



MERGERS AND ACQUISITIONS

Russia

Taxation of Cross-Border
Mergers and Acquisitions

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TAX

Russia

Introduction

Mergers and acquisitions (M&A) transactions have become increasingly common in Russia in recent years. There are a number of legal and tax issues that should be considered when such transactions are planned. This chapter summarizes the applicable provisions in Russian legislation. Please note that M&A issues are complex and, therefore, in each case the transactions should be planned taking into consideration all the facts and circumstances.

Recent Developments

The following summary of Russian tax considerations is based on current tax legislation as at the end of September 2009. Some changes have been made in response to the world economic crisis; others have been introduced under the general development of the tax system in Russia.

Profits Tax

The tax rate was reduced from 24 percent to 20 percent from 2009.

Value-Added Tax (VAT)

Imports of production equipment where no analogous equipment is manufactured in Russia are now exempt from VAT. The list of exempt equipment is determined by the Russian government.

This rule abolished prior VAT exemption on imports of certain technological equipment as in-kind contributions to the chartered capital.

The following anticipated developments of Russian tax system should also be taken into account.

Unified Social Tax (UST)

Replacement of current UST with maximum 26-percent rate by insurance premiums of the same rate. However, starting from 2011 the total rate of insurance premiums will be increased to 34 percent.

Transfer Pricing Rules

Amendments to transfer pricing regulations have been under discussion for several years. The main objectives are to develop legal regulation of tax administration and control, and to prevent the use of transfer pricing and

tax minimization schemes. In particular, the following is suggested:

- to determine the list of interdependent entities;
- to determine the list of transactions to be controlled;
- to specify a definition of a market price; and
- to develop a mechanism for symmetrical correction of the tax basis by all the parties involved in a controlled transaction.

Tax Consolidation

At present Russian tax law does not provide for tax consolidation of separate legal entities, but a draft law for such a regime has been under consideration for several years.

It should be noted that the above-mentioned amendments to transfer pricing rules and the introduction of a group consolidated concept had not yet been adopted as at the end of September 2009 and we are not aware of time-table for their adoptions.

Asset Purchase or Share Purchase

An acquisition in Russia can be structured as an asset or share deal. The main difference between them is that in a share deal all rights and obligations of the target company (including all historic tax liabilities) remain in the company acquired by the purchaser, whereas in an asset deal historic liabilities remain in the selling entity, although there are certain exceptions to this.

A share deal could be performed by the acquisition of shares in Russian joint stock company (AO) or an acquisition of the so-called participations in Russian limited liability companies (OOO). Share deals can also be affected by acquisitions of shares in the foreign holding companies of Russian targets.

An asset deal is usually a purchase of certain assets of the target company (generally tax risks except for customs risks are not inherited). The other form is the purchase of an enterprise as a property complex where all the assets and liabilities are assumed as well. This is a more complex procedure, which is rare in practice (in many cases the purchase of an enterprise as a property

complex occurs when a bankrupt company sells its business). It should be noted that if the parties sign a sale and purchase contract of all the target's assets, there is a risk that the deal could be re-classified as a purchase of an enterprise as a property complex (this has already happened) which would mean that the liabilities as well as assets would be transferred. In such a case the Russian tax authorities could claim that all historical tax liabilities are inherited by the purchaser.

An asset deal is generally subject to VAT and profits tax, whereas a share deal, if performed in Russia, is only subject to profits tax.

A summary of the implications of both types of purchase will be found at the end of the chapter.

Purchase of Assets

Assets of a Russian business may be acquired by a foreign legal entity directly or through a Russian branch. The acquired assets may also be contributed to the charter capital of a Russian subsidiary of the purchaser. In-kind contributions to the charter capital of joint-stock companies must be valued by independent valuers unless otherwise stipulated by the law. In-kind contributions to the charter capital of limited liability companies must also be valued by independent valuers if the nominal value of the in-kind contribution exceeds RUB 20,000. Alternatively, a special-purpose vehicle may be set up in Russia to acquire the assets of the target company.

Purchase Price

Generally the purchase price is determined by the mutual consent of the parties (under the so-called freedom of contract concept). However, the tax authorities could challenge the applied prices using the transfer pricing rules applicable to an asset deal.

Under Russian tax legislation, the tax authorities are entitled to control prices used in the following types of transactions:

- transactions between related parties;
- barter transactions;
- cross-border transactions; and
- transactions in which the price differs by more than 20 percent in either direction from the prices used by the taxpayer with respect to identical (similar)

goods (work, services) within a short period of time¹.

If the price applied under such transactions differs by more than 20 percent in either direction from the market prices, the tax authorities could challenge the price of transaction and recalculate the profits tax, VAT, and late payment interest charges.

