

# RUSSIA

## TRADE SUMMARY

The U.S. goods trade deficit with Russia was \$19.7 billion in 2010, up \$6.8 billion from 2009. U.S. goods exports in 2010 were \$6.0 billion, up 11.9 percent from the previous year. Corresponding U.S. imports from Russia were \$25.7 billion, up 41.1 percent. Russia is currently the 37th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Russia was \$21.3 billion in 2009 (latest data available), up from \$20.6 billion in 2008. U.S. FDI in Russia is led by the manufacturing and banking sectors.

## WTO Accession

With the entry into force on January 1, 2010 of the Russia-Kazakhstan-Belarus Customs Union (the Customs Union or CU), Russia turned its focus back to negotiating the terms of its accession to the World Trade Organization (WTO). Russia has completed bilateral market access negotiations with most interested WTO Members, including the United States. In 2010, Russia made significant progress on other issues in the accession negotiations by resolving most of the outstanding bilateral issues with the United States, EU, and other WTO Members, on the terms of its accession.

On the multilateral front, Russia and WTO Members have focused on revising the draft Working Party Report to reflect changes to Russia's trade regime resulting from the introduction of the CU. In the accession negotiations, Russia has made commitments on critical issues such as intellectual property rights (IPR) protection, the levels of certain export duties, and whether Russia's state-owned enterprises would operate on a commercial basis. Discussions are continuing on the adoption and application of sanitary and phytosanitary measures, agriculture (including domestic support levels), rules for requiring import licenses for products with encryption technology and other issues related to how Russia will comply with WTO rules. In addition, Russia's services and goods market access commitments from all 60 of its bilateral agreements must be combined to reflect the best terms for access negotiated by any individual Member with Russia. Finally, Russia must resolve its pending bilateral issues with Georgia.

## IMPORT POLICIES

On January 1, 2010, the Customs Union adopted a common external tariff (CET) with the majority of the tariff rates established at Russia's applied rates and on July 1, 2010, a common CU Customs Code entered into effect. As a consequence, Russia's import tariff levels, non-tariff import measures (*e.g.*, tariff-rate quotas, import licensing and trade remedy procedures) and customs policies (*e.g.*, customs valuation and country of origin determinations) are determined at the CU rather than the national level. On these issues, CU Agreements and CU Commission Decisions establish the basic principles that are then implemented at the national level through domestic laws, regulations and other measures. Customs Union agreements and CU Commission Decisions also cover issues such as border enforcement of intellectual property rights, development of technical regulations and sanitary and phytosanitary measures.

Although the three governments had announced that internal customs barriers between Russia and Belarus would be eliminated by July 1, 2010, this step has not occurred. Internal customs barriers between Russia and Kazakhstan are scheduled to be eliminated as of July 1, 2011.

Russia continues to maintain a number of import restrictions, such as customs charges and fees that exceed the cost of the service provided, and valuation procedures that result in artificially high total tariff charges. Compliance with licensing, registration, and certification regimes is burdensome. Discussions continue on eliminating these and other measures, or modifying them so that they are consistent with WTO requirements and other internationally accepted practices.

### **Tariff-Rate Quotas**

Russia's WTO bilateral market access agreement with the United States sets out a framework, including a time schedule, for negotiations on how meat and poultry goods will be treated up to and after 2009. On December 16, 2009, Russia extended its quota regime through 2012, with significantly reduced in-quota market access for poultry and pork, and a slight increase for beef. The CU now has responsibility for determining the overall TRQ volume for a product and its allocation among the three CU Parties. On November 18, 2010, the CU Commission announced new TRQs for 2011. While the scope of Russia's global poultry TRQ was narrowed by the exclusion of certain tariff lines, the in-quota level was reduced by approximately 40 percent and country-specific allocations were eliminated. Russia retained country specific TRQ allocations for beef, pork and pork trimmings. Russia's frozen beef in-quota allocation for the United States was increased and the in-quota allocation for fresh beef, pork, and pork trimmings was left unchanged.

### **Import and Activity Licenses**

Import licenses and/or activity licenses to engage in wholesaling and manufacturing activities are necessary for the importation of certain products, including alcoholic beverages, pharmaceuticals, products with encryption technology, explosive substances, narcotics, nuclear substances, equipment to be used at nuclear installations and corresponding services, hazardous wastes (including radioactive waste), and some food products (*e.g.*, unprocessed products of animal origin).

