

Investment Climate of St. Petersburg

Contents

Preface	1
Introduction: Northwestern Region	2
1. Investment and tax legislation. Powers of the subjects of the Russian Federation. Legal support of investment activities at the regional level	3
1.1 Investment legislation	3
1.2 Tax legislation	4
1.2.1 Tax concessions	4
1.2.2 Other tax measures concerning investment incentives.....	4
1.2.2.1 Deferment or installment plan with respect to tax payments.....	4
1.2.2.2 Tax loan.....	4
1.2.2.3 Investment tax loan.....	4
1.3 Support of investment projects through non-tax means	5
1.4 Granting rights to immovable property to foreign investors	5
1.5 Guarantees of stable legislation	5
2. System of Taxes and Duties of the Russian Federation	6
2.1 Federal taxes	6
2.2 Regional taxes	6
2.3 Local taxes and levies	7
3. St. Petersburg	9
3.1 Economic and geographic review	9
3.1.1 Location, population.....	9
3.1.2 Natural resources	9
3.1.3 Industry and agriculture	9
3.1.4 Transportation infrastructure.....	9
3.1.5 Banking system	10
3.2 Tax and investment legislation review	10
3.2.1 Legislative bases	10
3.2.2 Principles of investment policy.....	10
3.2.3 Legal guarantees	10
3.2.4 Forms of state support of investment activities	10
3.2.4.1 State guarantees	11
3.2.4.2 Granting budget funds	11
3.2.4.3 Concessions for lease payments on land plots.....	11
3.2.4.4 Investments in real estate.....	12
3.2.4.5 Strategic projects and strategic investors	13
3.2.5 Tax rates and concessions	14
3.2.5.1 Tax concessions	14
3.2.5.2 Tax rates and tax concessions review	16
3.2.5.3 Investment tax loans.....	17
3.2.5.4 State guarantees of St. Petersburg in case of implementation of investment projects	17
3.3 Investment activities in St. Petersburg	18

Preface

BEITEN BURKHARDT, one of the first German law firms to open a representative office in Russia, has been involved in legal consulting in the dynamically developing Russian market for more than ten years. Currently, the firm has two offices in Russia: in Moscow and St. Petersburg. In 2004, BEITEN BURKHARDT opened an office in Ukraine (Kiev).

BEITEN BURKHARDT is one of the major German law firms and is represented by 15 offices in 6 countries and employs approximately 250 lawyers and tax consultants.

BEITEN BURKHARDT provides its 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 and Commercial Law;
- Regulation of Real Estate Transactions;
- Legal Protection of Industrial Property;
- Labor, Administrative and Tax Law;
- Legislation on Mass Media and Information Technologies.

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.

In recent years, BEITEN BURKHARDT's specialists have published numerous analytical reviews of the main provisions connected with investing in the economies of the Russian Federation and Ukraine. Full versions of these analytical reviews (brochures, articles, informational memoranda) are presented on the firm's website at www.bblaw.ru.

This publication is part of a review, prepared by BEITEN BURKHARDT's specialists, of the investment legislations of the 11 Russian regions comprising the Northwestern Federal District.

Introduction: Northwestern Region

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 regions according to the Constitution):

- Arkhangelsk Oblast (including the Nenetsk Autonomy)
- Vologda Oblast
- Kaliningrad Oblast
- The Republic of Karelia
- The Republic of Komi
- Leningrad Oblast
- Murmansk Oblast
- 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 established by federal legislation and fixed by regional legal acts that play an important role in maintaining a stable economic situation. For instance, 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.

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

Apart from 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 Law "On Foreign Investments in the Russian Federation" and by the Law "On Investment Activities in the Russian Federation". These Laws entitle the subjects of the RF and local legislatures, in cases where the respective issues fall under the exclusive competence of the subject or the joint competence of the subject of the RF and the Russian Federation, 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 laws 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 exists 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 Laws also include the following guarantees concerning the legal protection of investors:

- Guarantees that investments can be made in any form not prohibited by law;
- Guarantees against unlawful seizure of property as well as compensation guarantees in cases of nationalization and requisition;
- Guarantees providing for stable legislation during the payback period of large-scale investment projects (up to 7 years);
- Guarantees assuring the free use and expatriation of income, profits, dividends, compensations and other monetary funds as well as 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 in accordance with RF legislation.