Goodwill

Goodwill could arise in a purchase of an enterprise as a property complex. Goodwill is defined as the difference between the purchase price of an enterprise as a property complex and the net book value of its assets. If the purchase price is higher the positive difference (positive goodwill) could be deducted, for profits tax purposes, over five years from the month following the month of the state registration of the property complex transfer. It should be noted that for statutory accounting purposes goodwill is subject to impairment over 20 years or until the company's dissolution, whichever is the sooner.

If the purchase price is lower than the value of assets, the negative difference (negative goodwill) is subject to profits tax in the month of the state registration of the property complex transfer.

A loss on the sale of an enterprise as a property complex can be deducted by the seller for profits tax purposes.

Depreciation

Depreciation of assets is generally deductible for profits tax purposes in Russia. Depreciation rates depend on the assets' useful life.

The useful life of an asset is determined by the taxpayer at the date when the fixed asset is put into operation, based on the Classification of Fixed Assets Included in Depreciation Groups. If a certain fixed asset is not included in the Classification, the taxpayer should determine the fixed asset's useful life, taking into account the technical characteristics of the asset and recommendations of the manufacturer.

According to Russian tax legislation, a taxpayer is entitled to apply either a straight-line or a reducing-balance method of depreciation.

Tax Attributes

As a general rule, neither tax losses nor tax liabilities of the target company are transferred to the purchaser

¹ Russian Tax Code, art. 40, p. 2

under asset deal (subject to certain limitations such as, for example, inheritance of customs risks).

Value-Added Tax (VAT)

The sale of most assets is subject to 18-percent VAT. If a foreign legal entity acquires an asset directly and wishes to transfer the acquired asset to its business in Russia (such as contribute the asset into the charter capital of its subsidiary in Russia) and provided that the foreign legal entity is not registered for the tax purposes in Russia, the amount of the input VAT paid on the acquisition will be a cost for the investor. If the asset is acquired by an investor's Russian subsidiary, the input VAT on the acquired asset may be offset against the subsidiary's output VAT.

The contribution of an asset to the charter capital of a Russian company is not subject to Russian VAT. However, the Russian subsidiary contributing the asset to the charter capital should reinstate previously offset VAT (in the case of fixed assets at their net book value). Reinstated VAT should be shown separately in the transfer documents and can be offset against output VAT of the company which received the in-kind contribution.

The sale of enterprise as a property complex is subject to specific VAT rules. For example, the tax basis should be defined as the net book value of assets per statutory accounting multiplied by a special ratio (in case the purchase price differs from the net book value of the assets sold). If the purchase price is lower than the net book value of assets the correcting ratio is determined by the proportion the purchase price is of the net book value. If the purchase price exceeds the net book value the correcting ratio is calculated in the same way but the numerator and denominator of the proportion is reduced by the value of accounts receivables and the value of securities (if no decision about their revaluation has been made).

The seller is to provide the purchaser with an inventory report and a consolidated invoice grouped by type of asset.

Transfer Taxes

Stamp duty is not applied in Russia. However, there are certain similar duties. For example, state duty is levied on the state registration of:

- rights to an enterprise as a property complex, a contract of alienation of an enterprise as a property complex, as well as limitations of or charges for rights to an enterprise as a property complex at the

rate of 0.1 percent of the value of assets, property or other rights being a part of the enterprise as a property complex, but no more than RUB 30,000;

- rights, limitations of or charges for rights to immovable property, and contracts of alienation of immovable property (excluding certain legally relevant actions) in the amount of RUB 7,500 for legal entities; and
- in some other cases.

The amount of state duty for registration of transactions relating to land plots and their encumbrances depends on the type of land plot and the entities involved. In most cases the amount is not significant.

Purchase of Shares

In general, a share deal may be preferable for the seller if the seller is a foreign legal entity since, according to Russian tax legislation, capital gains from the sale of shares are tax exempt unless more than 50 percent of the assets of a Russian target company consist of immovable property located in Russia.

Tax Indemnities and Warranties

In a share acquisition the purchaser takes over the target company together with all its assets and liabilities including contingent liabilities. The purchaser will, therefore, normally require more extensive indemnities and warranties than in the case of an asset acquisition. In order to protect itself from potential tax risks the purchaser may wish to initiate a due diligence procedure and include some indemnities in the sale-purchase agreement (SPA).

Tax Losses

Losses of the purchased company may be carried forward over 10 years following the year in which the corresponding losses were incurred. The taxpayer is entitled to reduce its taxable profits by the previously incurred losses provided that during the whole period of their use he/she retains the supporting documents which prove the losses were incurred.

In the case of a reorganization a company that takes over all the rights and obligations of the re-organized company is entitled to reduce its taxable profit by the amount of losses incurred by the re-organized company before its reorganization.

