BNA International

BNA's Eastern Europe Reporter

International Information for International Businesses

Monthly News and Analysis of Developments Affecting Business in the Former Soviet Bloc

Volume 17, Number 3 March 2007

News

A Russian draft law to restrict foreign investment in "strategic" sectors of the economy, such as oil and gas, nuclear energy, and so-called "natural monopolies," wins preliminary approval from the government. (Page 4)

Two major oil and gas pipeline projects are announced, with Germany's RWE proposing to build a new pipeline to transmit gas from Russia and other countries to Western Europe, and the governments of Russia, Bulgaria, and Greece initialing a pact for a new pipeline to transmit Russian oil to Southeastern Europe. (Page 28)

Poland's Finance Ministry issues its first advance pricing agreement with a term of five years, under new rules that entered into effect at the start of this year. (Page 8)

The Czech Republic launches e-Export, a new system for electronic data exchange between exporters and customs authorities in the European Union. (Page 9)

The Slovak Republic adopts a number of tax law changes that depart significantly from key principles of the previous government's tax regime. (Page 11)

The European Commission directs Poland and Hungary to take steps to reduce budget deficits that exceed previously agreed limits. (Page 18)

Bulgaria signs its first income tax treaty and protocol with the United States, which will lower tax rates on interest and dividends. (Page 14)

New Kazakh Tax Code changes regarding the taxation of dividends may benefit permanent establishments of non-resident legal entities. (Page 15)

Special Report

Russia's currency control law is significantly revised, giving foreign investors "unprecedented access to a wide array of new opportunities ... in the dynamic Russian market," as described by Glenn S. Kolleeny and Artem V. Zhavoronkov, of Salans, St. Petersburg, and Dmitri A. Pentsov, of Froriep Renggli, Geneva. (Page 30)

Analysis & Perspective

New Romanian tax regime changes in line with relevant E.U. directives are examined by Angela Rosca, of TaxHouse SRL, Bucharest. (Page 19)

BNA International Inc., a subsidiary of The Bureau of National Affairs, Inc., Washington, D.C., U.S.A.

Special Report

Major Changes In Russian Currency Control Law Create New Opportunities For Foreign Investors

By Glenn S. Kolleeny, Artem V. Zhavoronkov, and Dmitri A. Pentsov. Mr. Kolleeny and Mr. Zhavoronkov are partners at the St. Petersburg office of the Salans law firm, and Mr. Pentsov is an associate at the Geneva office of the Froriep Renggli law firm. The authors may be contacted by E-mail at gkolleeny@salans.com, azhavoronkov@salans.com, and dpentsov@froriep.ch.

Readers are cautioned that this Special Report is intended for informational purposes only. If legal advice is required, a lawyer should be consulted.

Introduction

On January 1, 2007, the process of liberalization of currency regulation and control in the Russian Federation, which began during *perestroika* in the late 1980s, marked another milestone.[1] With the beginning of the new year, a significant number of burdensome restrictions previously imposed by the law on currency regulation and currency control of 2003 (the "Currency Control Law" or the "Law") *(see analysis by Glenn S. Kolleeny, Artem V. Zhavoronkov, and Irina Grave, of Salans, St. Petersburg, at BEER, April 2004, page 28)*[2] were eliminated. From the standpoint of foreign companies and private individuals, these changes are genuinely remarkable, as they represent unprecedented access to a wide array of new opportunities for active involvement in the dynamic Russian market.

This Special Report analyzes the most recent changes in the regulation and control of currency in the Russian Federation, focusing on practical implications and the likely impact on foreign companies and individuals with Russian assets and clients, such as the opening of foreign bank accounts by Russian residents,[3] transactions on the Russian equity and bond markets (both internal securities (*vnutnrennie tseniie bumagi*) and external securities (*vneshnie tseniie bumagi*),[4] offshore trading in Russian securities, the purchase of other Russian assets (tangible and intangible), cross-border securitization transactions, cross-border project finance and leasing as well as the offshore trust management of Russian securities and other assets.

