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THE LEGAL REGULATION OF FOREIGN INVESTMENT IN RUSSIA

VLADIMIR F. POPONDOPULO
(Translated by Edward R. Brown)¹

The legal regulation of foreign investment in Russia is carried out in accordance with the Statute of the Russian Federation dated July 4, 1991, entitled, "Concerning Foreign Investment in the Russia Federation"² and in accordance with several other basic laws.

The statute prescribes the concept of foreign investment and the forms in which it may take effect, the procedure for the creation, operation and liquidation of foreign investment business enterprises, the procedure for the acquisition by foreign investors of ownership shares in the enterprise, its stock or other securities, the procedure for the acquisition by the foreign investor of the right to use real property and other property rights, the procedure for effecting foreign investment in free trade zones, and several other rules and regulations. Included in the notion of foreign investment are "all types of commercial and intellectual property invested by the foreign investor with the goal of achieving profits."³

Foreign investors can be foreign legal entities, foreign citizens, persons without citizenship, Russian citizens, persons maintaining permanent domicile abroad on condition that they are registered for the conduct of business in the country of their citizenship or permanent domicile, foreign governments, and international organizations.

Foreign capital can be invested in any target unless the law expressly prohibits foreign investments in such targets. Targets of foreign investment may be new business enterprises, reconstituted business enterprises that have

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Dr. Popondopulo prepared this article based on a lecture which he gave at Cleveland-Marshall College of Law on September 29, 1994. Mr. Brown prepared the footnotes.

² Foreign Investments in the RSFSR Act, July 4, 1991, *available in* LEXIS, Europe Library, Sovleg File.

³ *Id.*

already been active, or foreign investment may be undertaken by participation in the financing of construction of establishments in the public sector. Investment through participation in joint venture enterprises is encouraged. Foreign investors can also participate in the privatization process of governmental enterprises.

Prescribing the guaranties for foreign investment the July 4, 1991, law above all contemplates that the legal environment for foreign investment cannot be less favorable than the legal environment for investment activity of Russian legal entities and citizens, except in cases specifically contemplated in the law. In particular, foreign investment is not subject to nationalization, requisition or confiscation, except in those exceptional circumstances contemplated in the law. In the case of nationalization or requisition prompt, adequate and effective compensation must be paid to the foreign investor, who is entitled to damages, including damages for lost profits, in a currency acceptable to the foreign investor. In this regard the decision of the office of the executive branch conducting the confiscation can be appealed to the courts.

Disputes relating to the compensation for confiscated foreign investments, including disputes about questions of amount of compensation, the conditions or the procedures for payment of compensation may be referred either to the Supreme Court or the Supreme Commercial Court of the Russian Federation if there is no other forum contemplated by international agreement operating on the territory of the Russian Federation. But by agreement of the parties disputes may be reviewed by an arbitration tribunal designated in the investment agreement.⁴

Foreign investors, after the payment of all appropriate taxes, are guaranteed noninterference with the repatriation in a foreign currency of the income received on such investment. The income received by the foreign investor in rubles may be reinvested in businesses in the Russian Federation. In order to effectuate the monetary means for such reinvestments foreign investors may maintain cash and payment accounts in banks on Russian territory, but without right of repatriation abroad of sums in such accounts. However, foreign investors may utilize their ruble accounts to purchase foreign currency on the domestic currency exchange in accordance with procedures contemplated by Russian legislation, that is through duly authorized banks.

What are the procedures for the establishment of foreign investment business enterprises? These business enterprises are established and operate under the legal forms of enterprises contemplated in the Statute of the Russian Federation dated December 25, 1990, entitled "Concerning Business Enterprises and Business Enterprise Activity." There can be established and operated business enterprises with a share ownership by foreign investors, i.e., joint ventures, but also through subsidiaries or affiliates of foreign enterprises; or through business enterprises wholly belonging to foreign investors, or their

⁴For an extensive analysis of the judicial and arbitration forums where disputes between foreign and Russian parties may be heard, see Volker Viechtbauer, *Arbitration in Russia*, 29 STAN. J. INT'L L. 355 (1993).

subsidiaries or affiliates; or through affiliates and agent representatives of foreign legal entities.

