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ARBITRATION/LITIGATION

Russia's highest courts clarify matters relating to the demolition of unauthorised constructions

On 29 April 2010 Plenary Sessions of the Supreme Court and the Supreme Arbitrazh Court of Russia (the "Plenums") adopted Resolution № 10/22 "On certain questions arising in judicial practice regarding resolution of disputes concerning the protection of property rights and other proprietary rights" (the "Resolution").

In this article we will cover one of the most important provisions of this document. The Resolution contains clarifications of Article 222 of the Civil Code of the Russian Federation, which relate to the legal regulation of unauthorised constructions.

According to the provisions of the Civil Code, an unauthorised construction is real property, created on a land plot which is not designated for this purpose in the prescribed manner, and which does not have the proper permit in place. Constructions will also be considered as unauthorised if its existence substantially violates the relevant rules of law and regulations.

The Resolution clarifies the definition of unauthorised construction stating that it also relates to new facilities created as a result of an unauthorised reconstruction of real property. A court may order the demolition of an illegally reconstructed building if the property cannot be returned to its original condition. If the reconstruction does not create a new real estate object (from a legal point of view), it will not be considered as unauthorised construction.

Objects which are not real property should not be considered as unauthorised construction.

The Plenary Sessions have clarified the methods of legalising unauthorised constructions. A claim for the ownership of an unauthorised construction shall be satisfied if the

court finds that, besides the absence of construction permits and / or use permit, there were no other violations, and the entity which created the unauthorised construction took action to obtain the requisite documents. In this case, the courts must ensure that the unauthorised construction does not threaten life or health, or the legally protected rights and interests of other parties.

Neither state registration of the ownership of an unauthorised construction, nor encumbrances over an unauthorised construction in favour of third parties, can be an obstacle to court-ordered demolition of an unauthorised structure. However, in cases where such demolition would affect the rights of third parties, these third parties must participate in the proceedings.

In addition, the rules for determining the defendant to a dispute regarding demolition of unauthorised construction were clarified. If the unauthorised construction is in the possession of, or occupied by a party who did not construct the building, the defendant is the person who would become the owner if the construction was legal. For example, if the unauthorised construction has been disposed of or transferred, the defendant is the party which acquired it. If the unauthorised construction is transferred as a contribution to the charter capital of a legal entity, the defendant is the legal entity which receives such property. In the event of the death of such a person or the reorganisation of a legal entity, the defendant is the party which then succeeds to the possession or the occupation of the property. The courts also pointed out that if the ownership of an unauthorised construction is not registered for the benefit of the occupier or the party in possession, but for the some other party, that other party must be involved in any proceedings relating to demolition of that unauthorised construction.

It should be noted the Plenary Sessions confirmed that the principle of the limitation of actions does not apply to claims for demolition of an unauthorised construction if its existence threatens the life and health of citizens.

On these points, the Resolution of the Plenary Sessions will provide clarity and certainty in disputes relating to the demolition and legalisation of unauthorised construction.

[Resolution of the Supreme and the Supreme Arbitrazh Courts of Russia № 10/22 "On certain questions arising in judicial practice regarding resolution of disputes concerning the protection of property rights and other proprietary rights"]

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BANKING AND FINANCE

New requirements of the antimonopoly legislation in relation to credit organisations

The Resolution of the Russian Government No. 385 dated 1 June 2010 "On Amending the Russian Government's Resolution No. 335 dated 30 May 2007" raises certain asset thresholds that are applicable in connection with credit organisations for antitrust control purposes.

The key changes are:

- The threshold to require the antimonopoly authority's prior merger consent has been increased from RUR 24 to RUR 33 billion, in aggregate for the value of the

merging or acceding credit organisations;

- In connection with any contribution of any shares, participation interests or property held by a credit organisation into the charter capital of an established commercial organisation, the threshold to require the antimonopoly authority's prior contribution consent has been increased from RUR 24 to RUR 33 billion in aggregate value;
- The asset value of a credit organisation, which if exceeded, requires an antimonopoly authority's prior consent to transactions with shares, participation interests or property of the credit organisation or rights in respect of the credit

organisation, has also been increased from RUR 25 to RUR 33 billion.