The Opening Of Foreign Bank Accounts By Russian Residents

In light of its possible impact on the structuring of transactions involving Russian residents and assets, the expiration of restrictions previously imposed on the opening of foreign bank accounts by Russian residents is arguably the most significant change in the Currency Control Law taking effect on January 1, 2007. Prior to January 1, 2007, in accordance with Article 12(3) of the Currency Control Law, accounts in banks located in countries which are not members of the Organization for Economic Cooperation and Development (OECD)[5] or the Financial Action Task Force on Money Laundering (FATF)[6] could be opened only in accordance with the procedure prescribed by the Central Bank of the Russian Federation (Central Bank), which included a requirement on the prior registration of the account with the Russian tax authorities.[7] Moreover, Article 12(4) of the Law stipulated that the Central Bank was entitled to impose so-called "retention requirements" on the resident and oblige him/her to present the authorized bank with a stamped notification of the Russian tax authorities of the opening of the account at the time of the initial monetary transfer abroad.

On January 1, 2007, Articles 12(3) and 12(4) of the Law expired. Consequently, Russian residents may now freely open accounts at any foreign bank, irrespective of whether or not the bank is located in a OECD or FATF member country, provided they notify the Russian tax authorities within one month of the date of conclusion (termination) of the respective agreement on the opening of an account (making a deposit) (Article 26(3)(2) of the Law). From a practical standpoint, this means that, in structuring transactions with non-residents, Russian residents may provide that payment of the purchase price for the asset be transferred to their foreign bank account, irrespective of the country where the bank is located.

Operations On The Russian Equity And Bond Markets With 'Internal' Securities

Another major change in the Currency Control Law directly affecting the operations of foreign investors on the Russian equity and bonds markets is the expiration on January 1, 2007, of the previous provisions of the Currency Control Law concerning special banking accounts and the power the Central Bank had enjoyed to establish restrictions on the currency operations of non-residents involving internal securities.

Prior to January 1, 2007, the Currency Control Law featured the concept of a "special bank account," defined in Article 1(10) of the Law as a bank account at an authorized bank, a special section of a deposit account or a special section of an account in a securities register opened by a registrar, which were used to carry out currency operations in cases stipulated by the Law. In accordance with Article 8(3)(5) of the Law, the Central Bank had been entitled to require non-residents to use such accounts when buying internal securities from a Russian resident.[8] Article 10(2) of the Law vested the Central Bank with similar powers in

 03/07 Copyright © 2007 by The Bureau of National Affairs, Inc. BEER ISSN 1058-7365

currency operations concluded among non-residents in the Russian Federation involving internal securities. Moreover, under Article 8(8) of the Currency Control Law, monetary settlements between residents and non-residents in transactions involving internal securities had to be denominated in Russian rubles, unless otherwise provided by the Central Bank in general or with respect to certain types of internal securities. Finally, in accordance with Article 8(6)(2) of the Currency Control Law, non-residents purchasing securities from residents could be required by the Central Bank to retain up to 20 percent of the value of the currency operation in the special account for a period of up to one year.[9]

Technically speaking, although Article 1(1) of the Currency Control Law, introducing the concept of a "special account," and Article 8 of the Law, concerning the powers of the Central Bank, remained valid until January 1, 2007, both the requirement to use such accounts (and, presumably, the requirement to effect payment for the purchase of internal securities in Russian rubles) and the retention requirement had already been abolished by the Central Bank as of July 1, 2006 *(see BEER, August 2006, page 5)*.[10] As a result, the expiration of Articles 1(1) and 8 of the Law on January 1, 2007, does not change substantive law, but rather re-affirms the right of non-residents to pay Russian residents for internal securities from accounts at banks located outside the territory of the Russian Federation and without any retention requirements. As far as payments for internal securities between two non-residents are concerned, even though the provisions of Article 10(2) of the Law remain valid, in light of the abolition by the Central Bank of the requirement to use special bank accounts, such payments can also be made without the previously imposed restrictions.

