

RUSSIA

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ARBITRATION/LITIGATION

Russian Arbitration tribunals may consider disputes between foreign entities

The Presidium of the Supreme Arbitration Court (the "Presidium of SAC") adopted a ruling which approves the competence of Russian arbitration tribunals to consider disputes involving foreign entities.

Company "ESF Euroservices BV" (the "Company") transported three containers owned by "Hyundai Merchant Marine" (the "Firm") to the port of St. Petersburg. A leak of a flammable substance from the containers was detected and the unloading process was suspended. Officers of the Russian Emergency Situations Ministry were engaged to unload the containers. As it was discovered, the containers were not properly prepared for the transportation at the fault of the Firm.

The Company suffered additional expenses and sent a written claim to the Firm. The Company's claims were left unanswered.

The Company's representatives lodged a statement of claim with the Arbitration tribunal at the Central Agency for transport in the city of Moscow (the "Arbitration tribunal") on the basis of an agreement for dispute resolution contained in paragraph 25 of the Bill of Lading. The Arbitration tribunal ruled in favour of the Company.

The Firm did not agree with this decision and filed a statement for its abolition with the Arbitration Court of Moscow ("Arbitration court"). The Arbitration court overturned the decision of the Arbitration tribunal, and this ruling was later confirmed by the Federal Arbitration Court of Moscow District, who let the decision of the Arbitration court stand.

Previously certain courts have come to the conclusion that Russian arbitration tribunals could not consider the dispute between two foreign entities.

The Presidium of the SAC stated that the Russian Law on arbitration tribunals allows Russian Arbitration tribunals to consider cases involving foreign companies and individuals. A similar legal position was set out by the Presidium of SAC in an information letter regarding the execution of decisions of Arbitration tribunals.

The Courts in satisfying the claims of the Firm to cancel the decision of the Arbitration tribunal did not take into account the rules of the Arbitration tribunal on whether it has jurisdiction to consider disputes involving foreign entities and ignored the judicial practice which had been formed in relation to this type of dispute. The Arbitration tribunal considered the dispute involving foreign entities according to the provisions of the law.

Thus, the Presidium of SAC, approved the competence of Russian Arbitration tribunals to consider disputes involving foreign entities.

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BANKING AND FINANCE

Upcoming legislative amendments in relation to the bankruptcy of financial organisations

Federal Law "On amending the law of the Russian Federation "On the organisation of insurance business in the Russian Federation" and certain other legislative acts of the Russian Federation" (the "Law") was adopted on 22 April 2010 and will come into force on 27 July 2010.

The Law, inter alia, contains detailed regulation of the bankruptcy of financial organisations in the Russian Federation.

Current legislation does not provide effective mechanisms for protection of the material rights of individuals in the event of bankruptcy of financial organisations, and the Law aims to address this.

The new legislation specifies a list of financial organisations to whom the rules, established by the Law, shall apply. The Law names the following as financial organisations: credit institutions; insurance companies; professional participants of the securities market; non-governmental pension funds; and management companies of investment funds, share investment funds and non-governmental pension funds.

It should be noted that a special procedure for the bankruptcy of credit organisations is set out in the Federal Law "On Insolvency (Bankruptcy) of Credit Organisations" and the Law therefore does not cover any matters related to the insolvency (bankruptcy) of this type of financial institution.

The Law sets out the following provisions with regard to financial institutions:

- measures to be taken to prevent bankruptcy;
- measures for preventing a financial institution's bankruptcy through the development and the implementation of a solvency reestablishment plan and the institution of temporary administration, and provisions relating to temporary administration, such as the procedure for the introduction and dissolution of temporary administration, its composition, its period of existence, as well as relevant rights and obligations of parties during its term;
- the Law specifies the bankruptcy procedures applicable to a financial institution. In particular, the Law provides that the insolvency procedures of external management and financial rehabilitation do not apply to financial institutions;
- a federal executive authority in charge of regulating a relevant type of activity is obliged to participate in bankruptcy proceedings against a financial organisation; and
- a state arbitration court has the right to involve a relevant self-regulated organisation of financial institutions or a relevant professional association of insurers in bankruptcy proceedings.

The Law also sets out some specific procedures relating to the bankruptcy of certain types of financial institutions.

In respect of insurance organisations, the Law changes the priority of third-ranking creditors' claims in bankruptcy proceedings. In addition, it establishes a procedure for transferring an insurance organisation's insurance portfolio as part of the measures for preventing bankruptcy or indeed as part of the bankruptcy procedure.