Please note, that the Russian government has plans to introduce limitations on loss carry-forwards in mergers and takeovers.

Crystallization of Tax Charges

As the purchaser of shares takes over the target company together with all its liabilities, he/she inherits all the target's historic tax risks. It is, therefore, usual for the purchaser to obtain an appropriate indemnity from the seller with regard to outstanding historic tax liabilities. The purchaser may ask the target company to obtain a reconciliation statement and a statement of personal account from the tax authorities at the latest possible date preceding the date of a share deal. However, it should be noted that if the target company has no outstanding tax obligations according to these documents, it does not exclude the possibility that the tax authorities will challenge the accuracy and timeliness of the tax calculations and payments, and accrue additional taxes and penalties in future. It is also advisable to consider carefully the results of the field tax audits of the target company. Generally three calendar years preceding the current year are subject to field audit by the tax authorities. However, in certain cases the closed tax periods (from three to 10 preceding years) may be subject to repeat tax audits. Such a repeat audit could be performed, inter alia, if:

- the taxpayer is regarded as inhibiting the exercise of the tax control by the tax authorities;
- the higher tax authorities are checking the work done by the lower tax authorities; or
- by opening a criminal case against the officers of the company on the grounds of tax evasion.

Transfer Taxes

Stamp duty is not applied in Russia. However, there are other similar duties. For example, state duty is levied on the state registration of the issue of securities (shares, bonds) at 0.2 percent of their nominal value, but not exceeding RUB 100,000 (about USD 3,300 as at the end of September 2009).

Tax Clearances

Taxpayers can obtain tax clarifications from the tax authorities on unclear or questionable provisions in Russian tax legislation. If the taxpayer follows such clarifications and the case is then challenged by the tax authorities, the taxpayer is exempt from the penalties (fine and late payment interest), but not the tax itself. However, the authorities may claim that their clarifications were based on insufficient or uncertain information provided by the taxpayer. In such a situation the taxpayer will not be exempt from paying penalties.

Choice of Acquisition Vehicle

There are several possible acquisition vehicles for to a foreign investor and tax consequences will often influence the choice.

Local Holding Company

If the purchaser uses debt financing to acquire a Russian target it might be reasonable to set up a Russian holding company as an intermediary. In Russian tax legislation interest expenses are deductible for profits tax purposes irrespective of whether a loan was taken out for investment, or current business needs. It should be noted that there are certain limitations on interest deductibility (see section Deductibility of Interest).

A post-acquisition merger of the intermediate holding company and the target company could be considered. This would have the advantages of making it possible to offset the holding company's interest expenses against the target company's income (the holding company would not have such income) and reducing the administrative costs of maintaining two companies rather than one. Such a cascading structure is also inefficient from dividend payment point of view. Dividends will be subject to tax at a rate of 0 percent if certain conditions are met, or 9 percent when distributed to the holding company and this tax may not be creditable against further taxation of dividends paid to the foreign shareholder.

However, it should be noted that if the above-mentioned merger was mainly motivated by tax consideration, the tax authorities could invoke the concept of "unjustified tax benefit" and assess additional taxes as if no merger had occurred.

Foreign Parent Company

A foreign purchaser may wish to acquire the shares of a Russian company without an intermediary. This should be considered if a foreign parent is planning to re-sell the target. Russia does not tax capital gains on shares sold by a foreign legal entity unless more than 50 percent of the assets of the Russian target consist of immovable property located in Russia.

Although Russia levies WHT on dividends, interest, and royalties received by a foreign entity, it can be reduced or eliminated by an applicable double-tax treaty. Russia has an extensive network of such treaties.

A foreign investor may acquire shares in a Russian company for cash or in exchange for in-kind contributions of property (assets or shares). The tax

basis of the acquired shares in the Russian company would be equal to the tax basis of property (shares) given in exchange for the shares and costs related to the contribution.

The tax basis of property (assets or shares) received by the Russian company would also be equal to the tax basis of the contributed property stated in the records of the investor on the date of transfer (but not higher than the market value of the transferred property confirmed by an independent valuer for transfers made by a foreign investor). If the Russian company lacks supporting documents for the cost of property received, the tax basis of property would equal zero for Russian profits tax purposes.

Permanent establishment (PE) issues should also be taken into account. According to the Russian Tax Code, the activities of a foreign legal entity could create a PE in Russia if this foreign entity has a place of business in Russia (a branch, an office, a bureau, or other separate division) and regularly engages business activities through this place unless the activities are of a preparatory or auxiliary character. Most double tax treaties between Russia and other countries contain similar criteria for determining whether a PE of a foreign legal entity (FLE) exists in Russia.

