

# Investment Climate of St. Petersburg

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# Preface

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The international law firm BEITEN BURKHARDT has been rendering legal services in the dynamically developing Russian market for more than 15 years and is one of the first German law firms to open a representative office in Russia. Currently, the firm operates two offices in Russia: in Moscow and St. Petersburg. In 2004, BEITEN BURKHARDT opened an office in Ukraine (Kyiv).

BEITEN BURKHARDT is one of the major German law firms and is represented by 15 offices in 6 countries and employs approximately 300 lawyers and tax consultants.

The Russian and Ukrainian offices of BEITEN BURKHARDT provide their clients with a wide range of legal services within the framework of Russian, Ukrainian and International Law.

The main directions of the firm's activities include:

- Corporate Law
- Legal Support for Real Estate Projects
- Banking and Finance Law
- Intellectual Property Law
- Mass Media Legislation
- Information Technology Legislation
- Labor Law
- Tax Law
- Administrative Law

Special focus is placed on:

- legal support for investment projects in various economic spheres (in particular, in the sphere of investing in commercial real estate and industrial objects)
- projects associated with company acquisitions

Over the recent years, BEITEN BURKHARDT's specialists in Russia and Ukraine have published a vast number of analytical reviews of the main provisions connected with investing in the economies of the Russian Federation and Ukraine. These analytical reviews (brochures, articles, informational memoranda) are presented on the firm's website at [www.beitenburkhardt.com](http://www.beitenburkhardt.com).

# Introduction: Northwestern Region

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The Northwestern Region of the Russian Federation, comprising a population of 12 million people, is one of seven federal regions of the Russian Federation established by Decree of the President of the Russian Federation dated May 13, 2000. The Northwestern Region includes the following subjects of the Russian Federation (independent administrative units according to the Constitution of the Russian Federation):

- Arkhangelsk Oblast
- Vologda Oblast
- Kaliningrad Oblast
- The Republic of Karelia
- The Republic of Komi
- Leningrad Oblast
- Murmansk Oblast
- The Nenetsk Autonomy
- Novgorod Oblast
- Pskov Oblast
- St. Petersburg

St. Petersburg is the administrative center of the Northwestern Federal Region.

The Northwestern Region, which borders Finland, Norway, Estonia, Latvia, and Belorussia, and, in the Kaliningrad Oblast, Poland and Lithuania, is closely connected with many Western European countries.

In recent years the Northwestern Region of the Russian Federation (also referred to as the "RF") has attracted more foreign investment than any other region (with the exception of Moscow and Moscow Oblast). The Northwestern Region is considered to have a more favorable investment climate than other regions of Russia, due, in particular, to regional legislation that grants investors concessions on taxes payable to regional and local budgets. There are also certain legal guarantees both established by federal legislation and fixed by regional legal acts that play an important role in maintaining a stable economic situation. In particular, many regions of the Northwestern Federal Region offer protection for ongoing projects in the form of "grandfather clauses," i.e., provisions that allow existing projects to maintain their original legal status in the event of legislative changes that could otherwise adversely affect them.

The economic policies of the various regions of the RF are, to a considerable degree, politically and legislatively autonomous, as each region is a subject of the federal state. Very often particular characteristics of investment, tax, budget or customs legislation of an Oblast or Republic make that region economically attractive and produce worthwhile results for a given investment project.

# **1. Investment and tax legislation. Powers of the subjects of the Russian Federation.**

## **Legal support of investment activities at the regional level**

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The division of legal competence and powers among federal authorities and authorities of subjects of the RF, with respect to investment activities and tax revenues, is subject to general federal principles and rules. The laws of the subjects of the RF, including those falling within their exclusive competence, must comply dually with the Constitution and current federal legislation.

### **1.1 Investment legislation**

Besides the Constitution of the Russian Federation, the competence of the subjects of the Russian Federation with respect to investment activities is established by Tax and Budget legislation of the Russian Federation, the framework Federal Laws “On Foreign Investments in the Russian Federation” and “On Investment Activities in the RSFSR”. These Laws, within their jurisdictions, entitle the subjects of the RF and local legislatures to adopt statutory legal acts connected with investment activities and support for foreign investors in the particular region. Thus federal legislation vests subjects of the Federation, and to some extent local authorities, with the right to grant foreign investors concessions and guarantees from various budget and non-budget sources, and to finance and support different projects. The regional and local investment, tax and administrative legislation establish the particular forms and extent of that support. Within the joint competence of the state authorities of the RF and the authorities of subjects of the RF there exist the following state regulatory measures:

- Tax system improvement;
- Establishment of special tax regimes;
- Protection of investors' interests;
- Provision of land and other natural resources for use on concessionary terms;
- Development of data bank;
- Improvement of conditions for financial leasing development.