1.2 Tax legislation

Tax legislation concerns tax concessions, and other measures for stimulating investment activities.

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 particular categories of taxpayers with respect to taxes payable to their regional/local budgets (see Section 3 and Table 1). This is one of the most significant incentives used to attract investors.

The only exception, in accordance with the amendments introduced into the Tax Code of the Russian Federation that came into effect as of January 1, 2002, is the profits tax. Under the new legislation, subjects of the RF have the right to reduce the profits tax rate for certain categories of taxpayers by up to 4%. Local authorities lost the right to grant concessions with respect to the profits tax. In accordance with provisions of federal legislation, concessions on profits tax which were granted before June 1, 2001, remained in effect for a three-year period from the date of their granting, even after the respective amendments had come into effect.

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, tax loans 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 one to six months. Federal legislation lists a number of conditions for granting a deferment or an installment plan, 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.

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

1.2.2.2 Tax loan

A tax loan can be granted for a period of 3 months to 1 year on the basis of conditions specified by legislation. As in the case of a deferment or an installment plan, interest on the loan amount is accrued depending on the grounds for which it was granted. The amount of interest accrued is based on the refinancing rate of the Central Bank of Russia. A tax loan can be granted for payment of one or more taxes.

1.2.2.3 Investment tax loan

An investment tax loan is the most efficient tool to encourage investment activities. Deferment of payments is granted on the profits tax in the part payable to the regional budget. An investment tax loan can also be granted on regional and local taxes.

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

- Organizations involved in research, 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 is accrued on the loan amount.

The Tax Code provides subjects of the RF and local authorities with absolute autonomy over the adoption of normative acts regulating the bases and conditions for granting an investment tax loan, including, within limits specified 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 (security obligations related to the investment project).

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 the federal government, governments of various subjects, municipal governments, and by individuals. Subjects of the RF have complete control over property owned by them, including its lease and transfer of title. 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 from adverse legislation alterations is one of the measures aimed at ensuring the stability of investment activities. The framework laws mentioned in Section 1.1 establish this guarantee and state that any newly issued legislation, which could negatively impact investors, will not apply to ongoing investment projects during the payback period (which shall not exceed 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 Russian Government.

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 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

In accordance with current legislation 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 their own concessions thereon.

Listed below are major federal taxes and duties:

- Value-Added tax
- Excise
- Individual income tax
- Unified social tax
- Organizations' profits tax
- Tax on mining of natural resources
- Tax on inheritance or gift (to be abolished as of January 1, 2006)
- Water tax
- Charges for use of wildlife objects or for use of biological objects
- State duty
- + Customs duty *

* It is necessary to note that under the TC, prior to January 1, 2005, the customs duty was a federal tax. Starting January 1, 2005, the TC no longer mentions it among the federal taxes, and the imposition of the duty is governed by Russian Federation customs legislation.

2.2 Regional taxes

At the moment, both federal and regional laws regulate regional taxes. Most frequently the basic elements of a tax (taxable base, maximum rate, taxpayers) are defined at the federal level (in the TC), while regional regulations determine the exact rate, payment and tax reporting procedures. This also applies to granting concessions to the extent that the right to grant concessions is provided for to the subjects of the Federation by the framework laws mentioned in Section 1.1 above.

Major regional taxes and duties are listed below:

- Organizations' property tax
- Gambling tax
- Vehicle tax

2.3 Local taxes and levies

According to the general rule, local taxes shall be imposed through the acts of municipal establishments, which determine taxation procedures, concessions on local taxes and on the amounts of federal and regional taxes payable to local budgets. However, the maximum rate and taxable base are established at the federal level. It should be noted that St. Petersburg and Moscow, although subjects of the RF, are 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

Tax / Tax Level	Effective Tax Rates
VAT Federal tax	18% - for the majority of goods, works and services; 10% - for certain types of food products and goods for children.
Organizations' profits tax Federal tax	9% - for 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) - for income in the form of dividends payable between Russian and foreign companies; 10% (unless otherwise provided for by international treaties) - for 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) - for 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% - for income from state and municipal securities (with exceptions); 24% - for income of Russian or foreign companies whose activities create a permanent establishment in Russia (6.5% to the federal budget and 17.5% to the regional budget).
Organizations' property tax Regional tax	Not more than 2.2% - on the depreciated value of taxable property.
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.
Charges for insurance against industrial accidents or professional diseases Federal tax	0.2% to 8.5% - on payroll and payments under civil agreements.