Currently, in order to obtain a license to import alcohol or alcoholic products into the Russian Federation, an importer must also obtain an activity license to warehouse and distribute alcohol and alcoholic products even though those activities are not related to importation. In addition, Russia has adopted new technical regulations governing warehousing of alcoholic products. U.S. industry representatives have voiced concerns that enforcement of these new regulations, combined with the Federal Service for Regulation of the Alcohol Market's (FSR) refusal to accept license renewal applications more than 18 calendar days prior to the expiration of the activity license, will result in the expiration or revocation of many activity licenses, rendering any inventory in Russia illegal. According to industry representatives, the FSR's refusal to renew activity licenses in advance of their expiration increases the burden on importers. Even if a renewal is granted within the 18 days, the importer must then apply for an import license from the Ministry of Industry and Trade, acquire excise stamps from the Federal Customs Service, and secure the bank guarantee before importation can occur, leading to the possibility of significant disruptions in supply. Furthermore, pursuant to the new CU licensing regime, importers must obtain an import license for each type of alcoholic product (a requirement previously applied only to imports of vodka, tequila, grappa, and pure ethyl alcohol) under a burdensome and time-consuming process. Cumulatively, U.S. industry estimates that Russia's regulations on importation of alcoholic products have a negative effect of up to \$10 million annually on U.S. exports.

In 2010, the Customs Union issued regulations on the importation of products with encryption technology. Under CU regulations, Russia requires that any product containing high levels of encryption technology be tested and approved by Russia's Federal Security Service before it can be licensed for importation into Russia. This process can often take six months or longer to complete. Products with "low encryption" may be imported after a one-time notification is processed, which is typically completed

in 10 days. Under the CU's narrow definition of "low encryption," however, many mass market items whose cryptographic capabilities cannot be changed by the user fall under the more burdensome licensing procedures. In a November 2006 bilateral agreement, the Russian government agreed to establish a streamlined system for the importation of goods containing encryption technology through the implementation of transparent, nondiscriminatory procedures. Among other elements, the Russian government agreed to allow the importation of many commercially traded goods containing encryption technology after a one-time notification – including, specifically, "mass market" goods -- or in some cases, with the application of no licensing or notification requirements at all. The CU regulations, however, only partially implement these commitments. Leading U.S. technology companies contend that the current system impedes imports, delays the creation of an innovative and knowledge-based economy in Russia, and hampers the further development of research and development centers in Russia. The United States continues to work actively with the Russian government on its import licensing barriers for goods containing encryption technology in order to ensure the full implementation of the terms of the bilateral agreement. (*Additional information on electronic commerce barriers is reported below.*)

### **Customs Issues, Taxes, and Tariffs**

As noted above, on January 1, 2010, Russia, Kazakhstan and Belarus adopted a CET. In 2009, Russia's average "most favored nation" applied tariff rate was 10.5 percent. More specifically, agricultural exports to Russia faced an average applied tariff of 13.2 percent, while industrial exports to Russia faced an average applied rate of 10.1 percent. Import tariffs on automobiles and agricultural and construction equipment continued to present particular obstacles to U.S. exports to Russia in 2010.

In 2009, Russia increased import tariffs in various key areas to protect domestic industries, often citing the global economic crisis as justification. With the adoption of the CU CET on January 1, 2010, Russia made many of those "temporary" duties (*e.g.*, tariffs on automobiles, trucks, combine harvesters, soy meal, selected dairy products, and some construction equipment) permanent. With the adoption of the CET, Russia can no longer unilaterally change tariff rates, but rather must submit proposed import tariff changes for approval by the CU Commission. In 2010, the Customs Union decided to increase tariffs on polycarbonates, dairy items, tropical oils, plastic items, used and recapped tires, wine material, agricultural machines and equipment for ports, and decrease tariffs on paper and paperboard, inputs for production of solar modules, wood sheets for veneering, wolfram and cermet waste and scrap, wine material in bulk, equipment for ports (*e.g.*, cranes and supports), and leased aircraft. Because of a drought in Russia in 2010, the Customs Union Commission suspended import duties for six months on potatoes (normally between five percent and 15 percent), cabbage (normally at 15 percent) and buckwheat (normally at five percent).

