HOW TO INVEST IN RUSSIA

The AEB guide to investing in Russia

Adjusting to new realities, unfolding new opportunities

Foreign investment in strategic branches of the Russian economy

Impact of the waste management industry on climate change in Russia

Transfer pricing and customs requirements for importers

Investment protection and promotion agreements: outcomes and prospects
When deciding whether to invest in Russia, an investor usually considers preferential investment arrangements, tax benefits and government support available to the project, enabling the investor to maximise profitability.

The ability to leverage such support in Russia is usually contingent on the conclusion of long-term investment agreements.

In this article, we analyse three long-term investment agreements (Special Investment Contract, Investment Protection Agreement1 and a Special Economic Zone Agreement).

Selecting the appropriate investment agreement

First of all, the investor must understand whether a specific investment agreement is appropriate to the project, taking into account planned business activities.

Special Investment Contract (SPIC) is intended solely for industrial projects involving technology transfer, implying industrial production in Russia. The technology to be transferred must be approved by the Russian Government, including the production of medical products, automobile components, mechanical engineering and electronics products, and a whole range of other industrial products required in Russia.

Unlike SPIC, an Investment Protection Agreement (IPA) is intended for broader

1 Up-to-date detailed rules on the conclusion of Investment Protection Agreement are currently under government review.
use and may also apply to industrial projects involving the setup of production facilities in Russia. Investors may also conclude IPA to engage in healthcare activity, the setup of educational, cultural and sports facilities, transport infrastructure, hotels, tourist complexes, logistics centres, for investments in agriculture, implementation of environmental protection projects, and in the digital sector. An IPA is also applicable to natural gas liquefaction investment projects.

A Special Economic Zone Agreement (SEZA) intended for industrial production implies the production or processing of any goods or logistics activities within a Special Economic Zone (SEZA).

Procedure for concluding an investment agreement

The conclusion of an investment agreement implies that the state will become a partner of the investor.

Who concludes an investment agreement?

SPIC are concluded with the participation of federal and regional governments and municipalities.

IPA may be concluded independently at federal and regional levels.

SEZA are concluded with the federal government or the regional authority (if authorized) and Management Company of the Special Economic Zone.

How is the investment agreement concluded?

SPIC may be concluded on the initiative of the investor and the state.

If an investor initiates the conclusion of a SPIC for industrial projects, it submits the proposal to the Russian Ministry of Industry and Trade. The Ministry considers the investor’s proposal and decides whether to hold competitive bidding regarding the investment project open to all interested parties.

The Ministry may also announce, independently of the investor, the holding of competitive bidding to implement a specific investment project and invite investors to participate.

The competitive bidding procedure is regulated by the law, with the key criteria for winning related to:

» the shortest period for transferring technology;
» the largest production volumes;
» the highest technological level of localization of production.

Like SPIC, IPA may be concluded based on both a private and public initiative.

A private initiative implies that the investor submits an application to the state.

The federal or regional government may also propose the conclusion of IPA. Here, the government publishes a declaration on implementation of a specific investment project and indicates the planned government support.

The investor is selected on a competitive basis. The competitive bidding procedure is regulated by the law, with the key criteria for winning related to:

» the largest capital investments;
» the smallest amount of government support;
» the shortest implementation period of the investment project and the highest level of efficiency.

A SEZA is concluded on the investor’s initiative, subject to approval of the project’s business plan by the competent authority.

Capital investments

Capital expenditure is one of the investor’s key obligations under an investment agreement. In several cases, the law does not establish the minimum level of capital investment, but frequently makes specific measures of government support and the term of the investment agreement contingent on the level of capital expenditure.

SPIC assumes that the investor acquires or leases land plots for the construction or reconstruction of manufacturing facilities, invests in fixed assets, R&D and IP.

Under IPA, the law considers capital expenditures not only in R&D, construction of real estate or fixed assets intended for investment activities, but also creation of related and supporting infrastructure. Supporting infrastructure includes transportation, energy, social or digital infrastructure facilities used exclusively for the investment project. Related infrastructure includes the same facilities, but also intended for collective use by the state or third parties.

To conclude SEZA, capital expenditures must equal at least RUB 120 million (other than intangible assets), with at least RUB 40 million invested in the first three years from the conclusion of the agreement.

Legal effect of concluding an investment agreement

The key issue is the specific benefit of the investment agreement, and the specific support, guarantees, or special terms provided in exchange for the investor’s obligations. This legal effect is summed up below.

Simplified procedure for obtaining “Made in Russia” certificate

The investor obtains the certificate “Made in Russia” for products manufactured under the SPIC under the simplified procedure. During the first three years the products are declared “Made in Russia” even if they do not yet meet all the statutory localization requirements. The investor thereby accesses an additional market if “Made in Russia” status is key importance to sales of the products.