Non-Resident Intermediate Holding Company

A non-resident intermediate holding company could be used to reduce WHT on dividends, interests, and royalties by applying more favorable double tax treaties with Russia. However, it should be noted that the Russian tax authorities may challenge the deal if they consider that its only objective is to obtain a tax benefit (the so-called unjustified tax benefit concept).

PE issues should also be taken into account.

Local Branch

Instead of directly acquiring the target company, a foreign purchaser may structure the acquisition through its Russian branch. The taxation of the branch will depend on whether or not it constitutes a PE in Russia. Please note, that acquiring shares or participation units of a Russian legal entity by an FLE is not deemed a creation of a PE in Russia unless other characteristics of a PE are present.

If the branch does not constitute a PE in Russia, the tax consequences on the subsequent sale of the target are the same as in the case where a foreign parent company is used as an acquisition vehicle: there is no capital gain tax on shares sold by an FLE unless more

than 50 percent of the assets of the Russian target consists of immovable property located in Russia.

If the branch constitutes a PE in Russia, capital gains are taxed in the same way as capital gains of the Russian company (20-percent profits tax).

Joint Ventures

A joint venture may be corporate (usually in the form of an OOO) or incorporate (joint venture agreement). A corporate joint venture is considered a Russian legal entity and is normally subject to the general tax regime.

If a joint venture is to be set up as a simple partnership certain conditions have to be met. For example:

- participants in a joint venture have to carry out separate accounting of joint venture operations and operations not related to the joint venture activities;
- if one of the participants is a Russian legal entity, it should carry out the tax accounting of a joint venture; and
- only a Russian participant is entitled to recover input VAT.

Choice of Acquisition Funding

Typically, acquisitions are financed with debt, contributions to equity, or hybrid instruments. The main tax issues arising for each of these are summarized below.

Debt

Debt financing may be preferable from the tax point of view because the purchaser can deduct interest expenses for the profits tax purposes (subject to certain limitations). Payment of dividends, by contrast, does not give rise to a tax deduction. However, before using debt financing the company should thoroughly consider several financial factors and whether it is better to borrow from a bank or from another legal entity, related or unrelated.

Deductibility of Interest

In general, interest on debt instruments is deductible for profits tax purposes regardless of whether the loan is taken out for investment purposes or current business needs. Exchange losses on loans and interest are fully deductible and gains are fully taxable. The following limitations should, however, be taken into account:

- Arm's length principle: the accrued interest should not be 20 percent higher or lower than the average

level of interest on comparable loans, granted in the same quarter, under comparable conditions.

- In the absence of comparable loans, the maximum deductible rate on foreign currency loans is 15 percent. For loans taken out in rubles it is limited to the Central Bank of Russia refinancing rate multiplied by 1.1. From 1 September 2008 until 31 December 2009 the maximum deductible rate was set at 22 percent for foreign currency loans and twice the Central Bank refinancing rate for RUB loans.

Thin-capitalization rules apply when:

- a Russian borrower receives a loan from a foreign lender that owns directly or indirectly more than 20 percent of its share capital, or from a Russian lender affiliated with such a foreign indirect/direct shareholder, or if such a Russian affiliate guarantees the loan; and
- the borrower's debt-to-equity ratio is more than 3:1 (12.5:1 for companies which perform exclusively leasing activities).

Thin-capitalization rules in Russia should not apply to situations where a loan is received from a foreign sister company or from any other foreign company of the same group that is not the Russian company's direct or indirect shareholder. This means that restrictions established by the thin-capitalization rules may be mitigated by appropriately structuring of the lender-borrower relationship.

Any interest paid in excess of the above debt-to-equity ratio is not tax deductible and is treated as dividends for tax purposes.

Withholding Tax on Debt and Methods to Reduce or Eliminate

The statutory WHT rate on interest income is 20 percent, whereas the majority of double tax treaties (DTTs), which override domestic law, provide for a 0-percent or 5-percent rates. To obtain treaty relief, the foreign company receiving the interest income should provide the Russian company, its tax agent, with a tax-residency certificate.

Checklist for Debt Funding

- The use of bank loan could help the purchaser to eliminate or mitigate thin-capitalization and transfer pricing problems.

- The statutory WHT rate on interest income of 20 percent may be reduced by applying provisions of DTTs which provide for a lower rate.

Equity

According to Russian law, the contribution of cash by a shareholder (parent company) to the share capital of a Russian company (the target company) is not a taxable event, but dividends paid to a parent company are subject to WHT. If a parent company is a Russian legal entity dividends paid are subject to WHT at a general rate of 9 percent (0 percent if certain conditions are met). Dividends paid to a foreign parent company are subject to WHT of 15 percent, unless reduced by a double tax treaty's provisions (can be reduced to 5 percent under some treaties).