The aforementioned framework Laws also include such guarantees of legal protection of investors as:

- Guarantees that investments can be made in any form not prohibited by law;
- Guarantees of protection against unlawful seizure of property as well as compensation guarantees in cases of nationalization and requisition of property of a foreign investor;
- Guarantees providing for stable legislation during the payback period of large-scale investment projects (up to 7 years);
- Guarantees assuring the free use and transfer out of Russia of income, profits, dividends, compensations and other monetary funds as well as of expatriation of property and information imported as investments;
- Guarantees of the right to acquire Russian state and corporate securities;

- Guarantees of the right to participate in the privatization of state and municipal property objects;
- Guarantees of granting rights to immovable property according to the procedure established by RF legislation.

## 1.2 Tax legislation

Tax legislation governs, in particular, certain issues related to investments, including tax concessions.

### 1.2.1 Tax concessions

Subjects of the Russian Federation and local authorities are vested with the right to grant tax concessions to investors and other categories of taxpayers with respect to taxes payable to their regional/local budgets (see Section II and Table 1). This is one of the most significant incentives used to attract investors.

The only exception is the profits tax, the rate of which may be reduced by up to 4% by the subjects of the RF for certain categories of taxpayers.

### 1.2.2 Other tax measures concerning investment incentives

Russian legislation provides for the possibility of altering tax payment terms in the forms of deferments, installment plans or investment tax loans.

#### 1.2.2.1 Deferment or installment plan with respect to tax payments

Deferment or an installment plan, as a form of altering tax payment terms, can be granted for a period of up to one year. Federal legislation lists a number of conditions for granting a deferment or an installment plan, including, for instance, seasonality of production and (or) realization of goods, works and services. Depending on the basis for granting a deferment or an installment plan, interest can accrue on the outstanding tax sum in the amount of  $\frac{1}{2}$  of the refinancing rate of the Central Bank of Russia (5.125%).

Federal tax legislation allows subjects of the RF to create laws and legislative acts of local self-governing bodies that establish additional conditions for granting a deferment or an installment plan for payment of regional and local taxes.

#### 1.2.2.2 Investment tax loan

An investment tax loan is the most efficient tool to encourage investment activities. An investment tax loan is a change of the tax payment term according to which the taxpayer, given the existence of grounds established by law, is granted the possibility, within a certain term and limits, to reduce his/her tax payments with subsequent phased payment of the loan sum and accrued interest.

An investment tax loan is granted for the profits tax as well as regional and local taxes.

According to general rules, an investment tax loan can be granted to the following categories of taxpayers:

- Organizations involved in R&D or experimental and developmental activities or those technologically re-equipping their production;
- Organizations involved in implementation and innovation activities, the creation of new technologies or the development of existing ones, and the creation of new unfinished products and materials;
- Organizations fulfilling a very important order with respect to socio-economic development of the region or providing very important public services.

An investment tax loan can be granted for a period of one to five years. Interest amounting from ½ to ¾ of the refinancing rate of the Central Bank of the Russian Federation (5.125 - 7.6875%) is accrued on the loan amount.

The Tax Code of the Russian Federation provides subjects of the RF and local self-governing authorities with autonomy over the adoption of normative acts regulating the bases and conditions for granting an investment tax loan, including, within limits established by federal legislation, the term of the loan and its interest rate.

### **1.3 Support of investment projects through non-tax means**

Subjects of the RF are additionally entitled to support investment projects using budget funds in the form of:

- Loans (to be repaid with accrued interest);
- Subventions (the granting of budget funds on a non-refund and interest free basis for expenditures of a certain purpose);
- Guarantees and sureties (civil security of obligations).

Specific forms and conditions for the types of support listed above are determined by regional legislation.

### **1.4 Granting rights to immovable property to foreign investors**

Real estate in the Russian Federation can be owned by individuals, the federal government, governments of various subjects, municipal governments, and other entities. Subjects of the RF, as owners of real estate property, may exercise the entire range of an owner's powers, including alienate the title to property and lease the property. Within their powers, subjects of the Federation are entitled to grant to investors concessions on the lease of land and immovable property objects.

### **1.5 Guarantees of stable legislation**

Protection of investors against adverse legislation alterations is one of the measures aimed at ensuring the stability of investment activities. In particular, the framework laws mentioned in Section 1.1 provide for a guarantee of stable legislation stating that any newly issued legislation which could negatively impact investors will not apply to ongoing investment projects during the payback period, but not more than seven years. It should be noted that this provision applies only to so-called priority investment projects, the list of which is determined by the Government of the Russian Federation.

In addition, subjects of the Federation are entitled to provide similar guarantees for foreign investors at the regional level which may exceed the framework of the federal legislation. It should be noted that certain subjects of the RF in the Northwestern region have adopted provisions that allow existing investment projects to maintain their original legal status in the event of legislative changes that could otherwise adversely affect them.

## 2. System of Taxes and Duties of the Russian Federation

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According to the existing classification, all taxes and levies are divided into three groups:

### 2.1 Federal taxes

The Russian Federation Tax Code (hereinafter, the "TC") establishes federal taxes and concessions. Regional authorities are entitled to change the rates of certain taxes with respect to the parts payable to regional budgets and to grant concessions thereon.

