

## Coming to Russia

*These guidelines are designed to assist in deciding on the appropriate vehicle for establishing a commercial presence in Russia and to describe the basics of the Russian tax, currency control and registration regimes. Please note that these guidelines are of a general nature and do not describe specific requirements which might be applicable to certain types of regulated companies (e.g. banks and insurance companies).*

### Introduction

#### Subsidiary or branch?

The first key decision for a foreign company is whether it wants, or needs to, establish a subsidiary in Russia, i.e. a separate corporate entity regulated by Russian law, or whether it will operate through an entity with no separate legal identity, being either a branch or a representative office.

The difference in Russia between a branch and representative office is blurred in practice, however, formally speaking, a representative office is restricted to representing and protecting interests of its head company (a difficult concept to define in practice), whilst a branch may engage in commercial activities.

In this note we therefore do not distinguish between branches and representative offices - we use the term branch to include representative offices.

The key factors to be taken into account when deciding whether a branch or a subsidiary is a more suitable structure are as follows:

#### Liability

A branch has no separate legal identity and all its activities in Russia will be carried out in the name of the head company - the head company will therefore be liable for all activities of its branch.

With certain exceptions, the shareholders of a subsidiary company in Russia will not be liable for that subsidiary's obligations beyond their contribution to the subsidiary's share capital.

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## **Structure and management**

The form in which a branch is organised and managed is at the discretion of its head office. The head of the branch will have the power to bind the branch on the basis of a power of attorney issued by its head office.

Russian corporate entities are subject to varying degrees of regulation of structure and operation (as discussed later) and it is not possible to simplify the basic structures dictated by Russian legislation.

## **Tax**

A subsidiary will pay profits tax and other taxes in Russia. See the *Tax section* below for more detail.

A foreign company with a branch (or representative office, department or any other separate subdivision or other place of activity through which a foreign legal entity carries out its activity in Russia) is considered to constitute a permanent establishment when it is engaged in regular performance of its business activity (selling goods, rendering services, carrying out work etc.) on the territory of the Russian Federation. A permanent establishment also may be found when a foreign company acts through a dependent agent in Russia. The tax regime for such foreign entities is substantially the same as that for Russian legal entities, with the distinction that repatriation of profit by a permanent establishment is not subject to withholding tax and thin capitalisation rules do not apply to permanent establishments. Additionally, the effective management and control in Russia in respect of a local branch may trigger Russian tax residency for the whole company. See the *Tax section* below.

## **Regulatory issues**

Some activities which require licensing in Russia will have to be carried out through a subsidiary rather than a branch, because of minimum capital requirements, foreign investment restrictions or simply because the relevant licensing regime so requires.

## **Currency control**

A branch is considered non-resident for the purposes of Russian currency control and therefore is more flexible in structuring foreign currency operations, whilst a subsidiary has more flexibility for its Rouble operations. See the *Currency control section* below for more detail.

## **Registration**

The registration procedures for a branch are broadly similar to those for a subsidiary although registration of a subsidiary may be more time-consuming if a Federal Antimonopoly Service notification or consent is required (which is not required for the registration of a branch). For more detail please refer to the *Registration section* below.

## Summary

- > A branch is a relatively simple and easily established structure which is subject to less formality and regulation than a Russian corporate entity.
- > If the branch's activities are considered non-commercial under Russian tax legislation, it will pay less tax than a subsidiary.
- > A founder company will be fully liable for its branch's activities, whereas if it chooses to establish a Russian subsidiary, its liability will generally be limited to its contribution to share capital. Risks may be limited by using a special purpose offshore subsidiary to act as a branch's head office.

## Form of subsidiary

### Background

The Russian Civil Code differentiates between public and non-public companies. A limited liability company (“**LLC**”) and a non-public joint stock company (“**JSC**”) are non-public companies that have a similar regime and they are the most common forms for a Russian subsidiary. A public joint stock company (“**PJSC**”) is a public company similar to a UK public limited company or a French *société anonyme* and is very heavily regulated. PJSCs are used in a limited number of cases, e.g. if public offering of shares is planned.

### Management bodies

A key distinction between a PJSC, on the one hand, and a non-public corporate entity (i.e. JSC and LLC), on the other hand, would be that a non-public entity has more flexibility in respect of the structure of, and allocation of decision-making powers between, its management bodies.