The charter document of the foreign investment enterprise must prescribe the nature and business purpose of the enterprise, the allocation of ownership shares, the amount and procedure for the establishment of the stated capital, the amount of the participatory shares, the structure, composition and authority of the board of directors, the procedure for corporate decision making, those decisions requiring unanimous or special majority consent, and the procedure for the liquidation of the enterprise. The allocation of the investment in the stated capital of the enterprise is set by consent among the shareholders. The value of the investment may be effected in rubles or in a foreign currency converted to a ruble value at the exchange rate quoted by the Bank of Russia.

Government registration of the foreign investment enterprise is accomplished through the Ministry of Finance of Russia and through those government offices duly authorized by the Ministry. In particular, in St. Petersburg, registration is effected through the committee of external economic relations of the city mayor's office.

Government registration of the foreign investment enterprise is accomplished with the submission of the following documents:

1. *For joint venture enterprises—*

- written application of the incorporators with the request to effect registration;
- two authenticated (with notarization) copies of the incorporation documents, including the charter and by-laws of the joint venture enterprise;
- for the participating Russian legal entities: an authenticated (with notarization) copy of the decision of each proprietor or controlling shareholder relative to the formation of the enterprise or a copy of the decision to this effect by the board of directors, and also an authenticated (with notarization) copy of the charter and by-laws or other incorporation documents for each Russian legal entity participating in the formation of the joint venture enterprise; and,
- for each foreign investor: documentation respecting the credit worthiness of the foreign investor, issued by the bank whose customer is the foreign investor, with an authenticated translation into the Russian language, and also a certified extract of registration of the foreign investor entity from the appropriate records of the country or state of incorporation or organization or principal place of business of the foreign investor or equivalent documentation of the status of the foreign investor in accordance with the laws of the country or state of its principal place of business or domicile with an authenticated translation into the Russian language.

2. *For business enterprises wholly owned by foreign investors—*

- written application for registration by the foreign investor;
- two authenticated (with notarization) copies of the incorporation documents, including charter and by-laws of the enterprise;

- documentation as to credit worthiness of the foreign investor issued by the bank whose customer is the foreign investor with an authenticated translation into the Russian language; and,
 - certified extract of the registration of the foreign investor entity in the appropriate records of the country or state of incorporation or organization or principal place of business with an authenticated translation into the Russian language.
3. *For affiliates of foreign investment enterprises or affiliates of foreign legal entities—*
- application executed by the CEO or head of the enterprise establishing the affiliate, with a request to process registration;
 - authenticated (with notarization) copy of the minutes of the board of directors or other governing organ of the enterprise respecting the establishment of the affiliate;
 - authenticated (with notarization) copy of the charter and by-laws of the affiliate;
 - authenticated (with notarization) copy of the incorporation documents (charter and by-laws) of the enterprise establishing the affiliate; and,
 - for foreign legal entities: certified extract of the registration of the foreign entity from the appropriate records of the country or state of incorporation or organization with an authenticated translation into the Russian language.

The official authentication of the translation of the documents into the Russian language may be effected through the Russian consulate in the foreign country or through the consulate of the country of the foreign investor in Russia.

The registration process for the foreign investment enterprise must be completed within twenty-one days from the time of the submission of the application for registration. The enterprise is issued a certificate of registration and acquires the status of a legal entity from the moment of registration. Any refusal to register can be appealed to the courts.

The liquidation of foreign investment enterprises is effected in those circumstances and in accordance with the procedures contemplated by the applicable Russian legislation. In particular, in the event of failure to confirm within the first year after registration that each subscribing shareholder has fulfilled at least 50% of the capital investment to which he subscribed as set forth in the incorporation papers, then the office registering such enterprise may declare the enterprise insolvent and render a decision respecting its liquidation.