Pension reserves and pension accruals are excluded from the bankrupt assets of a non-state pension fund. This is due to the fact that pension reserves are intended to secure obligations to the fund's members and pension accruals, to insured parties.

The intention of the amendments proposed is that they will provide for more efficient measures to prevent financial institutions' insolvency (bankruptcy) and that the bankruptcy procedures for financial institutions will apply as a mechanism for facilitating the proportionate satisfaction of creditors' claims. In addition, once it enters into force, the Law should protect to a greater extent the substantive rights of individuals who are the customers of financial institutions.

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COMMERCIAL

Justice

Participants in civil or criminal judicial proceedings now have a right to receive compensation in the event of excessive delay in the commencement of proceedings.

The violation of the right to a fair hearing within reasonable time occurs if it takes more than three years for a hearing to take place in the civil court or the arbitration court of common jurisdiction, or four years for a hearing to take place in the criminal court. It is not necessary to demonstrate culpability of the law enforcement authorities or judicial executive bodies.

The following persons may file a claim for compensation with the court of next instance if their right to a fair hearing or to receive judgment within reasonable time has been violated: claimants and defendants in proceedings; third parties with an interest in the dispute; creditors and debtors; individuals who have been charged with an offence; convicted persons; people who have been acquitted; civil claimants and defendants in a criminal trial; and other interested persons. Compensation paid to such persons will be paid out of the federal budget. The amount of compensation is decided on by the court of next instance after considering the time of delay, its consequences, the background facts of the case, applicants' claims and principles of reasonableness, justice and the practice of the European Court of Human Rights.

Amendments have also been made to other federal laws as a consequence of the adoption of Federal Law No. 68-FZ. These include the Civil Procedural Code, Arbitration Procedural Code, and the Criminal Procedural Code Law "On the system of arbitration courts in the Russian Federation".

[Federal Law No. 68-FZ of 30.04.2010 "On compensation for violation of rights to a hearing within reasonable time or execution of a judicial act within reasonable time" came into force 4 May 2010]

Immigration legislation

Information on the arrival and departure of foreign nationals must be presented to the Federal Migration Services (FMS) of the Russian Federation

The rules established by the Decree set out new requirements for information providers (i.e. hotel management, hotels and spas, holiday centres, boarding houses, health camps for children, tourist resorts, camp sites, hospitals, healthcare institutions, shelters for the homeless, prisons which hold foreign nationals) in relation to the notification of FMS local departments on the arrival or departure of foreign nationals through the use of electronic communication facilities. Such exchanges of information must be performed in accordance with an agreement entered into between the information provider and its receiver. The information provider must send a notification on the arrival of the foreign national within one business day of that person arriving. If a foreign national arrives on a non-business day then the notification must be made during the first business day after the day of arrival.

[Decree of the Government of the Russian Federation N 310 from 10.05.2010 "On the establishment of the rules of transfer of information using electronic communication facilities regarding the arrival and departure of foreign nationals and stateless persons"]

The notification of the departure of a foreign national should be sent to the FMS no later than 12 hours after the day of departure.

Additional measures for the control of employment of foreign nationals in the Russian Federation

The amendments introduced by this new Law mean that non-Russian nationals who are highly qualified or skilled in certain defined areas of activity, and who have an annual salary of at least RUR 2,000,000, will no longer be subject to quota requirements when applying for a work permit in the Russian Federation. However, such individuals will remain classified as "foreign employees" for all other purposes. It should be noted that the Russian government can reduce the salary of such foreign employees.

The new Law establishes the criteria that individuals must fulfil in order to qualify for this exemption. It also establishes the procedure for verifying the qualifications / skills of such individuals.

Other categories of persons affected by the new Law include foreign workers who are legally in Russia under a visa-free regime for any type of domestic work (maintenance, construction etc). The amendments introduced by the new Law require foreign workers to obtain a work permit which will be valid for up to three months (with a possible extension of up to 12 months), payment for which is RUR 1,000 per month.

The procedure for obtaining such permits is also established by the new Law.

Other amendments relate to the technical aspects of immigration procedures, such as mandatory photographing and finger printing of the foreign national so that they may be issued with a work permit.

[Federal Law No. 86-FZ from 19.05.2010 “On introducing amendments to the law “On legal status of foreign nationals in the Russian Federation” and other separate legislative acts of Russian Federation”]

Technical Regulation

Rospotrebnadzor has clarified the types of unannounced inspections by public bodies which must be approved by the Public Prosecutor’s Office.