The simplified procedure is not applicable to IPA and SEZA.

“Stabilization clause”/“grandfather clause”

The “grandfather clause” is a key legal guarantee for SPIC investors, whereby legislative and regulatory acts do not apply for the duration of the SPIC if they were adopted after the SPIC was concluded and introduce restrictions or prohibitions on the investor’s rights or business activities under SPIC.

The “stabilization clause” is a key incentive for concluding IPA. The “stabilization clause” is a legal guarantee for the investor, as legislative and regulatory acts will not apply to the investor for a defined period if they worsen the terms of doing business related to the investment project. Under the “stabilization clause”, the volume or term of government support cannot be reduced. In addition, changes in the procedure for using land plots, and additional administrative procedures established for design work or construction, are not applicable. Additionally, the investor can (dependent on the project) expect a freeze in the rate of export customs duties and adverse environmental impact fees. Here the “stabilization clause” is contingent on the level of investment.
A successful long-term investment decision requires not only a substantiated financial plan and clear business targets but also a deep analysis of the most appropriate legal approach and tax benefits to make the investment project more secure and profitable.

The “stabilization clause” is not applicable for SEZA.

Other government support

Concluding a SPIC can grant the investor access to industry subsidies. However, the terms and conditions of the subsidy should be considered.

In IPA the state may reimburse capital expenditures of investors on the construction of related and supporting infrastructure and paid interest costs, as well as R&D costs and interest paid related to the set-up of investment facilities and IP. Under IPA, investors may also be eligible for other support (subsidies, etc.) stipulated by the law. However, the terms and conditions of the subsidy should be considered.

In SEZA the Management Company may be charged with creating certain infrastructure facilities for use by the investor. Investors can use land plots on preferential terms (lower lease rates). Duty-free customs arrangements may apply to goods (components for the manufacture of end products).

Tax effect of an investment agreement

Guarantee of tax stability

In SPIC, the current overall tax burden when the SPIC was signed remains unchanged during the contract.

This guarantee is implemented as follows:

» any rules increasing the tax rates established for SPIC participants or revoking tax concessions do not apply to SPIC participants;
» the guarantee remains in effect until the investor loses the status of SPIC participant, or the end of the effective term of the established tax benefits, whichever comes first;
» the guarantee applies to profit tax, corporate property tax, transportation tax, and land tax.

When concluding an IPA, the investor does not obtain tax preferences in exchange for any obligations and is guaranteed that the tax arrangements in effect on the date of the agreement will remain for the period specified in the agreement (“stabilization clause”).

New rules changing the procedure for calculating the tax base, rates, concessions, the procedure and deadlines for paying taxes do not apply to the investor if they entered into force after the effective date of the IPA. This rule applies to different taxes, depending on the specific party to the agreement, e.g. the Russian Federation, a Russian region, municipality or more than one of them. Investors are eligible for property, transportation and land tax concessions even if they were introduced after the conclusion of the agreement. The “stabilization clause” remains in effect until the expiry of the agreed term or termination of the IPA.

Taxation of income and dividends

SPIC participants enjoy the following concessions:

» federal tax rate of 0%;
» the regional tax rate may be lowered to 0%.

The concession may not exceed 50% of capital expenditures on the investment project. The existing rules do not stipulate concessions on the taxation of dividends distributed to the shareholders of SPIC participants.

For income from activity in SEZ:

» the federal tax rate may be 2% or 0%;
» the regional tax rate may be lowered and should not exceed 13.5%.

SEZ residents may apply an accelerated depreciation rate (up to 2), which lowers taxable income.

Property tax

The book value of buildings and structures is subject to property tax (maximum rate 2.2%), regardless of taxpayer turnover or income. Accordingly, concessions on this tax represent a significant part of regional investment policy.

Russian regions introduce concessions up to 0% for SPIC participants, usually for assets created or modernized under the SPIC.

SEZ residents are exempt from this tax for 10 years from the commissioning date of the assets. The buildings and structures must be located and used for activity in the SEZ.

Land tax

Municipalities may lower or abolish the tax rate for land plots used under SPIC.

SEZ residents are exempt from this tax for five years from the month when they purchase the land plot provided that it is located in the SEZ.

Conclusion

Our experience shows that in SPIC investors are attracted by the “Made in Russia” certificate and related market access or industry support. Tax concessions play a material role, but are not the overriding factor.

In a SEZ investors are attracted by the location, infrastructure benefits, the quality of the management team, preferential leases, administrative support with the reimbursement of VAT.

In an IPA, the key factor is the application of this regime to a number of economic sectors, the “stabilization clause” and the possible reimbursement of costs.