[Resolution of the Russian Government No. 385 dated 1 June 2010 "On Amending the Russian Government's Resolution No. 335 dated 30 May 2007"]

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COMMERCIAL

The Russian Government will approve a forecast plan (programme) for the privatisation of federal property for a period of one to three years rather than for any given calendar year as is currently the case

Some other amendments have been made to the Federal Law "On the Privatisation of State and Municipal Property":

- The law does not cover federal property privatisation carried out under the Russian Government's decisions that were taken for attracting investment, developing the stock market and modernising the economy;
- Any legal entities authorised by the Russian Government will now be entitled to sell privatised federal property;
- The law rules out the limitation of ways in which to privatise federal unitary enterprises and shares belonging to federal OJSCs with a book value exceeding an amount equal to 5 million minimum monthly wages;
- A resolution on the terms of property privatisation must specify its initial price rather than a "standard price" being the lower threshold of the initial price as currently envisaged;
- The law now includes provisions regulating the posting of information on state or municipal property privatisation on the Internet;
- The law contains a new article regulating the procedure for selling state or municipal property in electronic form;
- A deposit has been reduced from 20 to 10% of the initial price. The deposit is paid by participants of an auction to sell state or

municipal property. The maximum permitted deposit of 4.5 million minimum monthly wages has now been excluded.

[Federal Law No. 106-FZ dated 31 May 2010 "On Amending the Federal Law "On the Privatisation of State and Municipal Property"]

A procedure has been determined for calculating the amount of food products sold within the boundaries of a region, municipal or urban district

Under trade law (Federal Law No. 381), a food products retailer may not widen the area of its retail outlets if its market share exceeds 25% of all the sold food products (in monetary terms) in the previous financial year within a particular region, municipal or urban district.

The Russian Government has approved the method of calculating the amount of food products sold and the retail chains' share. This is done on the basis of monthly monitoring by the Federal State Statistics Service (*Rosstat*). Information on the total amount of all food products sold in a reporting year is posted by Rosstat's local offices on its official website prior to 1 May of the following year.

[The Russian Government's Resolution No. 305 dated 4 May 2010 "On approving the methods of calculating the volume of all food products sold within the boundaries of a constituent entity of the Russian Federation, including the federal cities of Moscow and St. Petersburg, and within the boundaries of a municipal or urban district, in monetary terms for a financial year, and determining a share of food products sold by a business entity engaged in the retail sale of such products by arranging a retail chain (other than an agricultural consumer cooperative or a consumer cooperation organisation), within the boundaries of

a relevant political subdivision, in monetary terms for a financial year"]

Customs regulation

The Agreement on the Customs Union's Customs Code signed in Minsk on 27 November 2009 has now been ratified

The President of the Russian Federation has signed the Federal Law "On the Ratification of the Agreement on the Customs Union's Customs Code". This law is part of the customs union legal framework which is currently being formed under the auspices of the Eurasian Economic Community.

The Unified Customs Code will introduce the following new measures:

- an increase in the time period for deferment of payment of customs duties from 15 days up to 2 or 4 months;
- the introduction of the concept of the "authorised economic operator" in order to simplify the completion of customs formalities for the participants of foreign trade (such operators will be able to store goods at their own warehouses and release goods into free circulation before submitting a customs declaration);
- the introduction of new customs regimes: free customs zone, free warehouse and special customs procedure.

The Unified Customs Code of the Unified Customs Union will enter into force on 1 July 2010.

[Federal Law No. 114-FZ dated 2 June 2010 "On the Ratification of the Agreement on the Customs Union's Customs Code "]

Court practice

The Federal Antimonopoly Service ("FAS") succeeded in its dispute with Open Joint-Stock Company "TNK-BP Holding" ("TNK-BP").

On 25 May 2010, the Supreme Arbitration Court's (the "SAC") Presidium upheld the decision of FAS to impose a fine on TNK-BP by way of administrative liability for an amount of RUR 1.1 billion (the equivalent of EUR 28,645,833 at the EUR exchange rate at 29 June 2010).