Forms of Reorganization

In general, the reorganization of a legal entity is a tax-neutral event and neither the reorganized company nor the new company created as a result of the reorganization should be subject to any additional taxation.

According to Russian civil law, the reorganization of a legal entity can take one of five different forms: merger, takeover, split-off, spin-off, and conversion.

The Russian Tax Code stipulates that obligations to pay taxes and fees of a reorganized legal entity should be fulfilled by its legal successor (successors), accordingly:

- in the case of a merger of several legal entities, the legal entity resulting from such merger should be recognized as the successor with respect to the obligation to pay taxes and fees of each of the original legal entities;
- in the case of a takeover of one legal entity by another legal entity, the accessing legal entity should be recognized as the successor to the obligations to pay taxes and fees of the accessed legal entity;
- in the case of split-off of a legal entity into several legal entities, the legal entities resulting from such division should be recognized as successors with respect to the obligations to pay taxes and fees of the original organization;
- in the case of a spin-off from a legal entity, no succession to the re-organized legal entity with respect to its obligations to pay taxes should arise. However, if as a result of the separation from a legal entity by one or more legal entities,

reorganized legal entity cannot fulfill its obligations to pay taxes and fees in full, then, pursuant to a court decision, the separated legal entities may be obligated jointly and severally to fulfill the obligation to pay taxes and fees of such legal entity;

- in the event of conversion of one legal entity into a new one, the legal entity resulting from such conversion should be recognized as the successor to the obligations to pay taxes and fees of the reorganized legal entity.

Hybrids

Hybrid instruments are classified as debt or equity for tax purposes depending on their legal form, rather than on their economic substance. Thus, such hybrid instruments as profit-sharing loans and interest-free loans are, in principle, classified as debt for tax purposes. The claim that such instruments are not debt may theoretically be challenged by the tax authorities in arbitration court with the assertion that they are an imaginary instrument that actually disguises the distribution of profits. But the chances of the tax authorities being successful in court are very low. Please note, that hybrid instruments are very rare in Russia.

Discounted Securities

According to the Russian Tax Code any previously determined income (including a discount) received from any kind of debentures is interest income and subject to a 20-percent tax WHT.

Deferred Settlement

An acquisition often involves an element of deferred consideration, the amount of which can only be determined at a later date on the basis of the business' post-acquisition performance. The Russian Tax Code has no specific provisions on the taxation of such transactions; the precise tax consequences would depend on the wording of relevant supporting documentation and the actual relationships between the parties. In general, deferred settlement could be taxed as follows (depending on whether foreign or Russian legal entities are involved):

- For foreign vendors with no PE in Russia: obligation to withhold tax by the Russian buyer arises at the moment of payment. Therefore, deferred settlement payments to foreign companies should be subject to Russian WHT (if any) at the moment of payment.
- The situation when deferred settlement is due to the Russian legal entity is more complicated and

depends on the precise contract terms and the tax policy of this Russian legal entity. A tax liability could arise on the receipt or accrual of deferred settlement amounts.

Other Considerations

Among many other considerations that should be taken into account when structuring M&A transactions are the following:

- The target's business could be transferred to a new legal entity.
- A simple partnership with joint activities could be formed.
- There are many other options available, and combinations thereof, depending on the specifics of the target and the transaction.

Non-tax factors, such as company law, anti-monopoly, and currency control provisions, should also be considered.

Concerns of the Seller

The tax consequences for the seller will depend on whether it is a Russian legal entity or an FLE.

If the seller is a Russian legal entity it is subject to a 20-percent tax on capital gains, provided that its expenses are supported by the required documents. If there is no documentary evidence of expenses the gross income from sale will be subject to taxation.

If the seller is an FLE it is exempt from tax on capital gain unless more than 50 percent of the assets of the Russian target company consists of immovable property located in Russia (otherwise capital gains are subject to 20-percent profits tax).

If the seller is an individual he/she is exempt from capital gains tax on a sale of shares before 1 January 2007. Currently, capital gains are subject to 13-percent income tax for Russian residents and 30 percent for non-resident individuals.

Company Law and Accounting

Commercial entities in Russian are divided into companies, partnerships, production co-operatives, and state and municipal unitary enterprises. The most widespread are joint stock companies (AOs) and limited liability companies (OOOs).

Joint Stock Company (AO)

- A joint stock company is a legal entity that can be either open (OAO, publicly-owned) or closed (ZAO).
- The minimum share capital for an OAO is RUB 100,000 whereas for a ZAO it is RUB 10,000.
- The minimum number of shareholders (both for OAOs and ZAOs) is one (unless the only shareholder is a legal entity owned by one person).
- The maximum number of shareholders for a ZAO is 50; for an OAO – no restrictions.

