

# Regulation of Foreign Investments in Russia

## Definition of Foreign Investments

The Federal Law dated 09 July 1999 No. 160-FZ On Foreign Investments in the Russian Federation (“**Foreign Investment Law**”) defines foreign investments as investment of foreign capital made by a foreign investor directly and independently into a business entity in the Russian Federation in the form of objects of civil rights owned by such foreign investor provided that transactions with such objects are not prohibited or restricted by the Russian federal laws, including cash, securities (in foreign currency and currency of the Russian Federation), other property, property rights, exclusive intellectual property rights (IP) having a cash equivalent, and services and information.

Foreign investments may be made in the form of direct investments through: **(1)** acquisition by a foreign investor of at least 10% in the charter capital of a business entity; **(2)** investment of capital in fixed assets of a branch of a foreign legal entity set up in the Russian Federation, **(3)** foreign investor acting in the Russian Federation as a lessor under a financial lease of equipment with customs value of at least 1 million Rubles (Resolution of the Eurasian Economic Commission dated 16 July 2012 No. 54 On Approval of Common List of Goods for Foreign Economic Activity of the Eurasian Economic Union and Common Customs Tariff of the Eurasian Economic Union).

We note that the laws do not specifically regulate indirect investments. However, if an investor acquires less than 10% of shares or interests in a business entity it may be deemed to have acquired indirect control and thus to have made indirect investments through acquisition of the shares (interests) through entities it controls.

## Foreign Capital Flow Statistics of the Recent Years

At the end of 2018 most of net direct foreign investments in Russia originated from eight countries: [Kazakhstan, Bermuda, British Virgin Islands, the Netherlands, UK, USA, Finland and Switzerland.](#)

Participation of foreign capital in the total charter capital of credit institutions holding a banking license was 12.41%.

As of 1 January 2019 foreign investment in credit institutions was RUB 391.7 bln.

The total charter capital of credit institutions used to determine the size of foreign capital participation in it [was RUB 2.7 trln.](#)

Direct foreign investment in Russia is expected to reach by the end of the current quarter RUB 3,600 mln, according to global macromodels of Trading Economics and analyst expectations.

The estimated direct foreign investment in Russia in 12 months will be at the level of RUB 9,100. According to our long term econometric models, it is forecasted that in 2020 direct foreign investments in Russia – net flow – will be [around US\\$10 bln.](#)

## Foreign Investment Regime

Legal regime of foreign investments and certain aspects of investor status are set out both in international agreements, and provisions of the Russian laws. At this time there over 70 inter-government agreements on encouragement and protection of investments which govern [the activity of foreign investors in Russia](#).

Since the current Russian laws do not uniformly define investments, and the definition depends upon the applicable law, there is no common investment regime either.

That is why there are multiple special investment regimes established by individual federal laws.

## **Overview of Laws and Regulations**

Foreign investor activity in the Russian Federation is governed by numerous laws and regulations.

In particular, the current laws prohibit foreign investors from acquiring control (direct or indirect) over Russian business entities that conduct business in certain sectors (we will name only a few): ownership of regional gas supply and gas distribution systems (Article 7 of the Federal Law dated 31 March 1999 No. 69-FZ On Gas Supply in the Russian Federation), holding on a freehold basis or otherwise of agricultural lands (Article 3 of the Federal Law dated 24 July 2002 No. 101-FZ On Dealing in Agricultural Lands), foreign trade in products for military use (Article 12(2) of the Federal Law dated 19 July 1998 No. 114-FZ On Military and Technical Cooperation of the Russian Federation with Foreign States), conducting business in the territory of Closed Administrative Territorial Units (ZATO) (paragraphs 2.1 – 2.2 of Article 3 of the Law of the Russian Federation dated 14 July 1992 No. 3297–1 On Closed Administrative Territorial Units), etc.

Below is an overview of the current federal laws related to foreign investments in the Russian Federation.

## **Foreign Investment Law**

This law provides for state guarantees of foreign investor rights in connection with their investments in the Russian Federation.

In addition, the Foreign Investment Law establishes a number of principles of foreign investments, namely: **(1)** foreign investors may not enjoy a more favorable regime as compared to national investors; **(2)** a 10% threshold for interests in the charter capital of a Russian business entity is deemed permissible and a foreign investor holding such stake enjoys all legal protections and guarantees provided for by the Foreign Investment Law; **(3)** Russian business entity acquires a status of a business entity with foreign investments on the day when a foreign investor becomes its member.

Legal guarantees are set out in the relevant section of the article.