According to current legislation, certain inspections carried out by public bodies require prior approval of the Public Prosecutor’s Office. Such prior approval is required if the following entities are to be inspected:

- state-owned enterprises;
- other commercial and non-commercial institutions; or
- an individual entrepreneur,

and the inspection is:

- a field inspection
- which is unannounced; and
- performed in connection with the damage or threat of damage to the health and life of citizens, animals, plants, the environment, objects of cultural heritage, security of the state, or in connection with a natural disaster or an emergency.

Inspections falling outside this ambit do not require prior approval. The following types of inspections are also excluded from the requirement for prior approval:

- unannounced inspections of documents;
- inspections to establish compliance with deadlines in order to eliminate breaches of the law;
- inspections to establish compliance with an order of the head of Rospotrebnadzor; and
- inspections relating to the violation of consumers’ rights.

[Letter of Rospotrebnadzor № 01/7132-10-32 from 11.05.2010 “Clarification of the list of inspections which should be performed with the approval of the Public Prosecutor’s Office”]

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CORPORATE

Interpretation by the Presidium of the Supreme Arbitration Court of the Russian Federation (SAC) of recent amendments to the laws governing limited liability companies (LLCs)

The Presidium of the SAC has issued an interpretation of certain provisions contained in the new laws amending the legal regime governing LLCs. The new laws came into force on 1 July 2009.

The new laws require LLCs to make certain changes to their charters, to bring them into conformity with the amended LLC legal regime. The relevant changes must be made on the first occasion on which an LLC makes any other amendments to its charter after the new laws have come into force. The relevant Russian registration authority can reject the registration of amendments to an LLC's charter if the charter has not also been brought into conformity with the new laws at the same time. However, failure by an LLC to bring its charter into conformity with the new laws at that time cannot serve as a basis for rejecting registration of other matters which are required to be registered with the relevant authority (e.g. new shareholders or officers of the LLC).

In interpreting the new laws, the Presidium of the SAC emphasised that LLCs who fail to update their charter when required to do so by the new laws will not incur any penalty to the extent that they have made the relevant updates to their charter since then. The Presidium also stressed that any such failure to update the charter should not serve to limit the LLC's legal capacity or the ability for shares in its issued capital to be transferred. Moreover, it should not be considered as grounds for nullifying transactions entered into by the LLC, or for credit

organisations refusing to open or conduct operations on bank accounts for the LLC. Furthermore, it should not be a reason for notaries refusing to notarize transactions relating to shareholdings or parts of shareholdings in an LLC's charter capital.

The Presidium of the SAC also clarified that where an LLC has dispensed with its foundation agreement (as is permitted under the new laws), all rights and obligations arising under that foundation agreement prior to 1 July 2009 remain in force (but only in respect of the shareholders which were parties to that agreement, and only insofar as the agreement is not contrary to the new legislation).

Under the new laws, agreements relating to the disposal of shares in LLCs must, in general, be notarised. However, the Presidium of the SAC confirmed that share pledge agreements executed in simple written form before 1 July 2009 will remain valid. Powers of representation granted in powers of attorney executed in simple written form prior to 1 July 2009 are terminated insofar as those powers of representation relate to transactions to dispose of, or pledge, shares in LLCs.

[Letter of the Presidium of the SAC № 135 "On certain issues in relation to the application of article 5 of the Federal Law, dated 30 December 2008, № 312-FZ "On amendments to Part One of the RF Civil Code and certain RF legislative acts"", dated 30 March 2010]

Protection of legal entities' and individual entrepreneurs' rights during the realisation of state control (supervision) and municipal control

The law relating to inspections by public bodies of legal entities and individual entrepreneurs has been

amended. Previously, the law required public bodies (e.g. authorities responsible for health and safety, fire and environmental matters etc) to consult the Public Prosecutor's Office prior to inspecting a small or medium-sized legal entity or individual entrepreneur). The requirement to consult the Public Prosecutor's Office now also applies in respect of large legal entities and individual entrepreneurs, thus extending this protection to all legal entities and individual entrepreneurs, regardless of size.

[Federal law № 66-FZ "On amendments to article 10 of the Federal Law "On legal entities' and individual entrepreneurs' rights of protection during the realisation of state control (supervision) and municipal control"", dated 26 April 2010]

Definition of derivatives

The types of contracts which constitute derivatives, for the purposes of the new regime being introduced to regulate them, have been defined. It has been expressly confirmed that a derivative can have more than one type of base asset, for example: securities; goods; currency; discount rates; inflation levels; statistics; physical, biological and/or chemical indices; environmental conditions; and contract-derivatives, among others.