The abolition of both the requirement to use special bank accounts and the retention requirement has been long awaited by potential foreign participants in the Russian government bond markets, many of whom still have vivid memories of the events surrounding the short-term state bond (GKO) default in 1998. At that time, a large number of foreign participants found their rubles trapped in so-called "S accounts" in Russian banks and, in order to repatriate their money, were forced to resort to certain creative, multi-phased solutions, notably: 1) buying ruble-denominated corporate bonds, 2) exchanging those bonds with the issuer for dollars, and 3) transferring the resulting hard currency out of the country.[11] As the use of special bank accounts in currency transactions involving internal securities is no longer required, the purchase of Russian government bonds by non-residents may also be carried out with the use of bank accounts in banks outside the Russian Federation, and payment can be made in foreign currency.

Operations On The Russian Equity And Bond Markets With 'External' Securities

The changes in the Currency Control Law could also have a profound impact on the structuring by non-residents of operations involving external securities. After January 1, 2007, the Central Bank may no longer require non-residents to effect transactions involving external securities using special bank accounts (Article 8(3)(3) of the Currency Control Law) or require that up to 100 percent of the value of the currency operation be retained by the non-resident for a period of up to 60 days or up to 20 percent for a period of up to one year (Article 8(5)(1) and 8(6)(1) of the Currency Control Law). As a result, in conducting transactions with residents involving external securities, non-residents can effect payments in favor of residents from accounts in banks located outside the Russian Federation to any of the resident's accounts, irrespective of the country in which the bank is located.

Offshore Trading In Russian Securities

The changes in the Law will not have a direct impact on offshore trading in Russian securities, which may still be freely conducted between non-residents, subject, of course, to the requirements of applicable foreign law. This stems from the fact that Article 10(2) of the Currency Control Law had permitted the Central Bank to require non-residents to use special accounts for the purchase of internal securities from other non-residents inside the Russian Federation. As a result, transactions between non-residents in internal securities outside the Russian Federation were beyond the scope of this Law from the moment of its adoption.

Purchase Of Other Russian Assets

The most recent changes in the Currency Control Law may also have a limited impact on the structuring of transactions among residents and non-residents for the purchase of assets other than securities. Since Russian residents may now freely open bank accounts in any country, non-residents are no longer required to effect payment for these assets to the resident's account at an authorized Russian bank; instead, they can effect payment to any account, irrespective of the country in which the bank is located.

Nevertheless, these changes will not have a major impact on this type of transaction. Under Article 6 of the Currency Control Law, currency transactions among residents and non-residents may be carried out without restriction, with the exception of the currency operations referred to in Articles 7, 8 and 11, parts 3 and 4, of the Law. As these articles referred exclusively to the purchase of securities and made no provision for the purchase of other types of Russian assets, their expiration will have no impact on the regulation of the purchase of these assets by non-residents. Thus, non-residents may continue to purchase these assets in foreign currency.

Offshore Trust Management Of Russian Securities And Other Assets

The changes in the Law could have a major impact on the offshore trust management of Russian securities, specifically in cases where this activity goes beyond the simple exercise of related rights (*e.g.*, voting rights, the right to receive dividends or interest, *etc.*) and encompasses the sale-purchase of the securities on behalf of the trust beneficiary. In such cases, the trustee is no longer subject to the requirement to use a special bank account or the retention requirement, which the Central Bank had been empowered to impose on the transactions of non-residents involving

internal and external securities pursuant to Articles 1(1), 8(3)(3), 8(3)(5), 8(5)(1), 8(6)(1) and 8(6)(2) of the Law.