## **Law on Investment in the Form of Capital Investments**

In addition, investments may be made in the form of capital investments. Pursuant to the Federal Law dated 25 February 1999 No. 39-FZ On Investment Activity in the Russian Federation in the Form of Capital Investments (“**Capital Investment Law**”) investments are made in fixed capital (fixed assets), and include costs of new construction, reconstruction and upgrade of existing facilities, purchase of machines, equipment, inventory, research and development and other costs.

## **Special Investment Contracts**

There is a special mechanism for conclusion of investment contracts in Russia (“**SIC**”). SIC was first introduced by the Order of the Government of the Russian Federation No. 708 in 2015 (Order of the Russian Government dated 16 July 2015 No. 708 On Special Investment Contracts for Certain Industry Sectors as amended on 27 December 2016) (“**SIC 1.0**”) as a form of public-private partnership between the government and a private investor designed to encourage local production in Russia. The principal underlying idea of SIC

is for a contract to be concluded between an investor and the state under which the investor agrees to undertake an investment project to develop and/or implement technologies for serial manufacturing of industrial products in the Russian Federation, its continental shelf or exclusive economic area. The public partner in its turn ensures stable business environment for investor and offers incentives. SIC 1.0 established a number of eligibility requirements, in particular, the term of the contract could not exceed 10 years, and the investments should have been RUB 750 mln or more.

On 18 June 2018 SIC 1.1 came into effect (Order of the Russian Government dated 16 July 2015 No. 708 On Special Investment Contracts for Certain Industry Sectors as amended on 16 December 2016). It modified the previously existing mechanism. In particular, the list of industry sectors for which SIC option is available was expanded, and a possibility for other regulations to establish the amount of investments was provided. A concept “project operating profit” was introduced for the purposes of SIC term determination. It means profit of investor (its contractors), and persons entitled to over 20% of net profit of the investor (its contractors) or providing over 20% of the project financing.

The State Duma has now passed the SIC 2.0 in the first reading. SIC 2.0 is designed not only for the industry in the narrow sense of the word, but also for the energy sector, and agricultural business. The bill provides for investment contracts to be made for a term not exceeding 15 years for projects involving investments of RUB 50 bln or less (net of VAT), or not exceeding 20 years for projects involving investments over RUB 50 bln (net of VAT, Bill 689101–7 On Amendment of the Federal Law On Industrial Policy of the Russian Federation relating to regulation of special [investment contracts](#)). The bill also excludes limitation of the tax benefit period — until 2025. Special investment contracts may be concluded in the form of SIC 2.0 until 31 December 2030.

## **Russian Offshore Zones**

In addition, in connection with a fairly recent Federal Law dated 03 August 2018 No. 290-FZ On International Companies (“**International Company Law**”) and the Federal Law dated 03 August 2018 No. 291-FZ On Special Administrative Districts in the Kaliningrad Region and the Primorye Region (“**SAD Law**”), we note specific features of regulation for the so called offshore zones located the territory of Russky Island (Primorye Region) and Oktyabrsky Island (Kaliningrad Region).

SAD Law contains provisions regarding creation, functioning and abolition of special administrative districts (“**SAD**”), rules of administration in such areas, requirements for obtaining a participant status etc.

Pursuant to the International Company Law a status of an international company (“**International Company**”) is provided to a business entity which: **(1)** conducts business in the territory of several jurisdictions, including Russia; **(2)** is a participant of SAD in Russky Island and Oktyabrsky Island; **(3)** agreed to make investments in the Russian Federation.

In particular, a status of an International Company is provided if the business entity agreed to make investments in the Russian Federation, including on the basis of: **(1)** a statement of intentions to make investments in the Russian Federation; **(2)** a special investment contract; **(3)** a concession agreement; **(4)** an agreement on public-private (municipal-private) partnership or another agreement.

Registration of a business entity as an International Company is effected by the management company assigned by the Russian Government to ensure functioning of a special administrative district to support operation of territories of advanced social and economic development in the Far East Federal District, or its subsidiary (Federal Law dated 29 December 2014 No. 473-FZ On Territories of Advanced Social and Economic Development in the Russian Federation).

## **Competition Law**

The Federal Law dated 26 July 2006 No. 135-FZ On Protection of Competition (“**Competition Law**”) provides for mandatory procedure pursuant to which a person qualifying as an economic concentration entity is required to report whether it holds a license for types of business named in the Federal Law dated 29 April 2008 No. 57-FZ On Foreign Investment in Business Entities Having Strategic Importance for Defense and Security of the State (“**Strategic Investment Law**”), or submit a written statement it does not possess such information.

In other words, in such case the government indirectly controls foreign investments.

We also note that such indirect control also applies to business entities which in fact do not make any investments in strategic companies, but which however are part of the same group with the investor, pursuant to the Competition Law.