Excise taxes apply to a number of "luxury" goods, such as liquor and cigarettes, as well as passenger automobiles. Excise tax rates for alcoholic beverages are increasing significantly: in 2010, excise tax rates rose 10 percent on spirits of more than 9 percent ethyl alcohol; Russia plans to increase those rates by an additional 10 percent in 2011. For spirits of 9 percent and less ethyl alcohol, excise tax rates increased 30.5 percent in 2010 and are scheduled to rise another 20 percent in 2011. The excise tax rates in 2010 for table wine, sparkling wine, and beer rose 34.6 percent, 33.3 percent, and 200 percent, respectively. In 2011, they will increase a further 42.8 percent, 28.6 percent, and 11.1 percent, respectively.

Customs authorities in Russia continue to assess duties on the royalty amounts for the domestic use of imported audiovisual materials, such as television master tapes. U.S. industry has complained that this practice represents a form of double taxation, since royalties are also subject to withholding, income, value added, and remittance taxes. U.S. consumer goods companies have also reported that Russian Customs calculates customs duties based on a value that includes royalty payments made by the

companies' Russian subsidiaries to their overseas parent companies for the use of parent company-owned product trademarks. U.S. companies are disputing these assessments.

Throughout 2010, Russian importers of some U.S. food products reported that Russian customs officials were challenging declared import values, particularly of commodity products for which world prices had recently declined. Instead, customs officials used reference prices, resulting in higher import values, and hence higher duty payments. Initially, Russian customs officials requested additional documentation in order to substantiate the declared value, but the requested documents were often unrelated to the specific commercial transaction at issue, as required under Russian law. Consequently, U.S. firms have been disadvantaged as Russian importers have often shifted to third-country suppliers who would provide the requested documents supporting the declared value. Some U.S. companies are challenging these assessments. In addition, U.S. Government officials have raised concerns about these inconsistent valuation practices with Russian Customs.

U.S. industry also reports that Russia does not publish all regulations, judicial decisions, and administrative rulings of general application to customs matters. In addition, U.S. exporters report that customs enforcement varies by region and port of entry, and that frequent changes in regulations are unpredictable, adding to costs and delays at the border.

U.S. companies continue to face a wide array of nontariff trade barriers when exporting to Russia. Nontariff barriers are a topic of detailed discussions in Russia's WTO accession negotiations and in bilateral United States–Russia discussions.

### **Pharmaceuticals**

As Russia prepares to develop its own innovative pharmaceutical industry, major market access barriers remain. Senior Russian government officials have repeatedly stated that they would like to see more local production of pharmaceuticals, including with foreign active ingredients and formulations. The government's long-term pharmaceutical industry development plan calls for Russian manufacturers to account for at least 50 percent of total sales (based on value) by 2020. On September 28, 2010, Russia passed amendments to the Law on the Circulation of Medicines that provide six years of regulatory data protection, which will enter into effect when Russia becomes a WTO member.

### **Alcohol**

Importers of alcohol face a variety of regulatory measures. There was significant confusion and market disruption in the beginning of 2010 as a result of the new CU regulations that required an import license for all imports of alcohol (by contrast, Russia had previously required an import license only for "white spirits"), and many importers were unable to obtain import licenses. Although General Import Licenses were eventually issued, allowing the resumption of imports, the broader array of products subject to import licensing is yet another barrier to exporting these products to Russia. Another long-standing challenge faced by importers is the requirement that all customs duties, excise taxes, and VAT on alcohol be paid in advance using a bank guarantee and deposit. Because the actual amount of the duties and fees may not be known when the guarantees are obtained, the government of Russia has established fixed guarantee amounts. On occasion, these amounts exceed the final actual amounts due, especially for lower value products. In addition, industry has reported that refunds of these guarantees are sometimes delayed for as long as seven months. The advance payment requirement for duties and taxes, and the length of time the bank guarantee refund is held open, may limit trade volumes due to the amount of money that must be dedicated to these guarantees.