A PJSC is required to have the following decision-making structure consisting of such shareholder and management bodies as:

- > general shareholders’ meeting;
- > an executive body - either an individual (a “general director” or “president”) or an individual together with an executive board;
- > board of directors (sometimes referred to as the “supervisory board”) comprising at least 5 members.

The allocation of decision-making powers between the management bodies of a PJSC is tightly regulated by law e.g. it is explicitly prohibited to extend the decision-making powers of its general shareholders’ meeting beyond those powers exhaustively provided for in the law.

The typical decision-making structure of an LLC/JSC is made up of its stakeholders (referred to as the “general meeting of participants” in an LLC or the “general shareholders’ meeting” in a JSC) and an executive body - either an individual (a “general director” or a “president”) or an individual together with an executive board. A board of directors (which is sometimes referred to as the “supervisory board”) may be created additionally (unless the number of voting shareholders of a JSC is at least 50, in which case the creation of a board of directors in a JSC is obligatory).

A JSC or an LLC allow a different allocation of powers between the management bodies than that prescribed by default legal provisions.

A charter of any corporate entity mentioned above - no matter if it is a public or non-public one - may also provide that the functions of an individual executive body may be performed by several persons acting jointly or independently.

## **Shares, capital and voting**

Share (or “charter”) capital (in other words, the sum of all shares’ nominal values) of JSC/PJSCs may be held in the form of ordinary shares and preference shares. Each ordinary share shall confer equal rights to their holders, whereas preference shares of different types may differ in the volume of rights granted to their holders.

Generally, voting rights are only granted by ordinary shares. Holders of preference shares can only vote on a limited number of issues specified in the law. However, a charter of a JSC may envisage the issuance of special preference shares which give additional voting rights to their holders.

Each voting share gives a shareholder one vote in the shareholders’ meeting, except when appointing the board of directors, when a cumulative voting system must be used (i.e. each shareholder may vote the number of his shares multiplied by the number of positions available by allocating the votes to one or more directors).

PJSC’s shares or other securities convertible into its shares may be publicly placed by way of an open subscription or publicly traded.

Participants in an LLC hold “participation shares”, which usually grant voting rights in proportion to each participant’s contribution to the LLC’s charter capital expressed as a percentage or a fraction. Participation shares are not issue securities and cannot be divided into separate classes.

As opposed to a PJSC, rights and obligations of stakeholders in a JSC and LLC may be re-allocated between themselves in a number of ways in a charter or a shareholders’ agreement.

The maximum number of participants in an LLC is 50, whilst the number of shareholders in a JSC or PJSC is unlimited.

## **Profits**

A JSC/PJSC may distribute dividends (based on the financial results for a quarter, six months, nine months or a year) paid out of net profits. Preference shares (if there are any) usually have the right to receive a specified dividend (for example, a certain percentage of profits) whilst any remaining distributable profits will be divided amongst ordinary shareholders.

An LLC may make distributions of net profits quarterly, bi-annually or annually. Unless specified otherwise in the LLC’s charter, profits are distributed in proportion to participants’ holdings.

## **Equity financing**

Contributions to the charter capital of each corporate entity may be made either in kind or in monetary funds. Contributions in kind are subject to independent valuation.

Since shares in JSCs/PJSCs are classified as “issue securities” for the purposes of securities legislation, increases in charter capital by JSCs/PJSCs are subject to a considerable number of disclosure, registration and other

requirements, most notably, filings with the Central Bank. This is a time-consuming process usually taking several months to complete. The disclosure requirements are specifically burdensome in the case of a PJSC.

The charter capital of an LLC may be increased by way of additional contributions by each participant upon a two-thirds majority vote of the participants. Alternatively, on a unanimous vote, all participants may decide to allow one or more participants or a third party to make an additional contribution to the charter capital. Finally, the charter capital may be increased by way of capitalisation of the LLC's profits. Participation shares are not "issue securities" and therefore do not fall within the ambit of the Central Bank regulations.

## **Regulation**

In general, JSCs and PJSCs, being joint stock companies, are subject to stricter rules of a regulatory nature than LLCs. This is primarily due to the fact that both PJSCs and JSCs are subject to the provisions of the securities legislation and, in particular, to regulations of the Central Bank, whereas only those LLCs which have issued "issue securities" (such as bonds) are affected by the relevant statutory provisions. It should be noted that the Central Bank can impose additional requirements on a JSC and/or PJSC (but not on an LLC) which do not necessarily relate to securities, such as procedures for convening general shareholders' meetings.