Limited Liability Company (OOO)

- The minimum charter capital for an OOO is RUB 10,000.
- The minimum number of participants is one (unless the only participant is a legal entity owned by one person).
- The maximum number of participants in an OOO is 50.
- Participants are not liable for the company's debts.
- Shareholders are not liable for the company's debts.

The taxation regime does not depend on the legal form of the company.

Anti-Monopoly Legislation

In general the anti-monopoly law restrictions on transactions and contractors. A number of transactions require preliminary consent from the responsible authorities or a simple notification after the event.

For example, prior consent is required for the following:

- Reorganization in the form of a merger of commercial organizations if:
 - the aggregated net book value of their assets at the last reporting date preceding the request to the anti-monopoly authorities exceeds RUB 3 billion;
 - the aggregated sales turnover for the year preceding the merger exceeds RUB 6 billion; or
 - one of the merging companies is included into the register of economic entities which dominate or have a share of more than 35 percent of the market of a certain product .

- For a number of sales of shares (participation units), rights and (or) property if:
 - the aggregated net book value of the seller's and purchaser's assets exceeds RUB 7 billion;
 - the aggregated sales turnover for the year preceding the deal exceeds RUB 10 billion and the net book value of the purchaser's assets exceeds RUB 250 million; or
 - one of the companies is included in the register;

In practice it could be difficult to collect all the necessary documents within a short period of time.

Group Relief/Consolidation

Russian tax law does not provide for tax consolidation of separate legal entities. However, for a Russian legal entity that has branches or representative offices, the profits tax is calculated on a consolidated basis by the head office and profit is attributed to each branch based on a proportion of the average number of employees of the branch and the residual value of the depreciated fixed assets of the branch.

Transfer Pricing

According to current legislation the tax authorities are entitled to control prices of transactions, in particular, if prices fluctuate by more than 20 percent in either direction from the prices used by the taxpayer in identical or similar transactions within a short space of time. If prices under such transactions deviate by more than 20 percent from market prices, the tax authorities could propose transfer pricing adjustments resulting in additional taxes calculated as if the transactions were executed at market prices. Late payment interest could also be due.

General transfer rules should not be applicable to the sale of securities (including, but not limited to shares). The Russian tax code contains special rules for determining their value for profits tax purposes. The method of determination depends on the kind of security (marketable versus non-marketable securities).

Dual Residency

Generally dual residency conflicts are resolved by the relevant double tax treaty by means of tax credit or exemption. Since obtaining these usually involves certain bureaucratic and time-consuming procedures, intentional dual residency is usually not used by Russian companies (the Russian residency of which is defined by registration).

Foreign Investments of a Local Target Company

In general, foreign investors may invest in Russia without any specific restrictions, except when investing in certain companies in certain sectors considered to be of strategic importance. The list of sectors of strategic importance includes, inter alia, extraction of natural resources from certain strategic mineral deposits. Foreign legal entities and Russian companies controlled by them are not allowed to obtain licenses for the extraction of minerals from certain deposits.

Comparison of Asset and Share Purchases

Advantages of Asset Purchases

- The price of purchased assets can be depreciated for profits tax purposes.
- If the acquiring company is in a loss position, such losses may be used against profits generated by the acquired business in the case of merger or take-over.
- It is possible to acquire only those assets which the purchaser really needs (this, inter alia, could be useful in the case of an acquisition of only part of a business).
- The tax liabilities and tax exposures of the target company should not generally be transferred to the buyer.
- If the target merges with its shareholder after the sale of its assets, the profits of the target accumulated before the transfer of assets will be transferred to the shareholder without additional taxation, whereas under a share purchase such profits, if distributed, would be subject to WHT at 9 percent, 15 percent, or less in accordance with a relevant DTT.

Disadvantages of Asset Purchases

- The sale of assets is subject to VAT, which may result in a negative cash-flow impact for the buyer. If the buyer's business is VAT-exempt, such input VAT is capitalized.
- Profit tax could be due if assets with a high market value and low tax basis are sold.
- Accumulated tax losses remain with the vendor.
- Any losses incurred on the sale of fixed assets are not immediately deductible and are recognized

evenly over the period of the remaining useful life of the assets.

- Customs risks cannot be eliminated.
- An asset deal could be reclassified into the sale and purchase of an enterprise as property complex resulting in inheritance of all liabilities thereof.
- It may not be possible to transfer all assets to another company if, for example, some assets are used as collateral securing loans and borrowings.
- Transfer of licenses might be impossible.
- Assets not reflected in the Russian Accounting principles (RAP) balance sheet could not be transferred.
- Difficulties in interrupting a long production cycle or construction in progress for the transfer of assets.
- Difficulties in obtaining consent from minority shareholders for the sale of assets.
- Long registration process of some asset deals.
- Significant VAT and customs duties claw-back.