Essential terms which must be contained in options, futures, forward agreements (stock-exchange or non-stock exchange) and swap contracts have also now been set out in legislation. The legislation also sets out optional terms which such contracts may contain.

Those contracts defined as derivatives can be deliverable or non-deliverable. However, stock-exchange forward agreements can only be deliverable.

[Order of the Federal Service on financial markets № 10-13/pz-n “On the approval of regulations on types of derivatives”, dated 4 March 2010]

Amendments to the list of activities that, when exercised, should be notified to Rospotrebnadzor (Federal Service on Supervision in the sphere of Consumer Rights and Human Welfare Protection)

The law “On protection of legal entities’ and individual entrepreneurs’ rights during the realisation of state control (supervision) and municipal control” contains a list of activities in relation to which legal entities and individual entrepreneurs must notify the competent authority when carrying out. The Resolution of the Government of the Russian Federation dated 14 April 2010 includes in this list the production of certain goods, such as bread and pastry; dairy products; fruit and vegetable juice; animal and vegetable oil; sugar; non-alcoholic beverages (except mineral water); flour and cereal products; and starch and starch products. Notification of commencement of production of any of these products must be addressed to Rospotrebnadzor and must indicate the INN (individual taxpayer’s number).

[Resolution № 245 of the Government of the Russian Federation “On amendments to the rules of notification of the commencement of certain activities and on the recording of such notifications”, dated 14 April 2010]

Pre-emption rights of shareholders

According to the recent ruling of the Presidium of the SAC, shareholders in a company who vote against an issue to existing shareholders of preference shares by that company, or who abstain from voting on such a resolution, have a priority pre-emption right (in priority to the other shareholders) in respect of the preference shares to be issued. The size of shareholding which each such dissenting / abstaining shareholder

may acquire pursuant to this pre-emption right is equal to the proportion of ordinary shares such shareholder holds in relation to the overall shareholding held by all dissenting / abstaining shareholders. Whilst the priority pre-emption right of dissenting and abstaining shareholders on an issue of ordinary shares to existing shareholders is generally considered a settled matter under Russian law, the question of priority pre-emption rights on an issue of preference shares is still an area of significant uncertainty, due to the lack of statutory legislation in this area.

In addition, the Presidium of the SAC has confirmed that preference shares cannot carry more than 25% of the total votes at any general meeting of shareholders.

[Ruling of the Presidium of the SAC, № 17536/09, dated 6 April 2010]

Authorised capital and net assets of joint-stock companies

The Federal Law dated 27 December 2009 imposed a new requirement on joint-stock companies to notify the EGRUL (Unified State Register of Legal Entities) of the level of its net assets on a quarterly basis. In the event that a company intends to reduce its charter capital (whether in order to comply with net asset / charter capital ratio requirements or otherwise), then this Law requires the company to notify the EGRUL on commencement by the company of the charter capital reduction procedure.

In their open letter dated 21 May 2010, the Federal Tax Service provided guidance on the procedure for notifying the EGRUL of the commencement of the charter capital reduction procedure. In particular, the notification must be made within 3 business days from adoption by the company’s shareholders of the resolution approving the charter capital reduction.

The obligation to notify applies in all cases where the relevant shareholder resolution is adopted on or after 31

December 2009. The obligation to report quarterly net asset levels first applies in respect of a company’s quarterly financial statements to 31 December 2009.

A failure to notify (or delay in notifying) is considered to be an administrative infringement. Infringement proceedings can be initiated after 10 June 2010.

[Letter of the Federal Tax Service, dated 21 May 2010, № MN-37-6/2212 “On the question of including in the Unified State Register of Legal Entities information concerning the fact that a joint-stock company is decreasing its authorised capital, as well as information concerning the amount of net assets of the joint-stock company”].

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TAX

Comments of the Supreme Arbitration Court relating to due diligence of the taxpayer

The permissibility of VAT deductions is a problem in tax practice. The Supreme Arbitration Court of the Russian Federation has repeatedly formulated its legal position on the question.

Last month the court issued several rulings relating to the application of VAT deductions. Despite the fact that these rulings do not contradict previous court decisions on the question, they do contain non-favorable conclusions for taxpayers.

In a ruling dated 13 April 2010 the Supreme Arbitration Court, supporting the position of the lower courts, indicated that a taxpayer is not entitled to VAT deductions where there were drafting defects in the invoices issued by the counterparties of the taxpayer. In this case the invoices were signed by unidentified persons and the taxpayer failed to prove that he had undertaken due diligence when selecting the counterparties.

In a decision on a similar case, the court stated, *inter alia*, that receipt by the taxpayer of extracts from EGRUL in relation to his counterparties was sufficient proof of the good faith of the taxpayer¹.