## **Securities Market Law**

Activities of foreign investors are also subject to certain restrictions pursuant to the Federal Law dated 22 April 1996 No. 39-FZ On Securities Market (“**Securities Market Law**”), in particular, activities involving transfer of securities under a repurchase contract (Repurchase Contract means a contract whereunder seller agrees to transfer to purchaser by the stated date securities, and purchaser agrees to accept securities and pay a certain consideration for them and also agrees to transfer such securities back to the seller by the stated date, and seller agrees to accept the securities and pay for them a certain consideration) between a Russian and a foreign entity which may include investment units or shares in a foreign investment fund.

## **Strategic Investment Law**

In our view, the Strategic Investment Law is the key law that determines legal regime for foreign investments in Russia as it most clearly defines the boundaries for foreign investors to conduct their business.

Pursuant to the Strategic Investment Law foreign investors are subject to certain restrictions when investing into entities that conduct strategic business. Here are the most important of them: **(1)** business related to radioactive substances and nuclear materials; **(2)** business related to weapons and military equipment; **(3)** space and aviation activities; **(4)** provision of services of a natural monopoly; **(5)** use of subsoil of federal significance.

According to the general rule, transactions resulting in acquisition by a foreign investor or its group of persons of 50% or more of interests (shares) in the charter capital of a business entity of strategic importance require a prior approval.

However the Strategic Investment Law provides for instances where even acquisition of a smaller interest in the charter capital still requires a prior approval. Thus, in relation to foreign investments in strategic subsoil use companies the term “control” includes: **(1)** ability to directly or indirectly control 25% or more voting shares (interests); **(2)** ability to act as a sole executive body; **(3)** right to appoint the sole executive body and/or 25% or more of the members of the collective executive body, or otherwise direct the decisions of the meeting.

Although indirect control over strategic companies may be acquired by a foreign investor through a chain of Russian legal entities it controls, such transactions will require a prior approval subject to the procedures set forth in the Competition Law.

## **Foreign Investor Legal Guarantees**

Legal guarantees for foreign investors are mainly provided by the Foreign Investment Law.

First of all, a foreign investor may make investments in any form which is not prohibited by the applicable laws, unless they require a prior approval from the Governmental Commission for Control over Foreign Investments in the Russian Federation (“**Governmental Commission**”) or antitrust authorities. These may include, in particular, transactions that result in acquisition of a right to directly or indirectly control over 25% of the total number of votes attaching to voting shares (interests) that constitute the charter capital of a Russian business entity, and in cases where a foreign investor is able to block decisions of the management bodies of such business entity.

Further, there are separate guarantees for foreign investors that develop priority investment projects the amount of which is at least RUB 1 bln or for foreign investors whose interest in the charter capital of a business entity is at least RUB 100 mln.

Such guarantees are intended as a protection against unfavorable changes which may, in particular, (1) affect the future profit of investor from the priority investment project; (2) result in an increase of the aggregate tax burden of the foreign investor and business entity with foreign investments related to priority investment projects; (3) trigger bans and restrictions upon foreign investments in addition to those that existed as at the time the priority investment project started.

Further, there are guarantees related to use and repatriation of funds legally obtained from investment activity.

In particular, these may be amounts received as: (1) proceeds from investments in the form of profit, dividends, interest and other revenues; (2) cash amounts in performance of obligations of a business entity with foreign investments or a foreign legal entity that opened a branch in the Russian Federation under contracts or other transactions; (3) cash amounts received by a foreign investor in connection with liquidation of a business entity with foreign investments.

### **Standard Forms of Investments**

In economic terms, there are two most common forms of investment: direct and portfolio investment. Investments where the investor participates in management of the investment target qualify as direct. Where there is no such control the investments are portfolio. Under the Russian laws only direct investors have a status of a foreign investor.

Forms of foreign investments directly depend upon their term. If a foreign investor proposes to invest for an unspecified period of time, generally, such investment will take designated organizational and legal forms for foreign investments. Thus, a foreign investor may conduct business in the Russian Federation through set up of branches and representative offices. A branch exercises all or some functions of its parent legal entity unlike a representative office which represents and defends the interests of a foreign legal entity. Investment of capital in fixed assets of a branch of a foreign legal entity established in the Russian Federation is a direct foreign investment (Article 2 of the Federal Law dated 09 July 1999 No. 160-FZ On Foreign Investments in the Russian Federation). In addition, a very popular form of foreign investments is a private equity fund (Federal Law dated 29 November 2001 No. 156-FZ On Investment Funds).

Normally, investment agreements are made for short-term foreign investment projects. Thus, for example, the Russian laws provide for a possibility to conclude an investment partnership agreement (Federal Law dated 28 November 2011 No. 335-FZ On Investment Partnership). The relevant federal laws do not restrict the ability of foreign investors to participate in such agreements.