## **EXPORT POLICIES**

Although Russia has eliminated export duties on a few products, it maintains export duties on 386 types of products for both revenue and policy purposes. For example, a variety of agricultural products are subject to export tariffs, such as certain fish products, oilseeds, fertilizers, and wood products. Russia has indicated that it intends to eliminate gradually most of these duties, except for products deemed as strategic, such as hydrocarbons and scrap metals. In November 2010, Russia restored a 10 percent export duty on exports of copper cathode, having lifted it in 2009, claiming the need to protect its downstream users of copper cathode (primarily copper rod and wire producers). Russia also increased the export duty on nickel from five percent to 10 percent in November 2010. Historically, Russia's government has established high export duties on crude oil to encourage domestic refining. However, priority fields in Eastern Siberia and the Caspian Sea enjoy a significant discount on the crude oil export duty. Ongoing discussions within the government may lead to a decrease in the gap between crude oil and refined product export duties in 2011.

Over the last three years, Russia's government has been pursuing a policy of raising export tariffs on coniferous logs and round wood in order to stimulate the development of a domestic wood processing industry and to encourage the export of sawn lumber and value added wood products. At the end of 2010, following intense negotiations with the EU, Russia agreed to postpone through 2011 a planned increase in export duties on raw timber (of special interest to Finland) from the current rate of 25 percent to 80 percent, and agreed to reduce its export duties on timber to levels between 5 percent and 15 percent, depending on the type of timber, upon accession to the WTO.

Severe drought and wild fires led to extensive crop damage in 2010, and on August 15, 2010, the government instituted a ban on all grain and flour exports through January 1, 2011. As traders refused to release their grain at below world prices, Russia extended the ban on grain (but not flour) to July 2011 and has suggested that the ban could last longer.

Russia also has burdensome procedures for obtaining export certificates for some items, including samples collected during research expeditions and raw data. Additionally, Russia has strict licenses to control the export of cultural goods, as well as precious stones and metals.

## **INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION**

Russia was listed on the Priority Watch List in the 2010 Special 301 Report. Key concerns cited in the Report included Russia's slow implementation of some of its commitments in the November 2006 Agreement between the Government of the United States of America and the government of the Russian Federation on Protection and Enforcement of Intellectual Property Rights (2006 IPR Agreement). In 2010, Russia implemented the legislative commitments in the 2006 IPR Agreement by passing amendments to Russia's IP law – Part IV of the Civil Code – required to implement the TRIPS agreement. These legislative changes included *ex-officio* authority for Russian customs officials to enforce IPRs at the border in the new Law on Customs Regulation, and (as noted earlier) amending the Law on Circulation of Medicines to provide six years of regulatory data protection, which will become effective when Russia is a WTO Member. In the context of the Custom Union, Russia signed a CU agreement authorizing the creation of a Unified Customs Union IPR Register. The agreement establishes the procedure for registering an IP as well as a framework for the customs authorities of each of the CU Parties to cooperate with each other and with rights holders on border enforcement.

Notwithstanding this progress, concerns remain over lack of action regarding the enforcement-related commitments in the 2006 Agreement, in particular the need for such actions as the imposition of criminal penalties to deter piracy and counterfeiting and increased Internet-related IPR enforcement. While Russia

met its 2006 IPR Agreement commitment to establish an accredited collecting society for the Performers and Phonograms category in 2008, U.S. industry has raised concerns regarding the transparency of how royalties are collected and distributed. The U.S. and Russian governments have an ongoing dialogue to obtain the full implementation of this agreement and to help ensure that Russia's legislation is consistent with international norms.

In 2010, Russia's optical disc production capacity continued to exceed domestic demand, raising concerns regarding optical disc piracy. U.S. copyright industries estimate that approximately 65 percent of sound recordings on the Russian market are pirated, resulting in reported losses of nearly \$2 billion in 2009. However, legitimate DVD sales are on the rise, in part due to increased law enforcement action against pirates, including a 2008 ban on camcording in movie theaters, and a growing preference for high quality products. Within the copyright industry, the software sector has enjoyed the benefits of increased enforcement. The Business Software Alliance estimated that from 2004 to 2009 the software piracy rate decreased in Russia from 87 percent to 67 percent, the steepest drop in that time period for any country in the world.