In a ruling dated 16 April 2010 the Supreme Arbitration Court also supported the decisions of lower courts, which stated that the taxpayer failed to explain why he had chosen a certain counterparty. The transactions on behalf of such counterparty were made by unidentified persons and the taxpayer failed to prove that he did not know and could not have known of the defects in the counterparty.

The Supreme Arbitration Court has also indicated that the mere fact of bad faith of the counterparty is not enough for the recognition of tax benefits to be unlawful. However, in order to confirm its right to VAT deductions, the taxpayer has to prove that he has undertaken due diligence when selecting the counterparties.

[Rulings on the refusal of transfer of the case to the Presidium Supreme Arbitration Court of the Russian Federation dated 13 April 2010 № VAS-3935/10, dated 16 April 2010 № VAS-3730/10]

Comments of the Supreme Arbitration Court relating to the reimbursement of judicial costs from the budget

In practice, a taxpayer, having won a case against the tax authorities, will seek reimbursement of court costs and frequently attempts to recover from the budget the costs of state duty paid in connection with the proceedings. However, the tax authorities have refused to compensate state duty, on the basis that the tax authority is exempt from the payment of state duty.

In a ruling dated 19 April 2010 the Supreme Arbitration Court indicated that if the tax authority loses a case, the taxpayer may recover from the budget the amount of state duty paid by him in connection with the recourse to justice. Such compensation is a reimbursement of judicial costs, rather than an obligation of the tax authorities to pay the state duty. Therefore, the exemption of the tax authorities from the payment of state duty is not applicable.

The case has been transferred to the Presidium of the Supreme Arbitration Court, which will soon issue a final decree on the question. The decree will be published on the Supreme Arbitration Court website (<http://www.arbitr.ru>).

[Ruling of the Supreme Arbitration Court on the transfer of the case to the Presidium of the Supreme Arbitration Court of the Russian Federation dated 19 April 2010 № VAS-4681/10]

Comments of the Supreme Arbitration Court relating to the costs of a taxpayer for the preparation of objections to a tax audit report

A common tax practice is the recovery from the budget by the taxpayer of expenses incurred in connection with the preparation of objections to a tax audit report. In essence, the tax audit report fixes the violations of tax legislation by the taxpayer and does not affect his rights and obligations. However, the taxpayer has to resort to competent legal assistance for the preparation of objections to this report in order to have a successful defence in court.

In a ruling dated 29 April 2010 the Supreme Arbitration Court, supporting the position of the lower courts, indicated that a tax audit report by itself does not violate the rights of the taxpayer. In addition, the expenses incurred in connection with the preparation of objections to the tax audit report take place as a result of an unlawful decision made by the tax authorities on the basis of such report.

Thus a taxpayer may recover these expenses from the budget in the framework of recovering judicial costs incurred as a result of an unlawful decision which draws the taxpayer to tax responsibility.

¹ See the tax part of the Legal Digest dated April 2010

[Rulings on the refusal of transfer of the case to the Presidium Supreme Arbitration Court of the Russian Federation dated 29 April 2010 № VAS-3303/10]

Comments of the Russian Ministry of Finance in respect of the administrative liability of a taxpayer for non-appearance to provide evidence

Russian tax legislation gives the right to the tax authorities to call upon taxpayers to give explanations in connection with the payment of taxes, tax audits and in other cases involving the performance by a taxpayer of its obligations under relevant tax legislation.

The Tax Code does not cover a situation where a taxpayer does not appear before the tax authorities in order to give the aforementioned explanations. However, the Russian Ministry of Finance in a letter dated 9 April 2010 № 03-02-08/21 has indicated that the taxpayer may still be subject to administrative liability in accordance with the Code for Administrative Offences. This Code provides for an administrative penalty for non-compliance with a lawful order or requirement of an official authority exercising state supervision (control).

The administrative fine for such offences may amount to RUR 2,000.

[Letter of the Russian Ministry of Finance dated 9 April 2010 № 03-02-08/21]

Comments of the Russian Ministry of Finance in respect of the possibility of a newly created company accounting for costs in the absence of income

In a letter dated 21 April 2010 the Russian Ministry of Finance indicated that if a newly created organisation does not generate income, but bears the expense of preparatory activities, such expenses may be accounted for if they are substantiated, documented, and are aimed at generating income.

Losses arising in this way can be carried over to future tax periods in order to reduce the tax base.

[Letter of the Russian Ministry of Finance dated 21 April 2010 № 03-03-06/1/279]

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