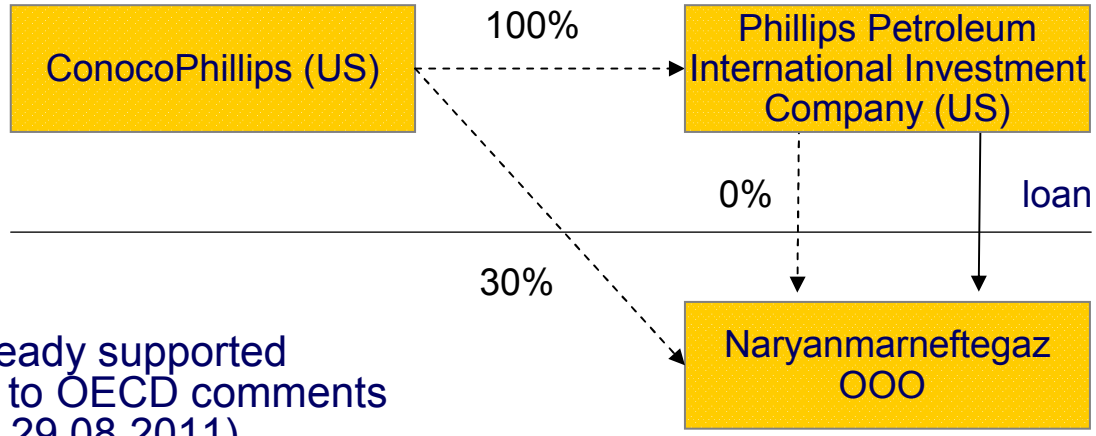
- The lender does not meet the criteria for applying thin cap rules
- The loans should not be treated as controlled debts
- DTT provisions on non-discrimination are applied to national thin cap rules

Now: Change of Approach

Naryanmarneftegaz OOO Case (2011)

- The actual lender is ConocoPhillips:
  - consolidated financial statements
  - shareholders agreement
- Foreign “sister” company was a conduit entity
- The 3:1 restriction was not observed

The loans should be treated as controlled debts



- Ministry of Finance has already supported this approach and referred to OECD comments (Letter No. 03-08-05 dated 29.08.2011)

What's next?

Review of intergroup financing arrangements:

- Any loans from "sister" companies?
- Is 3:1 (12.5:1) ratio observed?
- Estimation of tax risks
- Possible actions to take:

  - repayment of loan
  - conversion of loan into equity
  - additional contributions from participants / shareholders

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Development of the Russian Tax System in 2011 and prospects for 2012 - 2013

New trends in responsibility for tax crimes

Anna Lessova, Dewey&LeBoeuf

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Historical background

Article 173 of the Russian Criminal Code - Fraudulent entrepreneurial activity

Fraudulent entrepreneurial activity means organization of a business venture without the intention to carry out any business activities but with the intention

- to obtain tax preferences
- to receive bank financing
- to obtain other preferences

Article 173 was excluded from the Criminal Code on 7 April 2010 at the request of President Dmitry Medvedev as part of the criminal law liberalization process

Historical background (cont'd)

Set of legislative initiatives represented by the following law drafts brought to the State Duma

See **drafts** No. 449792-5, No.192931-5, No. 387589-4, No. 452067-4, No. 367632-5 on www.duma.gov.ru

As of today, most of them have been revoked

Historical background (cont'd)

Summary of proposed amendments:

1) Prohibition on use of residential addresses for state registration of legal entities
2) Prohibition of state registration by mail
3) Obligation to identify the person authorized to file registration documents *in the shareholders decision*
4) Consent by the landlord of premises to execute a rental agreement with the entity being incorporated
5) Subsequent confirmation of the entity being effectively located at the address communicated to the registering authority
6) Confirmation of the charter capital having been paid up by the time of state registration
7) Suspension of state registration in case of registering authority's doubts as to the authenticity of the documents provided
8) Rejection of state registration in case of any additions or corrections, etc. found in the incorporation documents
9) Deregistration of the legal entity in case of failure to file annual accounts, no income declared or no transactions showing on the bank account

New criminal sanctions for organization of one-day companies

Law No. 419-FZ dated 07 December 2011 / Draft Law No. 497961-5

Changes effective as of 19 December 2011

Criminal Code

Article 173.1
Illegal incorporation (organization, reorganization) of a legal entity

and

Article 173.2
Illegal use of documents for incorporation (organization, reorganization) of a legal entity

Criminal Procedure Code

Amendments to Article 151
Crimes under Articles 173.1 and 173.2 Criminal Code to be investigated by authority for internal affairs or by authority which has detected the crime

Elements of crime

Article 173.1

Incorporation of a legal entity by misleading a front party (*text of the Article*)

with *intention* to use such entity (business venture) to commit one or more offenses related to financial transactions, or transactions involving other assets, etc. (*citation from explanatory note to the draft law*)

Sanctions range from

Penalty of 100,000 rubles up to three years imprisonment

Penalty of 300,000 rubles up to five years imprisonment (crimes involving abuse of office, conspiracy to commit a felony)

Elements of crime

Article 173.2 section 1

Providing an identity document, or issuing a power of attorney for the purposes of incorporation (organization, reorganization) of a legal entity

with *intention* to commit one or more offenses related to financial transactions, or transactions involving any other assets (*text of the Article*)

Sanctions range

From a penalty of 100,000 rubles up to two years imprisonment

Article 173.2 section 2

Purchasing an identity document, or use of illegally acquired personal data for the same purpose as above (*text of the Article*)

Sanctions range

From a penalty of 300,000 rubles up to three years imprisonment

Public criticism

Goal of new provisions cannot be achieved

Tough sanctions on individuals, but insignificant for legal entities

Formally defined crimes, i.e. both crimes do not require damage as an element of crime

Vague language of new provisions

No definition or concept for one-day company in the law or doctrine

Risk of corruption exposure

Risk of objective imputation (under Article 173.2 section 2)

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