At present, federal taxes and levies include:

- Value-Added tax (VAT)
- Excise
- Individual income tax
- Unified social tax
- Corporate profits tax
- Tax on extraction of natural resources
- Water tax
- Charges for use of wildlife objects or for use of biological objects
- State duty

### 2.2 Regional taxes

At the moment, both federal and regional laws regulate regional taxes. Most frequently the basic elements of a tax (tax base, maximum tax rate, taxpayers) are defined at the federal level (in the TC), while regional regulations determine the exact rate and tax payment terms. This also applies to granting tax concessions to the extent that it is allowed by federal legislation.

Among the regional taxes and duties are the following:

- Corporate property tax
- Gambling tax
- Vehicle tax



## 2.3 Local taxes and levies

As a general rule, local taxes shall be imposed through regulatory acts of local self-governing bodies, which determine the particular tax rates, the procedure and term for their payment, as well as tax concessions. However, the maximum rate and tax base are established at the federal level. It should be noted that St. Petersburg, although a subject of the RF, is entitled to impose both regional and local taxes.

Major local taxes and levies are as follows:

- Individual property tax
- Land tax

**Table 1. Review of the Main Taxes Payable by Companies of the Russian Federation**

<b>Tax / Tax Level</b>	<b>Effective Tax Rates</b>
VAT Federal tax	18% - for the majority of goods, works and services; 10% - for certain types of food products and goods for children.
Corporate profits tax Federal tax	0% - on income of Russian companies in the form of dividends provided that a number of conditions established by legislation are met;  9% - on income in the form of dividends payable by Russian companies to Russian companies and individual-Russian residents;  15% (unless otherwise provided for by international treaties) - on income in the form of dividends payable between Russian and foreign companies;  10% (unless otherwise provided for by international treaties) - on a foreign company's income from freight of vessels, aircraft, other means of transportation and containers, provided that the foreign company's activities do not create a permanent establishment in Russia;  20% (unless otherwise provided for by international treaties) - on other income, other than that mentioned above, of a foreign company from sources in Russia, provided that the foreign company's activities do not create a permanent establishment in Russia;  15% - on income from state and municipal securities (with exceptions);  24% - on income of Russian or foreign companies whose activities create a permanent establishment in Russia (6.5% shall be paid to the federal budget and 17.5% to the regional budget).
Corporate property tax Regional tax	Not more than 2.2% - on the depreciated value of taxable property according to accounting data.
Vehicle tax Regional tax	2 to 50 rubles per horsepower depending on the engine capacity, or 200 rubles per each means of transportation for other means of water and air transportation which do not have engines. These rates may be either increased or reduced by laws of the regional subjects of the Russian Federation by 5 times maximum.

Tax / Tax Level	Effective Tax Rates
Charges for insurance against industrial accidents or professional diseases Federal tax	0.2% to 8.5% - on payroll and payments under civil agreements.
Unified social tax Federal tax	Regressive rate of 26% to 2% plus 104,800 rubles (about 3,050 euros). The rate decreases as aggregate taxable income increases.

**Notes:**

*For preparation of this review, the legislative acts in effect as of February 15, 2008, were used.*

*For calculation of amounts in rubles, the conventional EUR/RUR exchange rate of 36 rubles per euro was applied.*

*The refinancing rate of the Central Bank of Russia was 10.25% at the moment of preparation of this review.*

## 3. St. Petersburg

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### 3.1 Economic and geographic review

#### 3.1.1 Location, population

St. Petersburg is situated on the coast of the Gulf of Finland at the mouth of the Neva River. With a population of 4.6 million people, it is the second largest city in the Russian Federation and one of the largest cultural, industrial, political, tourist, scientific and financial centers of the country. The St. Petersburg labor pool has many professionals specializing in different spheres, with qualifications as high as those in Moscow, while at the same time providing for a much cheaper labor market.

St. Petersburg is a subject of the Russian Federation comprised of several districts.

The city is an administrative center of the Northwestern Region and the residence of the authorized representative of the President of the Russian Federation.

#### 3.1.2 Natural resources

Deposits of sand and gravel, glass, molding sands, clays, and peat are present within the city territory and its suburbs.

#### 3.1.3 Industry and agriculture

Practically all branches of industry are represented in St. Petersburg. In particular, the machine-tool industry, power plant engineering, metalworking, electrical and radio engineering, ship and carriage building, furniture making, printing, pharmacology, various types of light industry, and the food industry are well represented in St. Petersburg. Furthermore, enterprises producing plastic and polymer products, rubber products, pigments and paintwork materials, medical equipment and machinery are situated within St. Petersburg.

Within the city's territory there is a large hothouse complex and several large vegetable farms.

### **3.1.4 Transportation infrastructure**

Connected with 27 European and Asian cities by direct international flights, St. Petersburg is one of the largest Russian transport centers with: water, road, rail and air transport.