Both, JSC and PJSC, are required to transfer the shareholders' register to a third-party contractor holding a specific licence.

## **Major or interested party transactions**

Subject to certain statutory thresholds and exceptions, Russian companies must approve major transactions by either a general meeting of shareholders or a meeting of the board of directors, depending on the value of the transaction.

Entry into an interested party transaction is not subject to a mandatory prior director and/or stakeholders approval. However, (i) the CEO, (ii) a member of the management board, (iii) a member of the board of directors or (iv) a stakeholder(s) holding not less than 1 per cent of shares are entitled to request a prior approval of an interested party transaction.

The charter of a non-public company may (i) exclude the application of the statutory provisions relating to the interested party transactions or (ii) establish specific rules for approval of interested party transactions.

## **Exit**

Shares in a PJSC may normally be transferred without restriction, but sales of shares in a JSC may be subject to pre-emption rights/consents of other shareholders (which would depend on the provisions of JSC's charter).

Unless provided otherwise in the company's charter, participation rights in an LLC may be sold to third parties subject to the pre-emption rights of the other participants, in proportion to their interests.

A JSC/ LLC's charter may provide for the JSC/LLC itself to have the right to acquire shares sold by its shareholders/participants, if the shareholders/participants do not exercise their pre-emption rights themselves.

An LLC's charter may provide participants with a withdrawal right. In such case, a participant has the right to sell his participation right to the LLC irrespective from consent of other participants or LLC itself. The exit of the sole participant is prohibited.

Provided that the LLC's charter allows withdrawal, the participant is entitled to receive the actual value of his participatory interest. The actual value is determined on the basis of the accounts for the latest reporting period preceding the date on which the application to withdraw is filed and is calculated as a fraction of the LLC's net assets corresponding to the participant's participatory interest ratio. Actual value should be provided to the withdrawing participant in cash or, alternatively, upon the consent of the withdrawing participant, in kind, within three months from the arising of the respective obligation unless the charter provides otherwise.

## **Forced exit**

A shareholder, having acquired more than 95 per cent of shares of a PJSC, may in some circumstances buy-out other shareholders, which is the only instance of any shareholder in a PJSC being forced to exit a PJSC.

A stakeholder in any non-public company (i.e. a JSC shareholder and an LLC participant) may be expelled from the company in a judicial proceeding initiated by another stakeholder for a material breach of the participant's obligations or if such participant creates substantial difficulties for the company's activities.

## **Certain other issues for subsidiaries**

A range of further issues should be considered when establishing a Russian subsidiary. Most notably:

- > shareholder liability: in certain circumstances a shareholder of a JSC/PJSC or participant of an LLC may be held liable for the debts of the JSC/PJSC or LLC;
- > it is permissible for a JSC/PJSC or an LLC to have a single shareholder or participant. However, in these circumstances that single shareholder or participant should not itself have only one shareholder;
- > it is permissible for shareholders of JSC/PJSC and participants of LLC to enter into a shareholders' agreement;
- > with certain exceptions, agreements regulating transfer of participation shares in LLC have to be notarised, this requirement affects the timing and adds extra formalities to the transfer;
- > if more than one investor is involved, careful consideration should be given to minority protection rights and interested party rules;

- > it is recommended that a clear strategy for financing and repatriation of profit be formulated at the outset. Such a strategy should involve the appropriate level of tax planning;
- > remaining compliant in Russia remains a paperwork-intensive and time-consuming process. While certain matters, including book-keeping, can be outsourced, early consideration of logistics is highly recommended. For example, if the subsidiary's general director is to be a non-resident, who will operate the subsidiary's bank account?
- > some thought should be given to choosing the name of the subsidiary, in particular the use of the word "Russia" or its derivatives in a name is effectively impossible (i.e. a specific permit needs to be obtained which is conditional upon the company meeting certain stringent criteria).



## Registration - JSC/LLC

### Shareholding structure

A Russian legal provision applicable to Russian companies of all types states that a Russian company cannot have as its sole shareholder another company which, in its turn, itself has only one shareholder.