The foreign investment enterprise can effect any type of activity responding to the purposes set forth in the charter of the enterprise with the exception of those purposes prohibited by Russian legislation. For the conduct of certain types of activities the enterprise must receive a license, for example in the case of insurance or banking activities, activity on the securities market and several other activities. The license is issued by the appropriate government organ regulating the activity, such as the minister of finance, the central bank and others.

Foreign investors possess customs privileges. In particular there is exempt from import duties property brought into Russia in the capacity of an

investment in stated capital of the enterprise and contributed to the enterprise by the foreign investor within the limits of the prescribed term for contributions to initial capital, established in the incorporation papers. Also exempt from duty may be property designated strictly for production purposes and property brought in by foreign workers for their own use.

Foreign investment enterprises as well as foreign investors must pay taxes as fixed by the Russian tax laws. Those enterprises which operate in the priority sectors of the economy and in special free trade zones may be able to obtain privileged tax treatment. The tax system of Russia is just coming into effect and appears at the moment very complex. The tax system encompasses tens of different federal, regional and local taxes. In particular, the tax rate on profits for all enterprises since January 1, 1994, has been 35%. In addition there is a tax on value added, on personal property, on advertising, and other taxes.⁵

Labor relations for a foreign investment enterprise are regulated by Russian labor legislation, the applicable collective bargaining agreement and individual employment contracts. Foreign workers receiving their earnings in a foreign currency, after payment of taxes, may transfer the remainder abroad. Pension payments on behalf of foreign workers may be transferred to the pension fund of the worker's domicile in the currency and per the conditions prescribed by such foreign country.

Often, instead of establishing a separate legal entity, foreign legal entities prefer to conduct their business activity on Russian territory through a permanent agent/representative as such agent needs register only with the tax authorities. The representation of foreign legal entities may be effected through bureaus, offices, and agencies as well as through individual persons, duly authorized by the foreign legal entity to represent their interests in Russia.

Registration of the agent/representative may be made without charge. For such registration there must be submitted a certified extract of registration of the foreign legal entity from the appropriate record office of the foreign legal entity's country of origin along with a power of attorney to the head of the agency issued by the CEO or managing person of the foreign legal entity. The taxing authority charged with registering the agent then issues to the registering agent/representative a certificate of registration for a five year term. After that the agent/representative may open ruble and foreign currency bank accounts.

As distinct from Russian legal entities, including foreign investment enterprises, there exists no requirement in the Russian legislation for the agency/representative to have an accountant prepare periodic financial statements of its business activity. The agent/representative may submit one tax return per year and pay the tax on profits one time annually without making any advance payments on the basis of a declaration of estimated

⁵For a further discussion of the range of corporate profit taxes in Russia as well as other taxes, including VAT, and import and export tariffs, see Eric T. Bruder, *Russia's Rapidly Changing Tax Structure Creates a Challenge for U.S. Business*, BUS. AM., Nov. 1994, at 30.

income. The tax on profits is assessed only on that portion of the profits of the foreign legal entity, who maintains an agent/representative in Russia and which is earned in connection with the agent/representative in Russia. The tax is calculated in rubles and need not be paid in cash. According to the wishes of the taxpayer the tax may be paid in a foreign currency adjusted to the value of the ruble as quoted by the Central Bank on the date the tax is paid.

As has already been noted foreign investors may obtain a share participation in an existing Russian business enterprise, in the form of such enterprise's stock or other securities. In this regard, if the share acquisition is effected through payment in a foreign currency, then the enterprise in question is considered a foreign investment enterprise. If the acquisition of shares is paid for in rubles, the enterprise will be considered a foreign investment enterprise only if the foreign investor acquires more than 50% of the stock ownership or participatory share.