Providing for the transit of two thirds of total Russian import volume, the St. Petersburg Seaport is the largest port in Russia. There are also plans for a new port to be built on the coast of the Gulf of Finland, which will have an annual capacity of more than 100 thousand tons of cargo.

### **3.1.5 Banking system**

There is a large banking system in St. Petersburg consisting of more than 120 lending institutions and subsidiaries of foreign commercial banks as well.

## **3.2 Tax and investment legislation review**

St. Petersburg is a full subject of the Russian Federation and is therefore entitled to independently grant tax concessions to investors with respect to amounts payable to the city budget (for certain taxes) as well as adopt its own normative and legislative acts regulating investment activities.

### **3.2.1 Legislative bases**

General conditions of St. Petersburg investment legislation are established in the Law "On State Support of Investment Activities in the Territory of St. Petersburg." The Law "On the Procedure for Granting Real Estate Objects Owned by St. Petersburg for Construction and Reconstruction" establishes special conditions for investment in real estate objects owned by the city. Provisions of the said Law are applicable to land plots, objects of unfinished construction, and buildings subject to reconstruction, and establish the legal basis for transfer of these objects to an investor.

St. Petersburg investment law establishes basic principles for city investment policy, forms of state support of investment activities, rights and obligations of investors as well as bases for concessionary taxation. The procedure for granting tax concessions is regulated by the city Law "On Tax Concessions."

### **3.2.2 Principles of investment policy**

City investment law establishes the principles for investment support, open and free access to official information, clarity of the investment process, inalterability of adopted decisions, the mutual responsibility of St. Petersburg and investors, and presumes the good faith of investors.

### **3.2.3 Legal guarantees**

The Law "On State Support of Investment Activities in the Territory of St. Petersburg" guarantees equal rights for investors. This, in particular, applies to state support provided for by law and other normative acts as well as access to information necessary for performing investment activities. Law prescribes that public procedures should be consistent for all investors, and grants investors the right to own, freely use and repatriate profits gained from implementing investment activities.

It should be noted that the stability of conditions during implementation of an investment project is guaranteed. In order to ensure such stability, investors are guaranteed that any regulatory acts coming into effect in St. Petersburg, which have an adverse effect on existing investment projects, will not be applied to those projects for three years after their effective date.

### **3.2.4 Forms of state support of investment activities**

State support of investment activities is available in the following forms:

- Guarantees from St. Petersburg on loans attracted by investors for the implementation of investment projects;
- Investment support from the city budget;
- Concessions on leasing St. Petersburg real estate;
- Tax concessions within the amounts payable to the St. Petersburg budget (this provision should be brought into compliance with the Federal Law on Profits Tax);
- Concessions on profits taxes granted to banks and other lending institutions granting loans for investment activities within the amounts payable to the city budget (this provision should be brought into compliance with the Federal Law on Profits Tax);
- Deferments and installment plans with respect to payments for granting real estate objects owned by St. Petersburg (for a term of up to five years);
- Granting investment tax loans;
- Participation of St. Petersburg in the development, examination and implementation of city investment programs and particular investment projects.

#### **3.2.4.1 State guarantees**

The St. Petersburg Administration is entitled to grant investment loan guarantees under the following conditions:

- The borrowed funds attracted by the investor under guarantees provided by St. Petersburg comprise less than 50% of total investments;
- The borrower has no existing indebtedness to the city budget and non-budget funds, according to a report on the most recent financial reporting period;
- The investor shows no signs of insolvency as defined by federal legislation;
- The estimated payback period of the total amount of investments should not exceed 6 years from the beginning of investment activities.

Investment projects with the shortest investment payback periods and lowest requested guarantees have priority for guarantees. The term of each guarantee may not exceed five years. The investor shall pay a fee, in the amount of 0.25% to 10% of the amount of loaned funds attracted by the investor under the guarantee of St. Petersburg.

The total amount of guarantees may not exceed the limit determined by the city budget for the current fiscal year. The 2008 budget and the planned budget for the period of 2009 and 2010 allocate no funds for guarantees.

#### **3.2.4.2 Granting budget funds**

Investment project budget support includes:

- Granting loans from the St. Petersburg budget;
- Participation of St. Petersburg in establishing companies. It should be noted that the Budget Code of the Russian Federation provides for the possibility of granting budget investments to legal entities that are not state or municipal institutions or state or municipal unitary enterprises subject to commencement of the state ownership right to an equivalent portion of the authorized (share) capitals of the said legal entities, executed as participation of Russian Federation subjects in the authorized (share) capitals of such legal entities in accordance with civil legislation of the Russian Federation;
- Contracting with an enterprise for supply of services or goods required by St. Petersburg;

- Granting compensation payments from the St. Petersburg budget to persons intending to implement investment activities to develop programs that hold priority for St. Petersburg (the budget provides for compensations for certain projects considered to be of priority).

#### **3.2.4.3 Concessions for lease payments on land plots**

Concessions on lease payments are granted to investors involved in new construction or reconstruction of real estate situated on rented land sites, for the period of planning, capital construction or reconstruction.