Cross-Border Loan Transactions

The changes in the Currency Control Law could also have a significant impact on the structuring of loan transactions among Russian residents and non-residents. After January 1, 2007, the Central Bank may no longer require non-residents entering into loan transactions to use a special bank account (Article 8(3)(2) of the Currency Control Law) or retain up to 100 percent of the value of the currency operation for a period of up to 60 days or up to 20 percent for a period of up to one year (Articles 8(5)(2) and 8(6)(2) of the Currency Control Law). Viewed together with the expiration of restrictions on the opening of foreign bank accounts by Russian residents, it may reasonably be inferred that, as of January 1, 2007, non-residents may transfer the amount of a loan to a Russian resident to any account of this resident, irrespective of the country in which the bank is located.

Cross-Border Project Financing Transactions

Similarly to cross-border loan transactions, Western participants in cross-border project financing transactions, notably banks granting loans, are no longer subject to either the retention requirement or the requirement to use a special bank account. Furthermore, they may now transfer the amount of the loan to any of the Russian resident's bank accounts.

Cross-Border Securitization Involving Russian Assets

The changes in the Currency Control Law could also have an impact on cross-border securitization transactions involving Russian assets, in particular, so-called "true-sale securitizations," in which the Russian originator of a securitization transaction enters into an agreement with a Western company (special purpose vehicle, or SPV), and assigns to the SPV certain Russian receivables (automobile loans, credit card receivables, mortgages, *etc.*) in exchange for a payment. After January 1, 2007, the Russian Government may no longer require that residents granting non-residents a payment deferral of more than 180 calendar days retain up to 50 percent of the deferred payment due by the non-resident for a period of up to two years (Article 7(3) of the Currency Control Law). Taking into account that the expiration of this provision could offer parties to such transactions significant flexibility in structuring their terms and conditions — particularly those related to payment terms — these changes can be expected to lead to an overall increase in the number of securitization transactions involving Russian assets.

Cross-Border Leasing Transactions

Last but not least, the changes in the Currency Control Law could have a profound impact on cross-border leasing transactions among non-residents and Russian residents, particularly those involving ground transportation, aircraft and ships, as provided by Chapter XVII of the Foreign Trade Classification of Goods. Since Article 7 of the Currency Control Law expired on January 1, 2007, the Russian Government may no longer require Russian leasing companies to retain up to 50 percent of advance payments to non-residents for imported equipment (with the subsequent deduction of equipment cost) for a period of up to two years, as previously established by Article 7(5) of the Law. The abolition of these burdensome restrictions is likely to result in an increase in the overall number of cross-border leasing transactions, as well as an increase in the number of foreign investors interested in entering the Russian domestic leasing market by setting up a local company.

Conclusion

The expiration on January 1, 2007, of a number of provisions of the Currency Control Law opens a broad range of new opportunities for foreign investors interested in actively participating in the Russian markets.

Nevertheless, in order to avoid significant legal pitfalls, such investors are strongly advised to verify whether the regulations of the Central Bank issued on the basis of these provisions have been formally abolished before taking any affirmative steps in these new directions.

Furthermore, foreign investors may also wish to consider the possible implications of the provisions of the Currency Control Law which still remain effective, namely those concerning registration of the transaction with the bank where the respective foreign currency account is kept (the so-called "passport of the transaction") (Article 20 of the Law), the rights and obligations of currency control bodies and their officials (Article 23 of the Law) as well as the liability for violation of currency control legislation of the Russian Federation and orders of the currency control bodies (Article 25 of the Law).

NOTES

1 *See, e.g.,* Letter No. 352 of the Central Bank of the USSR "General Provisions Concerning the Regulation of Currency Transactions on the Territory of the USSR," dated May 24, 1991 (as amended).