Advantages of Share Purchases

- Capital gains from the sale of shares could be tax-exempt in certain cases if the deal is properly structured.
- Sale of shares is not subject to VAT.
- Tax losses accumulated by the target prior to acquisition may be used after the changes in shareholding of the target.
- The share acquisition procedure is technically less complicated than an asset deal; however, it may be necessary to perform anti-monopoly procedures.

Disadvantages of Share Purchases

- All tax liabilities and tax risks of the target will be inherited.
- Capital gains received by the vendor could be subject to taxation in Russia: 20-percent profits tax payable by a corporate vendor or 13-percent personal income tax payable by an individual vendor who is a Russian tax-resident.
- Goodwill cannot be depreciated for profits tax purposes; only the net book value of assets can be depreciated.

- Consolidation of profits and losses of the acquirer with the profits and losses of the target company is

not allowed (except in the case of a post-acquisition merger or take-over).

Withholding Tax Rate Chart

The rate information and footnotes contained in this table are from the 2009 IBFD/KPMG Global Corporate Tax Handbook.

Country	Dividends		Interest ¹ (%)	Royalties (%)
	Individuals, Companies (%)	Qualifying Companies (%)		
Albania	10	10	10	10
Algeria	15	5 ²	0/15 ³	15
Armenia	10	5 ⁴	0	0
Australia	15	5 ⁵	10	10
Austria	15	5 ⁶	0	0
Azerbaijan	10	10	10	10
Belarus	15	15	10	10
Belgium	10	10	10	0
Brazil ³⁷	15	10 ³⁸	15	15
Bulgaria	15	15	15	15
Canada	15	10 ⁷	10	0/10 ⁸
China (People's Rep.)	10	10	10	10
Croatia	10	5 ⁹	10	10
Cyprus	10	5 ¹⁰	0	0
Czech Republic	10	10	0	10
Denmark	10	10	0	0
Egypt	10	10	15	15
Finland	12	5 ¹¹	0	0
France	15	5/10 ¹²	0	0
Germany	15	5 ¹³	0	0
Greece	10	5 ²	7	7
Hungary	10	10	0	0
Iceland	15	5 ⁹	0	0
India	10	10	10	10
Indonesia	15	15	15	15
Iran	10	5 ²	7.5	5
Ireland	10	10	0	0
Israel	10	10	10	10
Italy	10	5 ⁶	10	0
Japan	15	15	10	0/10 ¹⁴
Kazakhstan	10	10	10	10
Korea (Dem. Rep.)	10	10	0	0
Korea (Rep.)	10	5 ¹¹	0	5
Kuwait	5	5	0	10
Kyrgyzstan	10	10	10	10
Lebanon	10	10	5	5
Lithuania	10	5 ⁹	10	5/10 ¹⁵
Luxembourg ¹⁶	15	10 ¹⁷	0	0
Macedonia	10	10	10	10
Malaysia	-15 ¹⁸	-15 ¹⁸	15	10/15 ¹⁹
Mali	15	10 ²⁰	15	0
Mexico	10	10	0/10 ³	10
Moldova	10	10	0	10
Mongolia	10	10	10	2 ²¹
Montenegro ²²	15	5 ⁹	10	10
Morocco	10	5 ²³	0/10 ²⁴	10
Namibia	10	5 ⁹	10	5
Netherlands	15	5 ²⁵	0	0
New Zealand	15	15	10	10
Norway	10	10	10	0

Country	Dividends		Interest ¹ (%)	Royalties (%)
	Individuals, Companies (%)	Qualifying Companies (%)		
Philippines	15	15	15	15
Poland	10	10	10	10
Portugal	15	10 ²⁶	10	10
Qatar	5	5	5	0
Romania	15	15	15	10
Serbia ²²	15	5 ⁹	10	10
Singapore ³⁷	10	5 ²⁷	7.5	7.5
Slovak Republic	10	10	0	10
Slovenia	10	10	10	10
South Africa	15	10 ¹¹	10	0
Spain	15	5/10 ²⁸	0/5 ²⁹	5
Sri Lanka	15	10 ²	10	10
Sweden	15	5 ³⁰	0	0
Switzerland	15	5 ³¹	5/10 ³²	0
Syria	15	15	10	13.5/18 ³³
Tajikistan	10	5 ²	10	0
Thailand ³⁷	15	15	10/- ³⁴	15
Turkey	10	10	10	10
Turkmenistan	10	10	5	5
Ukraine	15	5 ³⁵	10	10
United Kingdom	10	10	0	0
United States	10	5 ⁷	0	0
Uzbekistan	10	10	10	0
Venezuela ³⁷	15	10 ³⁹	10/5 ³²	15/10 ⁴⁰
Vietnam	15	10 ³⁶	10	15