Internet piracy remains a serious and growing concern. Authorities have begun criminal investigations against operators of Russia-based websites. Notably, Russia opened a criminal case against the administrators of interfilm.ru, a website offering pirated copies of movies before or immediately after they open in Russian theaters. Government investigators involved in the case estimate that the site had caused approximately 38.7 billion rubles (\$1.25 billion) in damages. Western and Russian recording companies have won several civil suits against Internet pirates, although resulting damage awards have been minimal by U.S. standards. Gaps remain in Russian legal and enforcement efforts to address Internet piracy, particularly with respect to sound recordings and movies.

U.S. and multinational companies continue to report counterfeiting of trademarked goods, especially of consumer goods, distilled spirits, agricultural chemicals and biotechnology, and pharmaceuticals. While in the past U.S. firms complained about "trademark squatting" by Russian enterprises attempting to appropriate well-known trademarks not active or registered in Russia, rights holders have been increasingly successful in countering "trademark squatting" schemes through the Russian court system or the Russian Federal Service for Intellectual Property, Patents, and Trademarks (Rospatent). In an effort to advance administrative intellectual property protection, a specialized higher patent chamber at Rospatent has brought greater expertise and efficiency to the adjudication of patent and trademark disputes.

## **Enforcement**

Poor enforcement of IPR in the Russian Federation is a pervasive problem. In the November 2006 IPR Agreement, Russia agreed to improve IPR enforcement while the United States agreed to step up IPR training programs and technical assistance for Russian customs and law enforcement officials. In 2009, the U.S. Patent and Trademark Office conducted seven IPR training programs for Russian police, investigators, prosecutors, judges, and customs officials, and in total trained 286 Russian law enforcement officials. Russian Customs has drafted an "IPR Enforcement Handbook", which will be used by all Russian Federal Customs Service (RFCS) officers. With the passage of the new Law on Customs Regulation, this handbook is now out-of-date, but Russia's customs service may provide a "new edition" of the handbook or issue new guidelines for rights holders in the future. Additional training programs are planned for 2011.

In 2010, Russian law enforcement agencies carried out raids on optical disc production facilities suspected of engaging in pirate activities, including major raids in Moscow and surrounding regions. However, most surprise raids are less effective as the date and time of pending raids are often leaked to the optical disc plant in advance. Russian police continue to carry out end-user raids against businesses

using pirated products. Non-governmental organizations report that police have used IPR enforcement as a bullying tactic to elicit bribes or harass them. For the copyright industry, key enforcement goals include the introduction and enforcement of Internet Service Provider liability in Russia, improved oversight and transparency of collecting societies, cracking down on illegal websites, such as allofmp3 clones, and enhancing measures against online social networks, such as vKontakte, that facilitate internet piracy.

The Supreme Arbitration Court has addressed the issue of civil IPR enforcement by submitting to the Duma a draft law that would create a specialized intellectual property rights court. If approved, the first-ever specialized IPR court would start its work by 2012. The creation of a specialized IPR court would have a positive impact on civil IPR enforcement in Russia. The court's judges would come from within the arbitration courts system and have expertise in intellectual property rights cases.

### **Domain Names**

The Russian Coordinating Center of the National Internet Domain (the Coordination Center) issued a regulation, "Provisions on Priority Registration of Domain Names in the PΦ Domain," that stipulates that domain names must either reproduce or match word designations contained in trademarks. Trademark owners with a ".RU" (Russia) domain name can keep the ".RU," but now have the option of obtaining a ".PΦ" (RF) as well. These .PΦ domain names may be registered for a fee of approximately \$20 for a one-year period, with the possibility of subsequent renewal of the domain name's registration annually. While in practice trademark holders are given priority in registering domain names that are similar to their particular trademark, there is still a potential issue with cyber squatting. The Coordination Center did not specify that domain names derived from the trademark holders would be protected.

On November 11, 2010, the second stage of the registration for Cyrillic domain names began. On that day, the Coordination Center registered 184,352 addresses for the general public. Any individual or legal entity registered in the Russian Federation can obtain a domain name through the registration process at the cost of approximately \$20. Previously, priority registration for the Cyrillic domain name zone began in November 2009 for government entities and trademark holders. Only Russian citizens and businesses registered in the country are able to buy domain names. The .PΦ domain has over 500,000 registered addresses. In December, 2010, the Russian government issued a clarification on the auction provision for domain names, suspending the auction for previously unclaimed names until further notice. The issue is still evolving.