2 Federal Law No. 173-FZ "On Currency Regulation and Currency Control," dated December 10, 2003 (as amended), Sobr. Zakonod. Russian Federation, 2003, No. 50, Art. 4859. *See also* New law on currency regulation and currency control by Glenn S. Kolleeny, Irina V. Grave, and Artem V. Zhavoronkov on the Salans law firm's website at *www.salans.com/FileServer.aspx?oID=600&lID=0*

3 According to Article 1(1)(6) of the Currency Control Law, residents are: (a) natural persons who are citizens of the Russian Federation, with the exception of citizens of the Russian Federation who are considered permanent residents of a foreign country in accordance with the legislation of the respective country; (b) foreign citizens and stateless persons permanently residing in the Russian Federation on the basis of a residence permit under the legislation of the Russian Federation; (c) legal entities created in accordance with the legislation of the Russian Federation; (d) branches, representative offices and other subdivisions of the residents referred to in subsection (c); (e) diplomatic missions, consular institutions and other official missions of the Russian Federation located outside the territory of the Russian Federation, as well as permanent missions of the Russian Federation to interstate and intergovernmental organizations; (f) Russian Federation, constituent territories ("subjects") of the Russian Federation, and municipalities participating in the relations governed by this Law, as well as other federal laws and regulations adopted pursuant to this Law. According to Article 1(1)(7) of the Law, non-residents are: (a) natural persons who are not "residents" in accordance with Article 1(1)(6)(a) and (b); (b) legal entities created in accordance with the legislation of foreign countries and located outside the territory of the Russian Federation; (c) organizations,

which are not legal entities, created in accordance with the legislation of foreign countries and located outside the territory of the Russian Federation; (d) foreign diplomatic missions, consular institutions of foreign states accredited in the Russian Federation and permanent missions of these states to interstate or intergovernmental organizations; (e) interstate and intergovernmental organizations, their branches and permanent missions in the Russian Federation; (f) branches, permanent representative offices and other separate or independent subdivisions of the non-residents cited in sections (b) and (c) above; and (g) other persons not indicated in Article 1(1)(6) of the Currency Control Law. Respectively, for the purposes of the Law, international financial institutions such as the World Bank and the European Bank for Reconstruction and Development are considered "non-residents."

4 It may be recalled that, in accordance with Article 1(1)(3) of the Currency Control Law, internal securities are: (a) mass-issue securities (*emissionnye tsennye bumagi*) denominated in the currency of the Russian Federation, the issuance of which is registered in the Russian Federation; and (b) other securities certifying the right to receive the currency of the Russian Federation, issued on the territory of the Russian Federation. On the other hand, external securities, according to Article 1(1)(4) of the Currency Control Law, are securities including those issued in non-documentary form, which, by virtue of the Currency Control Law, are not classified as internal securities.

5 As of January 1, 2007, the OECD member countries were (in alphabetical order): Australia; Austria; Belgium; Canada; Czech Republic; Denmark; Finland; France; Germany; Greece; Hungary; Iceland; Ireland; Italy; Japan; Korea; Luxembourg; Mexico; Netherlands; New Zealand; Norway; Poland; Portugal; Slovak Republic; Spain; Sweden; Switzerland; Turkey; United Kingdom; and the United States. *See www.oecd.org/documentprint/0,2744,en_2649_201185_1889402_1_1_1_1,00.html*

6 As of January 1, 2007, the FATF members were (in alphabetical order): Argentina; Australia; Austria; Belgium; Brazil; Canada; Denmark; European Commission; Finland; France; Germany; Greece; Gulf Co-operation Council; Hong Kong China; Iceland; Ireland; Italy; the Kingdom of the Netherlands; Luxembourg; Mexico; New Zealand; Norway; Portugal; Russian Federation; Singapore; South Africa; Spain; Sweden; Switzerland; Turkey; United Kingdom; and the United States. *See www.fatf-gafi.org/documentprint/0,2744,en_32250379_32237295_34027188_1_1_1_1,00.html*

7 Article 12(3) of the Currency Control Law; Resolution No. 623 of the Government of the Russian Federation "On the Approval of Rules for the Preliminary Registration of Accounts (Deposits) Opened at Banks Outside the Territory of the Russian Federation," dated October 17, 2005, Sobr. Zakonod. Russian Federation, 2005, No. 43, Art. 4404.