### Contribution to charter capital

In the case of an LLC, contributions to the charter capital shall be made within 4 months of state registration, unless a shorter term is agreed upon by the participants in an LLC foundation agreement.

In the case of a JSC/PJSC, 50 per cent of its charter capital has to be paid up within 3 months of state registration. The remainder of the charter capital of a JSC/PJSC must be paid up not later than one year from the date of the company's registration.

The minimum charter capital for a PJSC is 100,000 Roubles (approximately US\$ 1,500 as of December 2018) and for both JSC and LLC – 10,000 Roubles (approximately US\$ 150 as of December 2018).

### Contributions in kind

Founders may make their contributions to the charter capital of an LLC or JSC/PJSC in kind beyond the amount of the minimum charter capital which is always to be paid in cash. A copy of the first shareholders'/participants' meeting minutes containing a valuation (subject to the independent valuation as well) of the assets contributed must be provided to the registration authorities.

### Consent of the Federal Antimonopoly Service

Preliminary clearance of the Russian Federal Antimonopoly Service must be obtained, in certain cases, prior to the establishment of a Russian legal entity. Clearance must be received if the charter capital of the entity to be established will be paid in full or in part by shares or assets of another legal entity and the newly established entity will receive, as a result, over 25 per cent of shares of a Russian joint-stock company, or more than 1/3 of participation interests in a Russian limited liability company, or other control over a Russian entity, or over 50 per cent of shares in a non-Russian entity which supplies goods, works, services to the Russian market, or over 20 per cent of the main production and/or intangible assets of another entity (if such assets are located in Russia), subject to additional asset/revenue thresholds being met by the parent companies.

The asset/revenue thresholds are as follows: if the total value of the assets of the founders of the legal entity (and their groups worldwide) and the entities whose shares and/or assets are contributed to the charter capital of the new company (and their groups worldwide) exceed 7 billion roubles (approx. US\$ 106 million), or if the total turnover of the founders of the legal entity (and their groups worldwide) and entities whose shares and/or assets which are contributed (and their groups worldwide) exceeds 10 billion roubles (approx. US\$ 151 million) for the previous year.

Note that clearance may also be required for the establishment of a Russian legal entity if it is acquired rather than established (for example, established by one party of a future JV, and the second party buys in immediately thereafter), in which case such acquisition will also be subject to the above asset/revenue thresholds with the assets/turnover of the acquirer and its group and the Russian entity and its group, respectively, becoming relevant.

Further, clearance requirements may also be triggered if the establishment of a Russian legal entity may be regarded as an agreement between competitors for joint activities in Russia (i.e. an incorporated JV), if the parties' total value of assets or turnover (with their groups worldwide) exceeds 7 billion roubles (approx. US\$ 106 million) or 10 billion roubles (approx. US\$ 151 million) respectively.

Note that where a Russian legal entity is to be established by an entity which is controlled by a foreign state or international organization or a combination thereof, a pre-establishment clearance is required under the Russian foreign regime and this is also obtained from the Federal Antimonopoly Service of Russia. No asset/value thresholds apply, and clearance is required if the foreign state or international organization or a combination thereof will have over 25 per cent of shares in such Russian entity or any blocking rights in respect of it.

## Registrations

Russian corporate entities are required to be registered with various state authorities:

- > the tax authorities (which register newly created legal entities and record them as taxpayers);
- > state non-budgetary social funds (the pension fund and the social insurance fund); and
- > the Federal Service of State Statistics ("**Rosstat**").

Currently it is not necessary to make additional filings of documents for the purposes of registration with tax authorities as a taxpayer, registration with the state non-budgetary social funds and receiving the Rosstat registration codes, as the Russian tax authorities are responsible for arranging the requisite registration procedures.

## Outline timetable

- > Preparation of the necessary registration documents (approximately 3-4 weeks, which, however, is subject to a prompt provision of the requisite documents and information for the purposes of drafting of registration documents);
- > Registration of a JSC/PJSC or LLC with the local tax authorities (3 business days from the moment of filing a complete set of documents) followed by the registration as a taxpayer;
- > Receiving the Rosstat registration codes (2 days);

- > Creation of a corporate seal (2-3 days) (a corporate seal is not obligatory for a company, unless otherwise stated in its charter; it is, however, common practice to have such a seal);
- > Registration with the state non-budgetary funds (at least two weeks from the date of state registration of the JSC/PJSC or LLC, but depending on the internal procedures of the funds); and
- > Opening permanent bank accounts, notification of the tax authorities thereof and transfer of the contribution into the charter capital (at least one week, however the term may vary for different banks).
- > Only for JSC/PJSC – registration of a share issue with the Bank of Russia (20-60 days).

