

# Customs benefits for foreign investors localizing manufacture in Russia

The effective customs legislation of the Customs Union of Russia, Belarus and Kazakhstan (Customs Union) envisages, in particular, the following customs benefits for foreign investors planning to localize manufacturing in Russia:

1. an import customs duty concession in respect of goods imported as in-



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For over 15 years now, Alexander has been practicing in the field of customs and foreign trade in Russia. After graduating with honours from the Moscow State Open University, where specialized in customs issues, he worked with the customs authorities for six years. Alexander is experienced in advising clients on customs and foreign trade issues, including classification, customs valuation, non-tariff regulation, IP rights protection, currency control etc. Alexander represents clients' interests in disputes with the customs authorities. He participates as an expert in drafting legislative acts of the Customs Union and Russia.

kind charter capital contribution of a foreign investor into the charter capital of a Russian legal entity;

2. an import VAT concession in respect of the technical equipment, components and spare parts, for which substitutes are not produced in the Russian Federation;
3. an import customs duty concession in respect to (1) technical equipment, components and spare parts, as well as (2) raw materials and components, imported for the exclusive use on the territory of the state-member of the Customs Union in connection with an investment project, falling under the type of the priority activity (sector of economics) of the state-member of the Customs Union in accordance with the legislation of such state-member of the Customs Union;
4. exemption from import customs duty and taxes provided by the customs procedure of Free Customs Zone;
5. exemptions from import customs payments provided by the customs procedures of Processing on the customs territory and Processing for internal consumption.

Below we provide brief comments on each of the customs benefits.

## Customs duty concession for goods imported as an in-kind charter capital contribution of a foreign investor

The import customs duties concession may be provided under the condition that the goods refer to the main production assets (e.g. production equipment), are not be excisable goods (e.g. passenger motor vehicles) and are imported within the time period of the charter capital formation. If all these conditions are met, the importer may enjoy full exemption from import customs duty.

The main disadvantage of this customs concession is the complicated procedure involved in the importation of the goods as an in-kind charter capital contribution. These complications are caused by the significant management and administrative input required due to the time frame requirement. The import of the goods as an in-kind contribution to the charter capital and within the period of charter capital formation should be duly documented. The provision of security for customs payments for the period of the charter capital formation may be required under the placement of the imported goods under the customs procedure. The importer who is given a customs concession should comply with the restrictions on usage and disposal of the goods within a 5-year period from the date when the goods were released by the customs authorities. During this 5-year period, if the goods need to be repaired, the respective customs formalities may be required to be performed in respect of this equipment and its parts which are out of order. If the goods are subject to sale or lease to a

third party, or in case of withdrawal of the foreign investor from the founders (participants) during the above 5-year period, the customs duties that were exempt will have to be paid by the importer.

Please note that the effective Customs Tariff of the Customs Union envisages zero import customs duty rates in respect to majority of types of technical equipment. The rate of import customs duty depends on the classification code applied to the equipment according to the Commodity Nomenclature of the Foreign Trade Activity. Therefore, it is advisable to specify the classification codes under which the particular equipment should be classified, and the possibility of applying these codes taken into account in its shipping schedule, including by obtaining a preliminary decision on classification, before making the decision on the application of any customs concessions.

## Import VAT concession for the technical equipment, components and spare parts, substitutes for which are not produced in the Russian Federation

This concession may be applied in respect to the types of the equipment included in the List approved by the Resolution of the Government of the Russian Federation dated 30 April 2009 № 372. If the type of equipment is not included in this List an interested party may initiate the procedure of amending the List.

If the equipment is shipped to Russia in disassembled mode, it is advisable to obtain a preliminary classification decision which may be issued by the Federal



Customs Service of Russia or its regional customs departments.