#### **3.2.4.4 Investments in real estate**

Depending on whether the object of investments is a land plot or a building (or unfinished construction object), the following forms of investment activities are possible:

- 1) granting a land plot to an investor for the purposes of construction of a new object for lease or ownership and with commencement of the investor's ownership right to the result of investments (constructed building, structure, etc.);
- 2) granting buildings, constructions and parts thereof subject to reconstruction or to be completed by construction for the purpose of creation of a new real estate object.

As a general procedure, real estate objects in St. Petersburg are granted to investors through tenders or for target designation.

Tenders may be held in the form of a competition or auction. Tenders are open to participants and are conducted by a specialized organization authorized by the Government of St. Petersburg.

The investment conditions of tenders and the criteria for determining tender winners are established by the government of St. Petersburg.

The granting of real estate objects for designated use is permitted in the following cases:

- 1) granting of land plots for lease for construction purposes subject to prior approval of the location of the real estate object in accordance with land and city-planning legislation;
- 2) granting, for reconstruction purposes, of production objects, engineering and transportation infrastructure objects (with preservation of their designation) located on land plots included in production zones, engineering and transportation infrastructure zones;
- 3) granting dormitories for reconstruction;
- 4) granting, for reconstruction, buildings declared dangerous in accordance with the established procedure;
- 5) granting, for reconstruction, buildings for the purpose of making investments in the areas of culture, science, health services, ecology, education, physical training and sports, development of the hotel and tourism infrastructure;
- 6) to the sole participant of a tender not conducted who proposed investment conditions meeting the tender conditions;
- 7) in certain other exceptional cases.

Granting ownership rights to land plots for the purpose of designated use is not permitted.

The granting of real estate objects is executed by respective agreements concluded between investors and St. Petersburg determining the investment conditions. Investment conditions include:

- 1) the legal form of granting the real estate object (ownership right or lease right) and the result of investments (ownership right):

- 2) if the real estate object is a land plot, the initial price of such object (in case of sale of the plot), the rent amount (in case of conclusion of a lease agreement on investment conditions) or the payment for use of the land plot (in case of granting the right of restricted use);
- 3) if the real estate object is a building, construction, structure subject to reconstruction (completion of construction) – the value of the right to conclude an investment agreement;
- 4) the investor's obligation to finish construction (reconstruction) of the real estate object and put it into operation by no later than the determined date;
- 5) investment conditions may also include:
  - reimbursement for damages and other expenses related to demolition of real estate objects, transfer of constructions and transport networks, communications and engineering equipment;
  - obligations to grant St. Petersburg the ownership rights to apartments needed for housing citizens residing at the real estate object or to vacate non-residential premises needed for relocating state enterprises;
  - other rights and obligations of investors and St. Petersburg.

With respect to strategic investors, it should be noted that in the process of establishing investment conditions related to transfer of funds to the budget of St. Petersburg, the amount of which is determined on the basis of the initial price of the right to conclude an investment agreement, the market value of the rent for the land plot, the St. Petersburg Government is entitled to resolve to decrease the amount of the said funds.

#### **3.2.4.5. Strategic projects and strategic investors**

For the purposes of support of investment projects of strategic importance for St. Petersburg, the St. Petersburg Government adopted the Provision "On Strategic Investment Projects of St. Petersburg and Strategic Investors of St. Petersburg" and the Provision "On the Procedure for Interaction of Executive Bodies of St. Petersburg State Authorities for the Purposes of Implementing Strategic Investment Projects of St. Petersburg." The said provisions determine the criteria for acknowledging an investment project as strategic as well as the procedure for consideration of an application for acknowledgement of an investment project as strategic.

An investment project must meet the following qualifying requirements to be considered strategic:

- The investment project must have significant influence on the development of certain territories of St. Petersburg, St. Petersburg as a whole and/or particular branches of the city economy, stimulate investment and business activities;
- The investment project must be economically efficient from the point of view of payback;
- The total volume of investments, as a rule, must amount to at least 3 billion rubles (approximately 85 million EUR). The period during which investments in the said volume must be made is determined by a legal act of the St. Petersburg Government with respect to the particular strategic project;
- If the investment project is related to industrial production, the project must provide for use of high-tech, energy and resource saving as well as other high-efficiency technologies;
- If issues related to implementation of the investment project fall within the authority of a respective executive body of St. Petersburg state authorities, a positive conclusion of such executive body is required.

The following parties may act as strategic investors: individuals and legal entities, including foreign ones, as well as legal entities incorporated on the basis of cooperation agreements and unions of legal entities not having a legal entity status.

For the purpose of acknowledging an investment project as strategic and obtaining strategic investor status, the initiators of the investment project must submit to the Investments and Strategic Projects Committee a written petition which must contain the investors' obligations with respect to implementation of the proposed investment project or fulfillment of agreements. A set of documents confirming that the investment project and the investor's activities meet the necessary conditions and

qualifying requirements for investment projects must be attached to the petition for the purposes of acknowledgement of the investment project as strategic and granting the investors the status of strategic investors.