In total, given that in practice state authorities may cause delays in registration procedure, the registration process (including immediate post-registration actions) for an LLC should take about two to three months and for a JSC/PJSC – about three to four months.

## **Registration - representative office/branch**

### **Authorised body**

Under Russian legislation, the procedure for registration in Russia of both, representative offices and branches, is almost equivalent. As a general rule, a branch or representative office must be accredited with an authorised federal body being the Federal Tax Service (in cases of banks and civil aviation businesses, the procedure for accreditation would differ from the default one and the accreditation functions are performed by the Central Bank of Russia and Rosaviation State Agency, respectively).

Accreditation is granted once, does not need to be extended and is valid throughout the whole period of doing business in Russia.

### **Outline timetable**

- > Filing documents and accreditation with the Federal Tax Service - 25 business days for the accreditation process and 5 business days for the issuing of the accreditation certificate;
- > Receiving the Rosstat codes (2 days);
- > Filing documents and registration with the state non-budgetary funds (1-5 business days); and
- > Opening bank accounts (2-3 business days, however the term may vary for different banks).

It is, therefore, prudent to allow up to two months for completion of the registration process.

Also, all foreign citizens who are employees of an accredited branch or representative office shall be, as a general rule, accredited with the Chamber of Commerce of the Russian Federation.

## Immigration regime

A foreign national who is going to be employed in Russia and whose salary is equal to or more than 167,000 Roubles (approx. US\$ 2,500) per month would be regarded as a 'highly qualified specialist' for Russian immigration law purposes if his/her potential employer in Russia files the necessary application with the Russian immigration authority. If the Russian immigration authority approves such an application and grants the highly qualified specialist status to the foreign national, the advantages that foreign national will enjoy in comparison with the standard procedure would include:

- > the ability to enter into an employment contract with the local entity for up to 3 years (as opposed to 1 year applicable to regular foreign employees); and
- > the personal income tax of 13 per cent (as opposed to the 30 per cent personal income tax applicable to regular foreign employees).

As for the employer, the advantages would be as follows:

- > the ability to employ foreign nationals irrespective of any job quotas that apply to employment of regular foreign employees;
- > the ability to transfer the foreign employee to its offices in other parts of Russia (as opposed to the regular regime that limits the scope of a work permit to the boundaries of a particular region of Russia) and have more flexibility in terms of sending the foreign employees on business trips to other parts of Russia; and
- > the ability to avoid a number of other technical steps required for employing foreign nationals (e.g. obtaining prior approval of the proposed foreign employees by the local job centre, complying with work visa quotas etc.).

## Tax

### Profits tax

Russian companies and foreign companies which have Russian permanent establishments are obliged to pay profits tax on income received less allowable deductions. Effective management and control in Russia in respect of a local branch (permanent establishment) may trigger Russian tax residency for the whole company. Such a tax resident should pay Russian profits tax on its worldwide profits. Companies may deduct reasonable and documented expenses incurred in the course of receiving income profits.

The standard profits tax rate is 20 per cent. For certain kinds of income, there are different tax rates: as a rule, for interest on state and municipal securities the rate is 15 per cent, for dividends to be paid to a foreign company the tax rate is 15 per cent if a different rate is not envisaged in an applicable double tax treaty.

Profits tax is divided between the federal and regional budgets. Regional authorities have the right to introduce additional tax exemptions, reducing the total standard tax rate to a minimum of 15.5 per cent.

There is no separate capital gains tax in Russia or any local profit/income taxes.

Interest on any kind of debt normally is deductible when charged at arm's length basis.