## Investment project

The customs legislation of the Customs Union<sup>1</sup> envisages import customs duty concessions in respect to the following goods:

"Technical equipment, including components and spare parts for it, raw materials and/or materials, imported for the use on the territory of the states-members of the Customs Union in connection with the implementation of investment projects which correspond to the priority type of activity (sector of economics) of the states-members of the Customs Union in accordance with the legislation of such states-members of the Customs Union."

The indicated concession concerns the raw materials and/or materials, if such raw materials and/or materials are not produced in the states-members of the Customs Union or if the materials or if raw materials and/or materials, produced in the state-members of the Customs Union do not correspond to the technical characteristics of the investment project applied.

Please note that currently this concession is not applied in the Russian Federation (such exemptions are applied in Belarus and Kazakhstan only). Consequently, in Russia there are no normative acts which determine the procedure for rendering the indicated exemptions.

The perspective for the application of such exemptions in Russia is not clear. There is no direct prohibition or clear guarantees that such exemptions will not be applied in Russia. At the same time, following the Decision of the Court of the Eurasian Economic Community on application of this customs concession the Secretariat of the Eurasian Economic Commission should prepare the general rules of enjoying the tariff concession in the Customs Union, including the procedure of provision of the concessions for the importation of the goods connected with investment projects. Based on the above it is recommended to monitor the situation, and if following the resolution of the Eurasian Economic Commission the possibility to apply this customs concession in Russia arises, try to implement it.

<sup>1</sup> Sub-clause 7.1.11 of the Decision of the Commission of the Customs Union № 130 dated 27 November 2009 "On the single customs tariff regulation in the Customs Union of the Republic of Belarus, Republic of Kazakhstan and the Russian Federation".

## Special Economic Zones

Four Special Economic Zones ("SEZs") are being established in Lipetsk oblast, Republic of Tatarstan, Samara oblast and Sverdlovsk Oblast. Besides tax benefits, these SEZs envisage the possibility of applying the customs procedure of a free customs zone. The goods (i.e. the technical equipment, components and spare parts required for the manufacturing process as well as raw materials and components) customs-cleared under this procedure may be used within the territory of SEZ without paying import duties and VAT, and without the application of non-tariff measures<sup>2</sup>. No export customs duty should be paid in respect to the products manufactured from the imported components. If such products are released for free circulation, the import customs duties and taxes to be paid may be calculated based on the rates related to either the imported components or to the manufactured products based on the choice of the manufacturer, provided that the respective criteria for processing and identification requirements are met.

To enjoy the above customs benefits the Russian legal entity should be registered in the respective SEZ and it cannot have a branch outside the SEZ. The resident performs its activity in accordance with the Agreement on the Production Activity (production and/or processing of the goods (products) and their sales)<sup>3</sup> which should be concluded with the Ministry of Eco-

nomics Development of Russia. The resident of the special economic zone is obliged to make capital investments in roubles in an amount equivalent to USD 4.5 million, at least 1.5 million of which should be invested within the first year after the date of signature of the indicated Agreement<sup>4</sup>.

## Customs procedures of Processing on customs territory and Processing for internal consumption

The customs procedure of Processing on Customs Territory (inward processing) provides for full exemption from import customs duties and taxes levied on the imported goods, provided that the goods produced from the imported goods (the Processed products) are exported from the customs territory of the Customs Union and other conditions are met.

The Customs procedure of Processing for Internal Consumption stipulates that the imported goods are used for the refinery (processing) operations without paying import duty. The Processed products should be released for free circulation on the customs territory of the Customs Union after paying import duties at the rates applicable to the Processed products. Consequently, in cases where the customs duty rate with respect to the Processed products is zero, the application of the customs procedure of the Processing for internal consumption allows a decrease of the import customs duty expenses significantly.

