

Legal Considerations for Asian Investors in the Russian Market

As Russia seeks to attract substantial foreign investments from India and Asia, the Russian Far East has the potential to become a significant player in Asian-Pacific trade.

INTRODUCTION

Russia is both a European and an Asian country, but has often appeared to pay more attention to relations with Europe. That is changing, as shown by major energy deals between Russia and China; robust bilateral trade and political discussions with Japan, South Korea, India and Vietnam; and Russia's hosting of regional conferences, including the Eastern Economic Forum in September 2017. Among other goals, Russia seeks to attract substantial foreign investments from its Asian and Indian partners. For both geographical and practical reasons, foreign investors may wish to focus on the Russian Far East, a historically neglected region which has the potential to become a significant player in Asian-Pacific trade. This is a vast area with a population of more than 7 million people that includes the ports of Vladivostok, Khabarovsk and Nakhodka and extensive natural resources.

To facilitate investments into the region, Russia has developed several programs, including the establishment of *special economic zones* with reduced tax regimes, a *special gaming zone* in the city of Artem in Primorskiy Krai to attract hospitality and tourism investors, and a *free port zone* in Vladivostok. However, the applicable rules are scattered among a number of different laws and regulations, and are somewhat difficult to navigate. Below we provide a brief overview of the

Russian legal framework for investment incentives in the Russian Far East.

SPECIALLY REGULATED TERRITORIES

There are four types of specially regulated territories in the Russian Far East that seek to attract foreign investments:

- special economic zone (the “SEZ”) (the creation and operation of SEZs is governed by *Federal Law No. 116-FZ dated 22 July 2005 “On Special Economic Zones in the Russian Federation”*);
- priority development area (the “PDA”) (introduced by *Federal Law No. 473-FZ dated 29 December 2014 “On Territories of Priority Social-Economic Development”*);
- free port Vladivostok (*Federal Law No. 212-FZ dated 13 July 2015 “On Free Port Vladivostok”*);
- gaming zone “Primorye” (created by the *Government Decision No. 1213-p dated 20 August 2009 “On Establishment of Gambling Zone “Primorye”*).

Each of the above territories has its own unique legal framework and exists independently from the others. Notably, the regulations for each territory include special incentives for foreign investments.

Special Economic Zones

Currently there is only one operating SEZ in the Far East: the industrial and manufacturing SEZ



BRIAN ZIMBLER
PARTNER



ROMAN DASHKO
PARTNER



DMITRY DMITRIEV
ASSOCIATE

“Vladis”. Previously, two more SEZs existed, namely “Russkiy Island” and “Soviet Harbour”, but they were terminated by the Russian Government in 2016, apparently with the goal of switching to the PDA model.

Vladis was created on the basis of existing joint enterprises in the region – LLC “Mazda Sollers Manufacturing Rus”, an automobile manufacturing joint venture of Mazda Motor Corporation and PJSC “Sollers”, and LLC “Mazda Pacific Logistic”.

SEZ Vladis offers several types of benefits to its residents, including (i) tax benefits; (ii) a free customs zone regime; and (iii) liberalized administrative regulations.

A summary of the tax benefits is outlined in Table 1.

Priority Development Areas and Free Port Vladivostok

While SEZs were introduced a decade ago, PDAs or priority development areas are a more recent innovation in Russia’s legal system, focused primarily on the Russian Far East.

Currently there are 18 PDAs in several locations within the Russian Far East. These have already experienced some success in attracting Asian and Indian investors:

- Korea Trading & Industries Co. invested \$7 million in the construction of a fish processing complex in PDA “Kamchatka”;
- The Japanese greenhouse complex JGC Evergreen focuses on growing and marketing vegetables for the Russian market in PDA

TABLE 1 – SPECIAL ECONOMIC ZONE TAX BENEFITS

Tax Type (Basic Rate)	SEZ Rate (Period)
Corporate Profit Tax/ (20%)	2% (within the first 5 years from the moment of receiving first profit or upon expiration of 3 years since the creation a legal entity)
	3% (during the period from 2017 to 2020)
	12% (from the 5th until the 10th year)
	15.5% (starting from the eleventh year till the termination of the SEZ)
Property Tax (2.2%)	0% (within 10 years since the moment of registration of property with tax authority)
Land Tax (0.3 – 1.5%)	0% (within 10 years since registration of rights to the land plot)

TABLE 2 – PRIORITY DEVELOPMENT AREA PREFERENTIAL TAX RATES

Payment (Basic Rate)	Free Port Rate (Period)	PDA Rate (Period)
Social Security Payments (30%)	7.6% (within the first 10 years)	
Profit tax (20%)	0% (within the first 5 years from the moment of receiving first profit)	
	12% (within the following 5 years)	
Property Tax (2.2%)	0% (within the first 5 years since the moment of registration of property with the tax authority)	
	0.5% (within the following 5 years)	1.1% (within the following 5 years)
Land Tax (0.3 – 1.5%)	0% (Within the first 3 years since registration of property rights to the land plot)	

- “Khabarovsk”; and
- KGK Diamonds Private Ltd., a major Indian diamonds producer has become a resident of the free port Vladivostok with a gem-cutting factory project.