The Investments and Strategic Projects Committee shall consider the petition within three working days as of the day following the day of receipt of the petition (the term for consideration may be extended by five days). If the submitted materials are insufficient, the investor shall be granted two months to submit additional materials. If the materials are sufficient, the Investments and Strategic Projects Committee shall adopt a decision to conduct an examination, the term of which amounts to one month and may be extended by no more than one month. If the conclusion upon the results of the examination is positive, the St. Petersburg Government shall issue a legal act on the strategic investment project or the strategic investor. The said act contains a short description of the strategic project, information on the term of and procedure for its implementation as well as information on the term during which the investor retains the status of strategic investor.

#### **3.2.4.6 State guarantees**

Besides the aforementioned forms of state support of investment activities, St. Petersburg legislation also provides for the possibility for investors to obtain state guarantees. The granting of state guarantees of St. Petersburg is regulated, in particular, by the Decree of the St. Petersburg Government "On Granting State Guarantees of St. Petersburg" and the joint Order of the Government of St. Petersburg and the Financial Committee of St. Petersburg "On the Procedure for Granting State Guarantees of St. Petersburg in Case of Implementation of Investment Projects". The maximum amount of funds allocated for guarantees of St. Petersburg is approved by the Law of St. Petersburg on budget for the following financial year. The 2008 budget and the planned budget for the period of 2009 and 2010 establish a limit of 250 million rubles (approximately 7 million EUR) for obligations of St. Petersburg under state guarantees as at January 1, 2009.

State guarantees of St. Petersburg may be granted to legal entities (regardless of the form of ownership) for the purposes of securing their obligations to third parties in case of implementation of investment projects associated with goals for the social and economic development of St. Petersburg.

The share of borrowed funds attracted by legal entities under state guarantees must not exceed 50% of the total volume of the investments necessary for implementing the investment projects. The estimated payback period for the overall volume of investments under an investment project must not exceed five years.

The validity term of state guarantees is determined by the term for fulfilling the obligations for which the state guarantees are granted.

State guarantees are granted for a fee. The amount of the fee is determined in the law on budget of St. Petersburg for the respective year. The law on budget for 2008 and the planned period of 2009 and 2010 does not provide for the fee amount.

Guarantees may be obtained provided the investor pledges property (real estate, movable property, equity securities) as security in an amount equal to no less than 100% of the guarantor's obligations under the state guarantee. The interest rate of a loan attracted by an investor under a state guarantee must not exceed the rate of St. Petersburg borrowings for a similar term.

The scope of obligations of St. Petersburg under a guarantee provided to a creditor-resident is limited by the amount of the principal loan. The scope of obligations of St. Petersburg under a guarantee provided to a creditor-nonresident may comprise the entire scope of obligations under the loan agreement.

All other conditions being equal, those candidates whose founder or owner is St. Petersburg have priority in receiving state guarantees, as well as those:

- having maximum share of their own funds in the total amount of investments;
- requesting a state guarantee for the minimum term;
- whose investment project has the shortest payback period;



The procedure for granting state guarantees and the list of documents to be submitted to the Committee for Economic Development, Industrial Policy and Trade in this regard in order to evaluate the investment project are determined by the aforementioned joint Order of the Government of St. Petersburg and the Financial Committee of St. Petersburg. State guarantees of St. Petersburg are granted on the basis of the respective agreement concluded between the investor and the Financing Committee of St. Petersburg.

### **3.2.5 Tax rates and concessions**

#### **3.2.5.1 Tax concessions**

A concessionary taxation regime may be granted on both general and special bases to enterprises established with foreign investor participation. The current St. Petersburg Law "On Tax Concessions" provides for the following concessions:

#### **A) Concessions for investors:**

##### *Concessions on the corporate profits tax*

For investors who make investments to acquire fixed assets (with the exception of acquiring fixed assets under leasing agreements) and put them into operation, which have not been in use in the territory of St. Petersburg previously, construct (including non-contracted construction), reconstruct or modernize fixed assets for production purposes, as well as receive the said fixed assets as a contribution to share capital:

- the profits tax rate at which the tax is transferred to the St. Petersburg budget is established as **15.5%** (i.e. the total tax rate is 22%) if the amount of investments equals from 150 million rubles up to 300 million rubles (from 4 million to 8.3 million EUR) within any calendar year starting from January 1, 2005;
- the profits tax rate at which the tax is transferred to the St. Petersburg budget is established as **13.5%** (i.e. the total tax rate is 20%) if the amount of investments exceeds 300 million rubles (above 8.3 million EUR) within any calendar year starting from January 1, 2005, or if the sum of investments amounts to 3 billion rubles (approximately 83 million EUR) or more within any three consecutive calendar years starting from January 1, 2007, for taxpayers operating in the processing industry.