8 Specific types of special accounts were prescribed by the Central Bank of the Russian Federation in its Instructions No. 116-I "Concerning the Types of the Special Accounts of Residents and Non-Residents," dated June 7, 2004, Vestnik Banka Rossii, 2004, No. 36; 2005, No. 4.

9 Specific retention requirements were established by Order No. 1465-U of the Central Bank of the Russian Federation "On Establishing Requirements Concerning Retention in the Process of Depositing Funds in Special Banking Accounts and Transferring Funds from Special Banking Accounts," dated June 29, 2004 (as amended), Vestnik Banka Rossii, 2004, No. 44; 2005, No. 7; 2006, No. 24.

10 *See* Order No. 1688-U of the Central Bank of the Russian Federation "On the Abolition of the Requirement on the Mandatory Use of Special Accounts in the Process of Conducting Currency Operations and the Abrogation of Certain Acts of the Bank of Russia," dated May 29, 2006, and Order No. 1689-U of the Central Bank of the Russian Federation "On the Abrogation of Certain Acts of the Central Bank of the Russian Federation," dated May 29, 2006 (abolition of retention requirements), Vestnik Banka Rossii, 2006, No. 34.

11 *See* Michel Noel *et al.,* Development of Capital Markets and Institutional Investors in Russia: Recent Achievements and Policy Challenges Ahead. World Bank Working Paper No. 87 (2006) pp. 71-72. *See also* Glenn S. Kolleeny, Alexei Paramonov and Matthew D. Roazen, Recent Developments Affecting Frozen S-Account Rubles: The Gray Market and Other Schemes for Repatriation, Russia/Central Europe Executive Guide, 2000, Volume 10, No. 5, p. 3, 16-20.

SPECIAL REPORTS AVAILABLE NOW:

Major Tax Developments in the New E.U. Countries: 2006

Major Tax Developments In The New E.U. Countries: 2006

Tax Planning International: Special Report

Obtain objective reports on and expert analysis of key tax developments in the new E.U. member countries during 2006. These developments include the proposal and enactment of new laws – many intended to harmonize national legislation with E.U. law – regulatory actions, and judicial decisions.

Major Tax Developments in the New E.U. Countries: 2006 helps to ensure that you're fully informed about every significant new tax law, policy change, judicial ruling or tax treaty development that occurred in this region in 2006. In particular, gain coverage of areas of particular interest to foreign companies operating or investing in the region – including transfer pricing, tax treaties and tax-planning opportunities. It also covers areas of general concern such as tax inspections and penalties, amendments to laws on profits tax, corporate and personal income tax and VAT - as well as new incentives and allowances for certain types of investments.

The countries covered are all ten of the countries that acceded to the European Union on 1st May 2004: Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia.

Pages: 80. Price: £95/$175/€135

Major Tax Developments in Russia and Other CIS Countries: 2006

Major Tax Developments In Russia And Other CIS Countries: 2006

Tax Planning International: Special Report

Major Tax Developments in Russia and Other CIS Countries: 2006 helps to ensure that you're fully informed about every significant new tax law, policy change, judicial ruling or tax treaty development that occurred in this region in 2006. In particular, gain coverage of areas of particular interest to foreign companies operating or investing in the region – including transfer pricing, foreign entities, permanent establishments, guidance on the legitimacy of tax optimization arrangements and tax audits and disputes. It also covers areas of general concern such as tax administration, customs valuation rules, new incentives for certain types of investments and changes in various types of tax laws and rates.

Countries covered are Russia, Ukraine, Azerbaijan, Kazakhstan, Uzbekistan and Belarus.

Pages: 44. Price: £75/$135/€105

To order your copies, e-mail marketing@bnai.com, phone + 44 207 559 4801, or visit www.bnai.com/specialreports
Available in print or as PDF. Please confirm preferred format.
Note: prepayment is required before shipment.