PDA’s offer their residents a preferential tax regime, as summarized in Table 2 above. PDA residents also benefit from a free customs zone regime with duty and tax free import, storage and consumption of import goods.

Vladivostok Free Port

The Vladivostok Free Port includes the key sea ports of the Southern Far East and the Knevichi airport in Vladivostok.

Its legal regime provides the following incentives for foreign investors:

- the right to lease land plots at their registered “cadastral” value (generally, a low historical value) without the need for public tenders;
- right to hire foreign staff without meeting quota requirements; foreign employees may comprise up to 20% of the total workforce;
- reduced inspections by government authorities and liberalized administrative regulations;
- disputes with government authorities may be resolved with the assistance of the Russian Far East Development Corporation, a special state-owned entity designed to promote investment; and
- reduced visa requirements; foreign citizens arriving through checkpoints in the free port

may stay up to 8 days without a visa.

PDA and Vladivostok Free Port residents enjoy tax and payroll tax benefits as described in Table 2.

Primorye Gaming Zone

Under a Russian law adopted in 2006, gambling is only allowed in a limited number of designated regions. One such zone, “Primorye”, is located in the city of Artem in Primorskiy Krai, 50 kilometers from Vladivostok.

Foreign investors are already active in the gaming zone. A subsidiary of Hong Kong-based Melco Group has built and operates one of the biggest casinos in Russia, Tigre de Cristal.

The gaming zone also benefits from the same simplified visa regime as the nearby free port, supporting the flow of visitors.

INVESTMENT SUPPORT VEHICLES

In addition to creating special territories, the Russian government has established a special investment fund to facilitate new projects in the Russian Far East.

Far East Development Fund

The Far East Development Fund provides government co-financing to foreign and domestic investment projects. Created as a wholly owned subsidiary of the Russian state corporation “Vnesheconombank”, the Fund provides long-term financing on preferential terms for investment projects in designated industries and sectors, including infrastructure,

upstream and downstream production of minerals, small and medium enterprises and agriculture, in the Russian Far East and Baikal regions.

The Fund has its own selection criteria and models for assessing which projects to finance. Government approval is required before funding.¹ Generally, qualifying investment projects should:

- have goals in line with the Russian government's strategy for social and economic development of the Russian Far East and Baikal Regions;
- produce goods and services in the Russian Far East and Baikal regions;
- generate positive investment returns;
- together with Fund's input have a value in excess of 500 million Rubles (about US\$48.8 million at current exchange rates); and
- attract private investments.

The procedure to obtain approval for Fund financing includes coordination with several different government agencies, notably the Ministry for Far East Development and the Governmental Commission for Questions of Social-Economic Development of the Far East and Baikal Region.

Several have been co-financed by the Fund to date, including:²

- construction of a trans-border bridge crossing the Amur River into China;
- construction of a pig-breeding complex in the Primorsky Region;
- construction of a refrigerator warehouse complex in Primorsky Region; and
- formation of the Japanese-Russian Investment Platform.

Other Investment Support Vehicles

In addition to the Fund, other Russian institutions are also involved in attracting foreign investments to the Russian Far East, such as:

- the Far East Development Corporation;
- the Far East Agency for Attracting Investments and Export Support; and
- the Agency for Development of Human Capital in the Far East.

Notably, the Far East Development Corporation oversees PDAs in the Far Eastern Federal District. The Agency for Development of Human Capital in the Far East provides support to investors looking out to hire employees in the region, including assistance with relocation. The Far East Agency for

Attracting Investments and Export Support acts as a general promoter of investments.

While Russia's programs to promote investment in the Russian Far East are in early stages of development, the Russian government appears to be making this a strategic priority, in line with geopolitical developments. Accordingly, more projects can be expected in the future. ■

NOTES

- 1 See the Fund's investment memorandum at: <http://www.fondvostok.ru/en/about/documents/>
2 See: <http://www.fondvostok.ru/en/>

ABOUT THE AUTHORS

Brian L. Zimbler is a Partner at Morgan Lewis and advises clients in a wide range of industries on M&A, joint ventures, and corporate and financial matters. He has more than 25 years' experience with international transactions, having practiced in London and Moscow.

Email: brian.zimbler@morganlewis.com

Roman Dashko is a Partner at Morgan Lewis and advises international and domestic clients in M&A in the oil and gas, power, oilfield services, automotive, retail, pharmaceuticals, technology, and real estate sectors. He works on antitrust, pharmaceutical, and other regulatory matters as well.

Email: roman.dashko@morganlewis.com

Dmitry Dmitriev is an Associate at Morgan Lewis whose practice involves structuring employment relations with top management and advising on employment disputes. Additionally, Dmitry advises companies and individuals on matters that involve Russian corporate law and real estate transactions.

Email: dmitry.dmitriev@morganlewis.com

MOSCOW OFFICE

Morgan Lewis

Legend Business Center

Tsvetnoy Bulvar, 2

Moscow 127051, Russia

Tel: + 7.495.212.2574

www.morganlewis.com