Under Russian thin capitalisation rules, where a 3:1 debt-to-equity ratio (and 12.5:1 for banks and leasing companies) is exceeded and the interest is paid by a Russian company, the excess interest is to be re-classified as a dividend for tax purposes and taxed accordingly (i.e. it is not tax deductible for the debtor and is subject to 15 per cent withholding tax for the corporate recipient of interest, if a different rate is not envisaged in an applicable double tax treaty). As a general rule, the thin capitalisation rules will apply where (i) a foreign company or individual which is regarded as an affiliate (as defined in Russian tax law) of a Russian company or (ii) an affiliate of the such foreign company or individual:

- > grants debt financing to the Russian company; or
- > secures debt financing arrangements of the Russian company.

There are transfer pricing rules in Russia which enable the tax authorities to impose taxes and interest on the basis of the arm's length prices of goods, works and services.

Where Russia has a double tax treaty with another state, profits (or income) taxes paid outside Russia may entitle the payer to a credit against taxes due inside the country.

Under certain circumstances profits tax may be payable even in the absence of commercial activity (for example, on foreign exchange gains).

## **Withholding tax**

Interest paid to foreign corporate lenders is subject to a withholding tax at a rate of 20 per cent whilst dividends received from Russian companies by foreign individuals and companies are subject to withholding tax at a rate of 15 per cent respectively.

Withholding tax may be reduced or eliminated if the lender/shareholder is resident in a country which has a double tax treaty with Russia (or had one with the USSR). Taxes on dividends are normally reduced to 5 per cent or 10 per cent under double tax treaty provisions. Withholding tax on interest may be eliminated under certain double tax treaties.

A permanent establishment's profits (after tax) transferred outside Russia to its head office are not treated as a dividend and therefore are not subject to further withholding tax in Russia. Also, there is no exit tax for permanent establishments.

## **Value added tax**

VAT is payable on the turnover generated from sales of goods, works and services on the territory of the Russian Federation, and on imported goods.

The principles of VAT calculation are the following - businesses collect VAT from their customers and pay it to Russian state budget but may offset against such payment of VAT that they themselves pay on the acquisition of goods and services (including customs VAT). The current basic rate is 20 per cent and 10 per cent for certain foods and children's goods.

Russian law allows for a number of VAT exemptions. In particular, the contribution of technological equipment to the charter capital of a Russian company and sales of some medicines and medical equipment are not subject to Russian VAT.

Russian companies paying foreign companies not registered as Russian tax payers for works or services that are subject to Russian VAT are required to withhold VAT from their payments and pass it on to Russian state budget - a procedure known as the reverse VAT charge.

VAT exemptions are allowed in relation to rents payable on premises leased by accredited representative offices of foreign companies when the company in question is registered in a country with reciprocal VAT benefits for Russian companies.

## **Social payments**

Social payments to the Pension Fund of the Russian Federation, Fund of Social Insurance, Federal Fund of Mandatory Medical Insurance and Regional Fund of Mandatory Medical insurance are payable on payments made by companies to their employees. Such payments are deductible for profits tax purposes.

## **Customs duty**

All importers pay customs duties on the customs value of goods at rates which are usually between 0 and 100 per cent. Some items are exempt from custom duties (e.g. fixed assets contributed to the charter capital of company with foreign investments, humanitarian aid etc).

## **Property tax**

Russian companies and permanent establishments of foreign legal entities must pay a property tax on the balance sheet value of fixed assets at rates of up to 2.2 per cent per year. Foreign legal entities which do not have permanent establishments in Russia must pay the property tax on its immovable assets located in the Russian Federation.

Starting from 1 January 2019 movable assets are not subject to the property tax.

## **Accounting and reporting**

Russian legal entities and offices of foreign companies are subject to a considerable number of accounting and reporting requirements. They must keep their accounts in Roubles and are required to file tax returns.

## Currency control

Although the Rouble became a convertible currency in 2007, it does not yet settle through many clearing systems outside Russia and certain issues in relation to Rouble exposure and the making and receiving of Rouble payments in particular should be considered carefully in relation to any investment in Russia. Furthermore, certain currency restrictions do remain in relation to:

- > certain currency operations of residents and non-residents;
- > bank accounts of non-residents in Russia;
- > bank accounts of residents outside Russia;
- > the Russian domestic currency market; and
- > certain reporting requirements applicable to residents' and non-residents' operations.

A Russian subsidiary is treated as a resident even if wholly owned by a non-Russian person.

Russian currency control rules form part of Russian public law. Therefore, the application of foreign law to a transaction does not enable the parties to avoid Russian currency control requirements.



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