The background to the case is as follows: in 2008 FAS imposed a fine on four oil companies, namely TNK-BP, Lukoil, Rosneft and Gazprom Neft. The companies were charged with collectively maintaining high monopoly prices on the petrol-kerosine market, establishing unreasonable wholesale prices of aviation kerosine and creating discriminatory conditions on the wholesale petrol-kerosine markets. In the dispute between TNK-BP and FAS, three courts at different instances considered it impossible for FAS to proceed against TNK-BP. The courts recognised that the FAS incorrectly designated commodity markets, their product-related and geographical boundaries, the market volume and the company's share, and that it incorrectly treated TNK-BP as dominating such market.

However, the SAC's Presidium uphold the position of FAS that the geographical boundaries of the market may encompass the entire territory of Russia and not just limited to regions as decided by the lower courts. The Presidium agreed with the FAS on the way of proving high monopoly prices of petrol. It confirmed that a price may be considered monopolistic in nature if it exceeds economically reasonable expenses and profit ("cost criteria").

The resolution of the SAC's Presidium was deemed historic and will now constitute a precedent for other lawsuits against vertically integrated oil companies. The resolution expressly specifies that the interpretation contained in it is binding on state arbitration courts considering similar cases.

[Resolution of the Presidium of the Supreme Arbitration Court of the Russian Federation No. 16678/09]

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CORPORATE

Draft laws

Rules for maintaining share registers

The draft order covers joint-stock companies whose share register is maintained either by a professional registrar or joint-stock companies themselves.

The “Rules of maintaining a register” are to specify ways of providing documents required to effect operations therein. In this respect, a registrar may impose a number of restrictions on the provision of such documents - for instance only hand delivery of documents to open a personal account by a holder of securities or its authorised representative.

A registrar may delay an operation in the register for 10 business days if a potential error is detected. In such case the registrar shall notify the party which submitted the documents of the delay within three days of discovering such a potential error. In addition, the draft order specifies occurrences where a registrar is obliged to reject an operation.

Holders of securities may transfer the right to dispose of such securities to a trustee who does not possess a “professional participant of securities market” license.

Grounds are set forth for assigning a “notary’s deposit” status to a personal account. A registrar is authorised to establish a procedure and grounds for closing a personal account.

The innovations will enable share sale and purchase deals to be structured more flexibly by using the “notary’s deposit” as an escrow account.

[Draft order of the FSFM “On Certain Issues of Keeping a Register of Holders of Securities”]

Restrictions on crossholding of shares in an open joint stock company (OJSC)

A draft law has been introduced to the State Duma amending the law on joint stock companies to restrict the crossholding of shares. Crossholding arises where shares in a parent OJSC are held by business companies under its control (“subsidiaries”) which results in the subsidiaries becoming the parent company’s shareholders and exercising the rights conferred by such shares.

The amendments do not prohibit the purchasing of shares in an OJSC by the companies controlled by it, but such shareholders will not be able to exercise the votes attached to such shares or receive any dividends. The draft law prohibits controlled companies from purchasing financial instruments (other than shares) giving rights related to shares in a parent OJSC and any such instruments already purchased must be sold within 180 days of the date when the proposed amendments become effective.

[Draft Federal Law on amending the Federal Law “On Joint-Stock Companies”]

Court practice

Minority shareholders’ rights

A joint-stock company’s internal local regulations have been appealed against for the first time to the Supreme Arbitration Court (the “SAC”), more specifically, a number of provisions contained in the regulations of a board of directors, which prejudiced minority shareholders’ rights.

In December 2008, Ingosstrakh’s meeting of shareholders approved by a majority vote the new regulations of its board of directors.

Under these regulations:

- it was prohibited to include foreigners, persons not holding a degree in economics or convicted persons in the list of candidates to the board of directors;
- the board’s members could attend its meetings only while holding a one-day electronic pass to be issued upon a director’s application to the corporate secretary;
- any information was to be treated as confidential if received by a director in the course of, and even prior to, fulfilling his/her duties; a director could discuss it only at the board’s or its committees’ meetings; and
- without Ingosstrakh’s written consent a director was not to copy or take extracts from any company materials and was obliged to return any received materials to Ingosstrakh or destroy them.