Notes

- Many treaties provide for an exemption for certain types of interest, such as interest paid to the state, local authorities, the central bank, export credit institutions, or in relation to sales on credit. Such exemptions are not considered in this column.
- The lower rate applies if the recipient owns directly at least 25 percent of the capital in the Russian company.
- The lower rate applies to interest paid by/to public bodies of the contracting states; interest paid by other legal entities under the agreements on financial aid concluded by the public bodies of the contracting states.
- The rate applies if the value of the holding is at least USD 40,000.
- The rate applies to dividends paid out of profits that have borne the normal tax rate to an Australian company holding directly at least 10 percent of the capital in the Russian company, the Australian company's holding being at least AUD 700,000 and the dividends being exempt from tax in Australia.
- The rate applies if the recipient company owns directly at least 10 percent of the capital of the Russian company and the value of the holding exceeds USD 100,000.
- The rate applies if the recipient company owns at least 10 percent of the capital or voting power of the Russian company, as the case may be.
- The lower rate applies to computer software patents and know-how provided that the payer and recipient are not interdependent parties.
- The rate applies if the recipient company owns at least 25 percent of the capital in the Russian company and the value of the capital investment is at least USD 100,000.
- The rate applies if the value of the holding is at least USD 100,000.
- The rate applies if the recipient company owns directly at least 30 percent of the capital of the Russian company and the value of the holding is at least USD 100,000.
- The 5 percent rate applies if the French company has directly invested at least EUR 76,225 (FRF 500,000) in the Russian company and is subject to tax in France, but is exempt with respect to the dividends (i.e. participation exemption). The 10-percent rate applies if only one of the requirements is fulfilled.
- The rate applies if the German company owns at least 10 percent of the capital in the Russian company and the value of the holding is at least EUR 81,806.70 (DEM 160,000).
- The lower rate applies to copyright royalties.
- The lower rate applies to equipment rentals.
- The treaty does not apply to exempt Luxembourg holding companies or to any income, shares and other securities received from such companies by residents.
- The 10-percent rate applies if the Luxembourg individual or corporate recipient owns directly at least 30 percent of the capital in the Russian company and the value of the holding is at least EUR 75,000.
- The 15-percent rate applies to profits of joint ventures. Otherwise, the domestic rate applies; there is no reduction under the treaty.
- The lower rate applies to industrial royalties.
- The rate applies if the value of the holding is at least FRF 1 million.
- The domestic rate applies; there is no reduction under the treaty.
- The treaty concluded between Russia and the former Yugoslavia (Fed. Rep.).
- The 5-percent rate applies if the value of the holding of the recipient (individual or company) is at least USD 500,000.
- The lower rate applies to interest on foreign currency deposits and loans given to one of the contracting states.
- The rate applies if the Netherlands company owns directly at least 25 percent of the capital of the Russian company and has invested in it at least EUR 75,000 or its equivalent in national currency.
- The rate applies if the Portuguese company has owned directly at least 25 percent of the capital in the Russian company during an uninterrupted period of at least two years prior to the payment.
- The rate applies if the Singapore company owns at least 15 percent of the capital of the Russian company and has invested in it at least USD 100,000 or if the recipient is the government of one of the contracting states.
- The 5-percent rate applies if the Spanish company has invested at least EUR 100,000 in the Russian company and the dividends are exempt in Spain. The 10-percent rate applies if only one of the conditions is met.
- The lower rate applies to long-term loans (minimum seven years) granted by credit institutions resident in a contracting state.
- The rate applies if the Swedish company owns 100 percent of the capital in the Russian company (or in the case of a joint venture, at least 30 percent of the capital of such a joint venture) and the foreign capital invested exceeds USD 100,000; the recipient is one of the contracting states or one of its public bodies.
- The rate applies if the Swiss company owns at least 20 percent of the capital of the Russian company and the value of the holding exceeds CHF 200,000.
- The lower rate applies to loans of any kind granted by a bank.
- The 13.5-percent rate applies to copyrights, except films, etc., which are subject to a 4.5-percent rate.
- The 10-percent rate applies to interest paid to financial institutions (as defined). The domestic rate applies in other cases; there is no general reduction under the treaty.
- The rate applies if the value of the holding is at least USD 50,000.
- The rate applies if the Vietnamese company has invested directly in the capital of the Russian company at least USD 10 million.
- Effective from 1 January 2010.
- The lower rate applies if the recipient directly owns at least 20 percent of the capital of the Russian company.
- The rate applies if the recipient company owns at least 10 percent of the capital of the Russian company and the value of the capital investment is at least USD 100,000.
- The lower rate applies to technical assistance.

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