### **SERVICES BARRIERS**

Russia's services market is relatively open to U.S. services suppliers, including in areas such as financial services, education, legal services, and distribution, although specific problems remain in particular areas. The ability to provide services to public utilities and certain energy-related services (*see discussion on energy in the section on Investment Barriers*) remains limited. The process for an individual or a company to obtain a license to provide a service remains difficult, and limitations on the form of commercial establishment affect some sectors.

### **Financial Services and Insurance**

The 1996 federal law "On Banks and Banking Activity" permits foreign banks to establish subsidiaries in Russia. However, Russia does not allow foreign banks to establish branches in Russia. While there is no cap on foreign charter capital in the banking sector, in the insurance sector, foreign insurance firms are subject to a 49 percent equity limitation.

## **Telecommunications**

Many in the industry continue to criticize the lack of transparency in the licensing process in Russia, as well as the five-year to ten-year license validity period, which they argue does not allow them sufficient time to recoup their investment. The scarcity of civilian frequencies has led to competition among Russian mobile operators and impeded the development of new wireless networks in Russia, such as 4G and WiMAX. (Only about 5 percent of Russia's assigned communication frequencies are used for civilian purposes, while 95 percent are reserved for military use.) The government of Russia's efforts to free up and allocate spectrum in order to spur the development of advanced telecommunications are in their initial stages and proceeding slowly. Although Rostelecom initially won 39 of the 40 licenses for frequencies at 2.3 - 2.4 GHz in February and March 2010, in November, 2010, the Ministry of Defense (MOD) blocked the assignment of those frequencies to Rostelecom. Separately, in summer 2010, the government of Russia reportedly intended to award further 2.3-2.4 GHz and 2.5-2.7 GHz frequencies to companies affiliated with the Defense Ministry and Rostelecom. However, the three main incumbent operators (Megafon, MTS and Vimplecom) petitioned Prime Minister Putin in July 2010 to ensure transparency in the allocation of 4G frequencies, leading to postponement of further 4G allocations. Given the lack of an independent telecommunications regulator in Russia, existing private mobile players will face challenges in obtaining spectrum, while companies affiliated with the government are likely to receive preferential treatment. The timeline and process for allocation of 4G mobile spectrum in Russia remain unclear.

In May 2010, Russia issued Directive No. 858 tasking Russia's Ministry of Industry and Trade with developing parameters for telecommunications equipment to ensure that all telecommunications equipment was manufactured within the territory of Russia. Such mandates are consistent with Russia's broad industrial policy of requiring companies to localize their production and use local suppliers. Currently, the amount of Russian-produced telecommunication equipment is quite limited.

U.S. industry reports that certification of new products in the telecommunications industry still suffers from a lack of transparency. Companies in the satellite industry indicate that the lack of transparency also applies to the licensing process for obtaining access to a foreign satellite and that the process itself is overly burdensome. Further, they claim that some of the legal requirements and administrative responsibilities associated with the provision of satellite services appear to be discriminatory, with the Russian government granting a preference for Russian satellite communications systems.

In order to promote GLONASS, the Russian satellite system, the government of Russia is considering a 25 percent import tariff on equipment that has the capability to receive signal from only the U.S.-developed Global Positioning System (GPS), while imported dual GPS/GLONASS receivers would enter with no tariff. The Russian government also plans to mandate that domestic automakers equip their products with GLONASS-based emergency response systems. Additionally, according to the technical regulation on vehicle safety that came into force on September 23, 2010, the design specifications of all special-purpose vehicles (*e.g.*, buses, carriers of dangerous materials) should allow for installation of GLONASS or GLONASS/GPS navigation systems.

## **INVESTMENT BARRIERS**

Russia's foreign investment regulations and notification requirements can be confusing and contradictory, which has an adverse effect on foreign investment. The Russian government has made improving Russia's investment climate a priority, and in August 2010, Deputy Prime Minister Shuvalov was appointed as the country's first investment ombudsman. However, U.S. investors and others continue to cite corruption in commercial and bureaucratic transactions as a barrier to investment. President Medvedev's vow to tackle corruption in Russia included the creation of an Anti-Corruption Council in the



summer of 2008 and an anti-corruption legislation package, which was promulgated in December 2008. However, little progress has been made on implementation.