Foreign investors may acquire an ownership share in privatized government enterprises practically on the same terms as Russian share buyers. Foreign investors may participate in securities auctions and public sales, make investment trades, and buy shares in public companies. Acquisition of shares in privatized companies engaged in the production of fuel oil, the extraction and processing of ore, precious stones, semiprecious stones, precious metals, and radioactive elements is subject to the decision of the government of the Russian Federation or of its constituent republic.

Foreign investors and foreign investment companies are granted the right to the use of real estate, including renting land as well as to the use of other natural resources in accordance with the legislation of Russia. The sale of land parcels to foreign legal entities or persons so far has not been put into practice although existing law contemplates such practice, specifically Decree No. 631 of the President of the Russian Federation dated June 14, 1992.⁶ Foreign investors may obtain the right to rework or process natural resources on the basis of concessionary agreements, consummated by the foreign investors with the government of the Russian Federation or its duly constituted authorities. The duration of such concession agreements cannot be more than fifty years. At the present time there is work underway on a draft of a new law pertaining to this problem and entitled, "Concerning Concession Contracts and Agreements Relative to the Division of Output."

Russia maintains several free trade zones wherein is established a range of privileges for business activity for foreign investors and enterprises: streamlining of the registration procedures, a range of tax privileges, a lower rate of payment for the use of land and other natural resources, a special

⁶President's Edict No. 631, Procedure Governing Sale of Land Parcels at Privatisation of State and Municipal Enterprises, June 14, 1992, available in LEXIS, Europe Library, Sovleg File.

Paragraph 3 of Edict No. 631 states: "Any legal and natural person, including foreign persons, and stateless persons, recognized as purchasers under the Privatisation of State and Municipal Enterprises in the RSFSR Act, may be purchasers of land parcels, under the present Procedure."

customs regime, procedures for entry and exit from the zone without the necessity of visas for foreign citizens and so on. The most successfully developed free trade zones are Nakhodka and Vyborg.⁷

St. Petersburg appears to be one of the most forward looking regions for foreign investment.⁸ At the present time in St. Petersburg there are registered almost 8,000 foreign investment enterprises from more than forty countries of the world. In this regard there are more than 850 enterprises whose capital is wholly owned by foreigners. Fifty per cent of all foreign investment enterprises originate from ten countries: 11.25% American; 10% Finnish; 8.5% German; 4.7% Polish; 4.3% Swedish; 3.6% Chinese; 3.3% Italian; 2.9% British; 2% Bulgarian; and 1.7% French. In St. Petersburg there are more than ninety agent/representatives for American companies alone. The principal attractions for such foreign capital investments are banks, all forms of transportation, telecommunications, tourism, and customs handling.

For the purpose of creating a favorable investment climate there is underway in St. Petersburg the construction of multi-faceted business centers. Already established and functioning are United States and German business centers.⁹ There are underway in the planning stage another twenty such business centers. They are and will be called upon to assure normal business activity for foreign and Russian businessmen from the standpoint of providing them information, banking, legal infrastructure, consulting, and conference facilities.

⁷Nakhodka is a Far Eastern port on the Japan Sea about 100 kilometers east of Vladivostok. Vyborg is about 130 kilometers northwest of St. Petersburg, close to the Finnish border.

⁸For corroborating opinions of Western journalists that St. Petersburg offers a favorable investment climate and investment advantages superior to Moscow, see *St. Petersburg, Rude Awakening*, EUROMONEY, Sept. 1994, at 133-38; see also *St. Petersburg, The Cradle of Capitalism*, THE ECONOMIST, Nov. 6, 1993, at 94.

⁹For the United States Commerce Department's version of the opening of the American Business Center at 57 Bolshaya Morskaya Street in St. Petersburg, see Cherie Peacher, *New US&FCS Office/American Business Center is Open in St. Petersburg, Russia*, BUS. AM., Nov. 1994, at 27-28. The article states that the new center will serve as a clearinghouse for information on related United States government and private sector programs and offer such services as telecommunications, office and computer rental, meeting facilities, interpretation and translation, secretarial help and photocopying.