In April 2009, Ingosstrakh’s minority shareholders holding in aggregate 38% of the voting shares in the company filed a claim with the Moscow State Arbitration Court against Ingosstrakh to invalidate the resolution adopting the revised Regulations of the board of directors of OJSC Ingosstrakh. The court invalidated the shareholder meeting’s resolution.

Having lost in appellate and cassation proceedings, Ingosstrakh’s majority shareholders filed a supervisory complaint. On 27 April 2010, the SAC’s Presidium upheld the courts’ decisions and resolutions and dismissed the application made by Ingosstrakh’s majority shareholders.

Through this test case, the SAC proposed a method of protection from the discriminatory provisions of local internal regulations: namely, to invalidate a resolution of a general meeting of shareholders approving such local internal regulations. It is expected that the SAC’s resolution

concerning this case will be of key significance in shaping corporate relations.

[Resolution of the Presidium of the Supreme Arbitration Court of the Russian Federation No. 67/10]

Preliminary interim relief relating to foreign arbitral tribunals' awards

The Supreme Arbitration Court (the "SAC") considered a dispute following an application from Shalva Chigirinsky's creditor – a Cypriot company "Edimax Ltd" (the "Company") seeking to seize the entrepreneur's Moscow apartment.

For the first time, the highest court granted the right of a party to international arbitral proceedings to obtain interim relief from the Russian arbitration courts

[Resolution of the Presidium of the Supreme Arbitration Court of the Russian Federation No. 17095/09]

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TAX

Draft law on consolidated group of taxpayers

On 18 June 2010 the Government of Russia introduced the draft law № 392729-5 “On amending part one and two of the Russian Tax Code in connection with the creation of a consolidated group of taxpayers” (the “**Draft law**”) to the Russian State Duma.

The amendments are being proposed as a result of forthcoming changes relating to the improvement of the legislative framework for transfer pricing. A draft law № 305289-5 introducing new rules on transfer pricing was adopted by the State Duma at the first reading on 19 February 2010¹.

The Draft law aims to introduce the concept of a consolidated group of taxpayers to further the aim of improving the taxation procedure in relation to corporate groups. The obligation to calculate and to declare corporate income tax in relation to the whole group is entrusted to a single entity – to the ‘participant in charge’.

In addition, the consolidated group of taxpayers would be able to enjoy certain advantages, e.g. to pool the income and expenses of the group members for the purposes of calculating the tax base of the corporate income tax. In the opinion of the authors of the Draft law, such a possibility would reduce the incentive for companies to use unlawful transfer pricing mechanisms.

The Draft law would introduce a new chapter into part one of the Russian Tax Code containing the following provisions:

- a consolidated group of taxpayers is created with the aim of encouraging the calculation and payment of corporate income tax on a voluntary basis by signing a treaty between the members of the group. The treaty

should be registered with the tax authorities in the location of registration of the participant in charge;

- an entity may be included in the consolidated group of taxpayers provided the parent company of the group holds at least a 90% participation in such entity;
- in order to create a consolidated group the aggregate of federal taxes declared by all members of the group for the previous calendar year must exceed RUR 15 bln., the aggregate revenue from the sales of goods, works and services must exceed RUR 100 bln. and the aggregate assets must be at least RUR 1000 bln.;
- the onsite tax audit in relation to the payment of corporate income tax must be held simultaneously in respect of all the members of the consolidated group;
- arrears, default interest and fines are primarily claimed against funds in bank accounts of the participant in charge. Claiming against other funds and assets of other group members is possible only when there is a lack of funds in the bank accounts of the participant in charge; and
- losses of the group members relating to periods prior to their entry into the consolidated group cannot be used towards the tax base of the consolidated group.

The draft law was transferred to the Committee of taxes and budget in the Russian State Duma and is not yet included in an approximate agenda to be considered by the Russian State Duma.