However, this customs procedure may be applied only in respect of goods which are included in the List approved by the Government of the Russian Federation<sup>5</sup>. The effective Resolution of the Government № 565 of 12 July 2011 envisages the list of components required for assembling units of passenger cars and train. Therefore, for the purpose to enjoy it, the respective amendments should be introduced into the Resolution of the Government. The maximum period of Processing of the goods for Internal Consumption is 1 year from the date when the first shipment of goods was placed under the customs procedure. The Commission of the Customs Union may establish a longer or a shorter period for separate types of goods<sup>6</sup>. Special permission should be obtained, and reporting should be provided, to the customs authorities for applying this customs procedure.

Please also note that products manufactured in Russia, owing to the creation of the Customs Union, may be supplied to Belarus and Kazakhstan without the need for any customs formalities. If such products are supplied to other CIS countries (e.g. Ukraine, Moldova, Uzbekistan, Kirgizstan and etc.) tariff preferences (i.e. full exemption from import customs duties) may be applied in the respective CIS country, subject to compliance with relevant conditions (for example, the resident rule, direct supply rule, criteria for processing, certificate of origin ST-1, etc.). ■

<sup>2</sup> Article 10 (Clause 1) of the Agreement on the issues of the free (special) economic zones on the territory of the Customs Union and on the customs procedure of free customs zone dated 18 June 2010.

<sup>3</sup> Article 10 (Clause 1) of Federal Law "On special economic zones in the Russian Federation".

<sup>4</sup> Article 12 (Clause 2) of Federal Law "On special economic zones in the Russian Federation".

<sup>5</sup> Article 265 of the Federal Law "On the Customs Regulation in the Russian Federation".

<sup>6</sup> Article 268 (Clause 1) of the Customs Code of the Customs Union.

# Vital legal issues to consider when investing in technology-based projects in Russia

Foreign companies are looking to expand technology investments in the Russian market, targeting software development, IT, medicine, energy and other technology-based spheres.



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Ekaterina Tilling is recognised in Russia for her experience in the IP field. She is highly skilled at solving IP disputes in Russian courts at all levels, including the Supreme Arbitration Court. She has significant experience in handling complex investment projects involving different IP assets, as well as in negotiating and advising on various IP/IT transactions.

Ms. Tilling is recommended among the European legal experts for IP matters (Chambers Europe, 2008–2014, Chambers Global 2010–2014, The Legal 500 EMEA, 2007–2014 and others).

Ekaterina is a Deputy Chairperson of the IP Committee of the AEB in Russia and is actively involved in the Committee's work.

The base models for a standard investment project may be described as follows:

- the investor acquires the rights to an off-the-shelf technology in Russia;
- the investor comes with its own technology;
- a technology is developed from scratch in Russia.

Irrespective of the model selected for an investment project, the investor needs to evaluate existing and potential risks. This is why investors need an instrument enabling them to check the legal status of a target technology and determine its value. IP due diligence serves to protect the investor.

The goal of IP due diligence is to analyse how well the technology fits the investor's business objectives, whether it provides exclusivity within the market and may be effectively enforced against others.

In the case of an off-the-shelf technology, the goal of the investor may be either to purchase or invest in a company holding a certain technology or purchase individual rights to a technology of interest in order to set up its own manufacturing. If the investor comes with its own technology, it will want to save its background IP rights for this technology and duly determine the rights of all

participants in the project for future developments.

In all of these cases, it is particularly important to conduct IP due diligence before purchasing technologies. Where the goal of the investor is to buy a company, financial and corporate due diligence may be needed, too. Due diligence helps generate a model for the creation and use of technologies that is risk-free to the maximum possible extent. The three key guidelines for creation of such a model are:

- **Structuring of IP and Perfection of Rights** — identification of IP, definition of the form of its protection and understanding how to make a "product" of IP for subsequent commercial purposes.
- **Territory** — regions of presence (national and international protection of IP).
- **Protection** — this means the form of IP protection and the regions of presence. Two key stages are implied — primary protection (title documents) and subsequent protection (against unauthorised third-party use — both extra-judicial and judicial).

While a technology transaction may involve different intellectual property rights, it mostly relies on know-how and patent