The above concessions are granted for three years as of January 1 of the year following the calendar year in which the amount of investments in fixed assets equaled at least 150 million rubles (approximately 4 million EUR), and if the amount of investments equals 3 billion rubles (approximately 83 million EUR) or more within any three calendar years, the concession is granted for a period of five years.

##### *Concessions on the corporate property tax*

For investors that have invested at least 150 million rubles (approximately 4 million EUR) in fixed assets, the property tax rate is **1.1%** for the three years following the year in which the total amount of investments equaled no less than the above amount.

Within five years from the date of inclusion of the property to accounting, organizations operating in the processing industry may be released from paying the property tax, if within any three consecutive years starting from January 1, 2007, they put into operation fixed asset objects (including those obtained as a contribution to the share capital) worth at least 3 million rubles (approximately 83 million EUR).

#### **B) Concessions granted on other bases**

The rate of the corporate property tax at which the tax is transferred to the St. Petersburg budget is established as **13.5%** (the general tax rate is therefore 20%) for organizations performing the following types of production activities:

- production of computers;

- production of fiber-optic cables;
- production of image converters, image amplifiers, photo-electronic devices;
- production of ultra-high frequency devices;
- production of semiconductor elements, devices;
- production of transmitting devices for radio telephone, radio telegraph communication, radio broadcasting or television;
- production of medical diagnostic and therapeutic devices, surgical equipment;
- production of liquid crystal devices;
- production of lasers;
- development of ready-to-use software: development of system software, tools, applications,

provided that such organizations invest at least 50 million rubles (approximately 1.5 million EUR) in fixed assets as of January 1, 2005, and that the share of proceeds from the above types of activities equals at least 80% of the organizations' total turnover.

The rate of the corporate property tax, the amount of which is allocated to the budget of St. Petersburg, is also fixed at 13.5% for taxpayers that are residents of the special economic zone located within the territory of St. Petersburg for the entire period of existence of the special economic zone.

### 3.2.5.2 Tax rates and tax concessions review

Tax rates and concessions are reviewed in detail in the following table:

**Table 2. Tax rates and tax concessions in St. Petersburg**

<b>Tax rates</b>	<b>Tax concessions</b>	<b>Notes</b>
<b>Profits tax</b>		
<b>Federal budget - 6.5%</b>		
<b>Regional budget - 17.5%</b>	Reduction of the tax rate by 2% or 4%	The bases for concessions are set forth in Section 3.2.5.1.
<b>Corporate property tax</b>		
2.2% of the remaining value of the property	Reduction of the tax rate to 1.1% Exemption from tax payments	Concessions are granted on the bases set forth in Section 3.2.5.1
<b>Land tax</b>		

Tax rates	Tax concessions	Notes
<p>The amount of the tax is calculated on the basis of the cadastre value of the land plot:</p> <p>0.004% - on land plots used for agricultural production</p> <p>0.042% - on land plots occupied by objects of residential premises and engineering infrastructure or provided for residential construction</p> <p>1.5% - on other land plots</p>	<p>Exemption from tax payments</p>	<p>The concession is granted, in particular, to organizations that are residents of the special economic zone located within the territory of St. Petersburg for a term of 5 years as of the moment of commencement of the ownership right to the land plot</p>
<b>Vehicle tax</b>		
<p>From 20 to 150 rubles (approximately 0.55 – 4.2 EUR) per annum per horsepower of a vehicle's engine</p>	<p>Exemption from tax payments</p>	<p>The concession is granted to organizations that are residents of the special economic zone located within the territory of St. Petersburg for a term of 5 years as of the date of registration of the vehicle in the territory of the said zone, with the exception of water and air transportation</p>

### 3.2.5.3 Investment tax loans

The bases for granting investment tax loans in St. Petersburg are established by the Law "On Investment Tax Loan". An investment tax loan is a deferment of tax payments which are to be paid later with accrued interest. In St. Petersburg an investment tax loan can be granted with respect to corporate property tax, in the amounts payable to the St. Petersburg budget.

Investment tax loans can be granted for a term of from 1 to 10 years at a rate of 1/8 to 1 refinancing rate of the Central Bank of Russia (1.28125% - 10.25%) provided that the respective organization is implementing an investment project requiring expenses aimed at financing investments in fixed assets and intangible assets (including amounts for modernization) used in production of goods (works, services) in the territory of St. Petersburg in an amount exceeding 3 million rubles (approximately 83 thousand EUR) for the period starting from January 1, 2002, until the last day of the month of the reporting period preceding the day of submission by the organization of an application for an investment tax loan or within the term of the agreement on granting an investment tax loan.

To be eligible for an investment tax loan, an investor should have no existing indebtedness on taxes and levies payable to the budgets of all levels, and cannot be in bankruptcy proceedings.

Decisions on granting investment tax loans are adopted by the St. Petersburg Finance Committee and legalized through the conclusion of an agreement on granting the loan. Priority for granting investment tax loans is given to investors whose projects have:

- the shortest term of reimbursement of the funds granted;
- the greatest number of jobs created;
- the greatest increase in tax revenue for the St. Petersburg budget from realization of the project.