[Draft Federal Law № 392729-5 “On amending part one and part two of the Russian Tax Code in connection with the creation of a consolidated group of taxpayers”]

Draft law on the order of

collection of taxes against the property of individuals

On 8 June 2010 the President of Russia introduced to the State Duma the draft law on amending article 48 of the Russian Tax Code in part relating to judicial collection of taxes against the property of individuals.

The explanatory note to the Draft provides that the amendments are necessary due to the large amount of court cases relating to collection of taxes against the property of individuals. Such cases are initiated by the tax authorities even in relation to relatively insignificant sums and are often resolved in accordance with the procedure for collecting taxes in undisputed circumstances (i.e. simply by issue of a court order without any hearing).

For this reason, the Draft law provides amendments both to the Russian Tax Code and to the Russian Code of Civil Procedure.

The Draft law supplements the Russian Tax Code with a provision according to which a court request for the collection of taxes against the property of an individual may be filed only within 6 months of the payment date under a demand for payment issued by the tax authority.

Moreover, the said court request may be filed only when the unpaid sum of taxes exceeds RUR 1500.

The Draft was included in an approximate agenda to be considered by the Russian State Duma in July 2010.

[Draft Federal Law № 387757-5 “On amending article 48 of part one of the Russian Tax Code and article 122 of the Russian Code of Civil Procedure”]

Comments of the Russian Ministry of Finance in respect of the interdiction of holding an in-house tax audit on the basis of a report on the average quantity of employees

¹ See our comments on the key aspects of the draft law on transfer pricing in par. 1 of the Legal Digest (Tax part) for February 2010

According to the Russian Tax Code an in-house tax audit can be held by the tax authority on the basis of a tax return and documents filed by the taxpayer, and on the basis of other documents at the disposal of the tax authority. However, in practice the tax authorities use a wide interpretation of this rule and conduct audits when the tax return is not yet filed.

In a letter dated 5 May 2010 № 03-02-08/28 the Ministry of Finance indicated that the in-house tax audit should be conducted within three months of the moment of the filing of the tax return. Such a filing is the ground for the tax audit.

Conducting an in-house tax audit on the basis of documents other than the tax return (e.g. on the basis of a report on the average number of employees) is not provided for by the Russian Tax Code and therefore prohibited.

[Letter of the Russian Ministry of Finance dated 5 May 2010 № 03-02-08/28]

Comments of the Supreme Arbitration Court of the Russian Federation on the order of payment of state duty upon the filing of a claim in the arbitration court

In the circular dated 11 May 2010 № 139 the Supreme Arbitration Court (the “SAC”), having amended the circular N 117 dated 13 March 2007 and the circular № 91 dated 25 May 2005, clarified and supplemented its recommendations relating to the state duty payable upon the filing of a claim to the arbitration courts.

The SAC indicated that generally the state duty is paid in accordance with the tariffs in force at the moment of the claim.

However, if the claimant decided to increase the amount of the claim during the court procedure and the tariffs of the state duty had changed from what they were at the moment of the claim, the claimant will have to pay the remaining part of the state duty under the tariffs in force at the moment of the increase in the amount of claim.

Following its previous comments on the question of reimbursement of court

costs², the SAC indicated that a person acting as a defendant and having lost the case is obliged to reimburse the judicial cost of the claimant, including the amount of the state duty paid by the claimant, even if the defendant is exempt from state duty (e.g. state and municipal authorities).

The SAC also noted that organisations not belonging to the structure and system of state and municipal authorities, but which nevertheless execute public functions, (e.g. the Central Bank of Russia, Pension Fund, Social Insurance Fund) are also exempt from the payment of state duty.

[Circular of the SAC dated 11 May 2010 № 139 “On amending the circulars of the Presidium of the SAC dated 25 May 2005 № 91 “On certain issues relating to the application of chapter 25.3 of the Russian Tax Code by the arbitration court” and dated 13 March 2007 N 117 “On certain issues relating to the application of chapter 25.3 of the Russian Tax Code”]

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² See par. 2 of the Legal Digest (Tax part) for May 2010