Telecommunications and media services companies report specific investment restrictions. Russian entities with more than 50 percent foreign ownership are prohibited from sponsoring television and video programs or from establishing television organizations capable of being received in more than 50 percent of Russia's territory or by more than 50 percent of the population. Even tighter investment restrictions have recently been imposed on security firms. As of January 1, 2010, the Law on Private Detective and Security Activities in the Russian Federation prohibits the participation of any foreign capital in a private security operation.

Further obstacles to investment in Russia include inadequate dispute resolution mechanisms, weak protection of minority stockholder rights, the absence of requirements for all companies and banks to adhere to accounting standards consistent with international norms, and the failure of some companies to adopt and adhere to business codes of conduct. Initiatives to address these shortcomings, either through regulation, administrative reform, or government-sponsored voluntary codes of conduct, have made little progress. In July 2010, Russia passed the Law on Consolidated Financial Accounting which requires that, as of 2011, credit, insurance organizations, and other publicly traded companies should prepare their consolidated financial accounting in accordance with international financial reporting standards (IFRS). Effective implementation and enforcement of the law may be undermined, however, by the absence of the necessary by-laws and Russian regulations, in particular, on the recognition of the IFRS and their application in Russia. Inadequate transparency in the implementation of customs, taxation, licensing, and other administrative regulations also discourages investment.

### **National Treatment**

The 1999 Investment Law codifies principles of national treatment for foreign investors, including the right to purchase securities, transfer property rights, pursue rights in Russian courts, repatriate funds abroad after payment of duties and taxes, and receive compensation for nationalizations or illegal acts of Russian government bodies. However, the law goes on to state that federal law may provide for a number of exceptions, including, where necessary, "the protection of the constitution, public morals and health, and the rights and lawful interest of other persons and the defense of the state." These broadly defined exceptions give the Russian government considerable discretion in prohibiting or inhibiting foreign investment in a discriminatory fashion. The 1999 Investment Law includes a "grandfather clause" that stipulates that existing (as of 1999) "priority" foreign investment projects with foreign participation of over 25 percent be protected from unforeseeable changes in the tax regime or new limitations on foreign investment. The law defines "priority" projects as those with a foreign charter capital of more than \$4.1 million and with a total investment of more than \$41 million. However, the lack of corresponding tax and customs regulations means that any protection afforded investors by this clause is only theoretical.

The government enacted the Strategic Sectors Law (SSL) in May 2008. The SSL introduces a list of 42 "strategic" sectors in which purchases of "controlling interests" by foreign investors must be preapproved by the Russian government. Many observers, while welcoming more clarity on the rules, have criticized the SSL for being overly broad in the number of sectors it covers, and raised concerns regarding the approval process. During 2010, Russian government officials, including Prime Minister Putin, called for further liberalization and streamlining of the law. The Federal Antimonopoly Service has already submitted to the Cabinet several proposed amendments, which will soon be sent to the State Duma for approval.

In addition, the government is pursuing steps to privatize state assets, both to increase market forces in the economy and to raise revenue for the federal budget. In June 2010, President Medvedev signed a decree

reducing the number of “strategic” companies from 438 to 200, with a view to selling government shares in the firms removed from this list. On October 17, the Cabinet approved its 2011-2013 Privatization Plan, paving the way for an estimated sell-off of nearly \$60 billion of stakes in more than 850 enterprises. The government of Russia will retain controlling stakes, however, in major Russian companies such as Rosneft, Russia Railways, and banking giants Sberbank and VTB.

To date, the Government Commission on Control of Foreign Investment in the Russian Federation has received around 100 applications for foreign investment, reviewed dozens and disapproved two applications. However, the majority of the approved transactions actually involved Russian investors as many of them are structured using foreign offshore holding companies. Public information was available on the following foreign companies that received approval under the SSL: Coca-Cola and French Danone (food manufacturing); Germany’s Fraport AG (operator of Frankfurt’s airport, for purchase of St. Petersburg’s Pulkovo Airport); Bulgarian Aviation Group (for purchase of Kazan’s airport); France’s Sanofi-Aventis (pharmaceuticals); South African DeBeers (diamond mining, but the deal fell through because of the financial crisis); Italian Alenia Aeronautica (development of Sukhoi Superjet 100); Canadian Barrick Gold and Kinross Gold Corp., and Kazakh Gold (gold mining); and Khartron, which is controlled by the Ukrainian government (space cooperation).