### **Overview of Regulatory Procedure**

Acquisition of shares (interests) in a business entity is controlled by the Federal Antimonopoly Service of the Russian Federation (the “**Russian FAS**”). Transactions with shares (interests) of a business entity require

a pre-clearance from the Russian FAS if the total asset value of the company purchasing the shares (interests) and the company whose shares (interests) are purchased exceeds 7 bln Rubles and if their aggregate proceeds from sale of goods in the most recent calendar year exceeds 10 bln Rubles and the total book value of assets by reference to the most recent balance sheet of the purchaser company and its group of persons exceeds 400 mln Rubles and if: **(1)** investor acquires over 25% of the voting shares in a joint stock company (“JSC”); **(2)** investor acquires at least 1/3 in a limited liability company (“LLC”); **(3)** investor acquires no less than 1/3 and no more than a 50% interest in a limited liability company; **(4)** investor acquires at least 25% and no more than 50% of voting shares in a joint stock company; **(5)** investor acquires at least 50% and no more than 2/3 in a limited liability company; **(6)** investor acquires at least 50% and no more than 75% of voting shares in a joint stock company; **(7)** investor acquires assets worth over 25% of the book value of the company’s assets; **(8)** investor acquires over 50% of voting shares in a foreign legal entity.

Further, transactions involving entities that supply goods to the Russian Federation for over 1 bln Rubles in a year preceding the date of the transaction are controlled transactions.

Control over foreign investments in strategic companies generally amounts to obtaining a prior consent of the Governmental Commission.

A foreign investor intending to make a transaction that requires clearance must make a filing with the Russian FAS. The Russian FAS reviews the filing and if it is not complete, i.e. does not contain certain documents, then the Russian FAS requests additional information. Having reviewed the filing the Russian FAS forwards the same to the Russian Ministry of Defense and the Federal Security Service (if the transaction involves investment in strategic companies). Ultimately, after all stages of approval, the filing is submitted to the Governmental Commission which in its turn may make one of the following decisions: **(1)** approve the transactions without conditions; **(2)** approve the transaction with conditions to be complied with by the business entity receiving such authorization; **(3)** refuse to approve the transaction. The applicable decision is communicated to the applicant via the Russian FAS.

If the person applying for prior approval of the transaction by the Governmental Commission does not agree to the conditions proposed by the Commission as conditions precedent to approval of the transaction, then the Russian FAS will issue an automatic refusal.

Further, we note that there are certain consequences of incompliance by a foreign investor investing in strategic companies with the transaction pre-clearance procedure.

First of all, the Strategic Investment Law provides for application of such remedy as invalidation of a transaction and bilateral restitution. However such method is not always efficient as many of such transactions are made outside Russia and due to enforcement of foreign judgments in Russia being fairly difficult.

Secondly, the court may take an enforcement action against a foreign investor in the form of disallowing such investor that acquired control over a strategic company to actually control the company’s operations by obtaining a court order prohibiting the exercise of votes under the shares (interests) indirectly owned by such investor.

In addition to civil liability for violation of the transaction pre-clearance procedure in relation to a transaction involving strategic companies, the applicable laws provide for administrative liability for failure to make a filing with the body controlling foreign investments in the Russian Federation (Governmental Commission) in the form of a fine: of RUB 500,000 to RUB 1 mln for legal entities, of RUB 30,000 to RUB 50,000 for officers.

## **Regulatory Trends**

Due to imposition by a number of foreign countries of economic sanctions against certain persons and sectors in the Russian Federation the Russian government responded with countersanctions. On 04 June 2018 the lawmakers passed the Federal Law No. 127-FZ On Measures (Countermeasures) in Response to Hostile Actions by the United States of America and Other Foreign States. Such sanctions may be imposed by the Russian Government by decision of the President against hostile countries and organizations under their jurisdiction, controlled by such states or affiliated with them, and against officials and nationals of such countries. Companies from hostile countries are restricted from participating in state procurement contracts and privatization of Russian state property. Currently the Russian sanctions list includes many major Ukrainian companies and over 300 individuals. Thus, when a foreign investment is made it is important to take into account that the Russian governmental authorities tend to impose sanctions against foreign individuals and companies.

Also there is a number of bills that impact foreign investments. In particular, the provisions of the Strategic Investment Law will apply not only to business entities, but also legal entities that are not business entities but which are engaged in a certain activity set forth in Article 6 of the Strategic Company Law and/or holding licenses and/or other authorizations to conduct such types of activity.

For more information please contact our Managing Partner [Andrei Danilov](#).

*This legal update is prepared for the purpose of information only. It is not intended to be a comprehensive study or professional opinion and shall not be used as a substitute for a legal advice.*