For each fiscal year the Law of St. Petersburg on Budget establishes the limit amount of funding provided for granting investment tax loans. In 2008, the Law set the limit for investment tax loans for a term exceeding the year 2008 in the amount of 10 million rubles (approximately 280 thousand EUR).

## 3.3 Investment activities in St. Petersburg

According to expert data, St. Petersburg ranks first in Russia for minimal investment risk and second, after Moscow, in its investment potential. Countries such as the USA, the UK, Finland, Sweden, Germany, the Netherlands, and Japan have made considerable investments in the economy of St. Petersburg. The largest investments were made in industry, construction and transportation.

Due to activities of the Administration of St. Petersburg aimed at improving the investment climate and co-operation of the city Administration with international business circles, over recent years the amount of foreign investments in the economy of St. Petersburg has been steadily growing. In 2006 the amount of foreign investments equaled 5.255 billion USD, of which foreign direct investments accounted for 643.4 million USD. In the first half of 2007 the inflow of foreign investments increased by 30% as compared to indicators of the preceding year and amounted to 2.573 billion USD.

Based on such tendencies, further growth of foreign investments in projects now being implemented with foreign capital participation can be expected. These projects include, in particular:

- further works financed by investors with respect to the business activities zone around Pulkovo airport;
- construction and reconstruction of terminal complexes in the sea port of St. Petersburg;
- construction of international hotel complexes in the central part of the city;
- construction of a complex of sewage treatment plants;
- construction of a household appliances plant;

- construction of a number of automobile factories.

Over recent years, the volume of financial inflows and, in particular, loans granted by foreign banks has significantly increased, which evidences the stable growth of the economy of the Northwestern region and the reduced risk of investing in St. Petersburg.

## List of basic documents: Investment and tax legislation in St. Petersburg

1. St. Petersburg Law "On the Budget of St. Petersburg for 2008 and the Planned Period of 2009 - 2010" No. 534-107 dated November 13, 2007;
2. St. Petersburg Law "On State Support of Investment Activities in the Territory of St. Petersburg" No. 185-36 dated July 30, 1998, as last amended on December 9, 2003;
3. St. Petersburg Law "On Tax Concessions" No. 81-11 dated July 14, 1995, as last amended on November 2, 2007;
4. St. Petersburg Law "On the Land Tax in St. Petersburg and Amendments to St. Petersburg Law 'On Tax Concessions' No. 611-86 dated November 28, 2005, as amended on November 2, 2007;
5. St. Petersburg Law "On Investment Tax Loan" No. 316-28 dated July 12, 2002, as last amended on July 20, 2006;
6. St. Petersburg Law "On the Procedure for Granting Real Estate Objects Owned by St. Petersburg for Construction and Reconstruction" No. 282-43 dated June 17, 2004, as last amended on March 19, 2007;
7. Regulation of the Government of St. Petersburg "On Approval of the Provision on the Procedure for Decision-Making on Allocation of Real Estate Objects for Construction and Reconstruction," No. 1592 dated September 21, 2004, as amended on January 30, 2008;
8. Regulation of the Government of St. Petersburg "On Measures to Improve Valuations of Real Estate Objects Allocated for Construction," No. 66 dated December 9, 2003, as last amended on September 2, 2004;
9. Decree of the St. Petersburg Government "On Strategic Investment Projects of St. Petersburg" No. 216 dated March 1, 2005;
10. Regulation of the Investment and Strategic Projects Committee "On Approval of the List of Mandatory Documents to be Attached to an Application on a Strategic Investment Project of St. Petersburg or Strategic Investor of St. Petersburg, and the Provision on Examination of Materials which is required to Determine whether the Decision-Making on a Strategic Investor of St. Petersburg is Substantiated," No. 1 dated June 17, 2005;
11. Regulation of the Government of St. Petersburg "On the Program for Locating Hotel Infrastructure Objects in St. Petersburg" No. 1268 dated July 6, 2004, as last amended on February 26, 2007;
12. St. Petersburg Law "On Establishment of Price of Land in St. Petersburg" No. 692-101 dated December 29, 2004;
13. Decree of the St. Petersburg Government "On Granting State Guarantees of St. Petersburg" No. 1385 dated August 17, 2004;
14. Joint Order of the St. Petersburg Government and the Financial Committee of St. Petersburg "On the Procedure for Granting State Guarantees of St. Petersburg in Case of Implementation of Investment Projects" No. 23-p dated February 28, 2005;
15. St. Petersburg Law "On Vehicle Tax" No. 487-53 dated November 4, 2002, as last amended on November 2, 2007;
16. Decree of the St. Petersburg Government "On Methods for Determining Rent for Land Plots" No. 1561 dated September 14, 2004, in the latest version dated October 12, 2006;
17. Other legislative acts applicable in St. Petersburg and information available on the official website of St. Petersburg, see [www.spb.ru](http://www.spb.ru).

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