## **Taxes**

From 2002 through 2008, the corporate profits tax was 24 percent, 11 percentage points higher than Russia’s flat 13 percent tax on personal income. However, in late 2008, as an economic stimulus measure, Russia reduced the corporate profits tax rate to 20 percent, effective January 1, 2009. In 2010 Russia decreased the social payments tax for information technology companies from 26 percent to 14 percent. For companies in other sectors, the social payments tax will increase in 2011 from 26 percent to 34 percent. President Medvedev announced in November 2010, however, that the social payments tax should remain at 26 percent for small and medium enterprises in the manufacturing and social sectors for the next two years.

Companies report that VAT refunds to Russia-based exporters, which should be provided within three months after a claim is submitted, often do not occur on time, with customs and tax authorities applying a number of burdensome additional requirements. In addition, leasing companies find that VAT assessed on inputs to exported final products is often not refunded at all, for a number of reasons. In some cases, local tax inspectorates have initiated audits and attempted to seize bank accounts of the leasing companies, thus forcing exporters to seek very expensive and time consuming court enforcement. In fact, anecdotal reports from a variety of Russian and U.S. companies indicate that in many cases, companies have to resort to court action to receive their VAT reimbursements. In addition, during the course of their audits, Federal Tax Service officials now have the authority to confiscate improperly disbursed VAT refunds, with penalties. VAT refunds on exports are also the source of significant fraud, making it even more difficult for legitimate exporters to obtain refunds.

U.S. companies have also raised concerns about Russian tax authorities’ scrutiny of payments that cross Russia’s border, but remain within the structure of the same legal entity. This tax issue has arisen chiefly in two contexts: (1) when a multinational company transfers an employee temporarily to the company’s Russian office from another office outside Russia; and (2) in intra-company payments for the use of intellectual property. Under internationally accepted accounting standards, these normal business practices are handled as an intra-firm payment from one office to the other, or to the headquarters in the case of royalty payments. However, tax inspectors have often disputed such expenses as “economically unjustified” and, consequently, not permissible under the Russian Tax Code. While foreign firms with Russian operations have been careful to ensure that their accounting methods are consistent with the

Russian Tax Code, several foreign firms have been subjected to audits and claims for back taxes in these situations.

### **Energy Sector**

The Strategic Sectors Law and Russian subsoil legislation require government approval for foreign investment in excess of 10 percent in companies operating subsoil plots of “federal significance”, as well as for foreign investment in excess of five percent if the target company is state-owned. “Federal significance” is defined as oil fields with 510 million barrels or more of reserves and natural gas fields with 1.8 trillion cubic feet or more.

In addition, subsoil legislation limits the licensing of strategic fields located on the continental shelf to Russian legal entities at least 50 percent controlled by the government with at least five years of experience in the development of fields on the continental shelf. In November, the Ministry of Natural Resources announced plans to reduce the prior experience requirement for licenses on the continental shelf. Foreign companies may participate in shelf projects as a minority partner.

### **ELECTRONIC COMMERCE**

Electronic commerce is growing rapidly in Russia, and was estimated at \$20 billion in 2010. The volume of online commerce is expected to exceed \$25 billion by 2012. Russia’s law currently does not provide identical legal status to both electronic and paper documents. Because of this discrepancy, electronic settlement of outstanding charges is problematic, and currency control provisions may apply when paying in a currency other than the ruble. The tax aspects of electronic commerce are virtually unexplored, and this area of the law is still developing.

Russia’s Law on Electronic Digital Signatures went into effect on January 14, 2002. This law does not follow the Model Law on Electronic Signatures of the U.N. Commission on International Trade Law, but rather defines electronic signatures narrowly, making public-key technology the sole acceptable digital signature technology. It also requires that hardware and software used in digital signature authentication programs be certified in Russia. This requirement gives the Russian government the right to insist on the decompilation of electronic signature programs. The requirements contained in Russia’s digital signature law, as well as the licensing requirements related to goods with encryption technology, impede trade in goods that could be used to further electronic commerce in Russia.