Tax / Tax Level	Effective Tax Rates
Unified social tax	Regressive rate of 26% to 2%.
Federal tax	The rate decreases as aggregate taxable income increases.

Notes:

For preparation of the review on investment legislation of the Northwestern region the legislative acts in effect as of September 1, 2005 were used.

For calculation of rubles, the conventional exchange rates for the Euro (35 rubles per EUR 1) and for the USD (30 rubles per USD 1) were applied:

The refinancing rate of the Bank of Russia was 13% at the moment of preparation of this review.

3. St. Petersburg



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 100 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 latter are applicable, in particular, to land plots, unfinished construction objects, and buildings needing reconstruction, and establish the legal basis for transfer of real estate 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

St. Petersburg investment law 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 city 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 the city (for a term of up to 5 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 2005 budget allocates no funds for guarantees.

3.2.4.2 Granting budget funds

Investment project budget support includes:

- Granting loans from the St. Petersburg budget;
- Participation by St. Petersburg in establishing companies;
- Contracting with an enterprise, on a competitive basis, for supply of services or goods required by the city, along with granting concessions and quotas;
- 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

During implementation of investment activities involving housing on land plots, completion of unfinished construction objects, reconstruction of buildings, facilities and parts thereof, the said real estate objects may be granted to the investor in one of the following ways:

- a) on the basis of lease rights;
- b) under a sale and purchase agreement concluded upon the results of a tender;
- c) for designated use.

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 – land plots, buildings, constructions, structures, unfinished construction objects – for designated use is permitted in the following cases:

- 1) in accordance with agreements concluded by St. Petersburg with the Russian Federation, subjects of the Russian Federation, foreign countries, and **strategic investors**, as well as in accordance with agreements between the Russian Federation and foreign countries;
- 2) in accordance with target programs of St. Petersburg and federal target programs;
- 3) to the sole participant of a failed tender;
- 4) also, for the purposes of implementing investment activities in the spheres of culture, science, public health services, ecology, education, physical training and sport, **hotel and tourist infrastructure development**.

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 with St. Petersburg determining the investment conditions. Investment conditions include:

- 1) the legal form of granting the real estate object and the result of investment:
 - provision of a land plot on investment conditions with the right to develop it, for lease, ownership, permanent (perpetual) use, under right of restricted use (servitude), and with commencement of the ownership right (economic control, operating management) of the investor to the result of investment;
 - provision of buildings, constructions, structures subject to reconstruction or completion of construction for investment activities for the purposes of creation of a new real estate object with commencement of the ownership right to the result of investment;
- 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.

Also, it should be noted that, as of the beginning of 2005, in accordance with the St. Petersburg Law "On Establishment of Price of Land in St. Petersburg" the buy out price of land was reduced by three times. At present, the buy out price of 1 square meter of land equals the land tax rate multiplied by 9 (previously, the buy out price was calculated on the basis of the land tax multiplied by 30).

3.2.4.5. Strategic projects and strategic investors

For the purposes of developing important investment relations 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:

- A strategic 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 in the territory surrounding the result of implementation of the strategic investment project or stimulate economic activities in a particular sphere of the city economy.
- A strategic 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 three billion rubles (~100 million US dollars). 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 a strategic 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 a strategic 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 petition in a free written form 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 is one month (the said term may be extended but by no more than one month). If the conclusion upon the results of the examination is positive, the St. Petersburg Government shall issue legal acts on the strategic investment project and the strategic investor. The said acts contain 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.

3.2.5 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) *Granting tax concessions on general bases:*

- 1) Organizations of all branches of the economy shall not pay **land tax** on land plots not transferred for lease, trust management, other use, which are being used for the purposes of new construction and/or reconstruction of real estate objects located thereon, as of the actual commencement of capital investments for the entire established period of construction and/or reconstruction in accordance with approved projects and for two years following the termination of this period;
- 2) Taxpayers producing excisable products shall not pay **land tax for five years**. To be eligible for this concession the taxpayer must make capital investments in fixed production assets in an amount equal to at least 5 million US dollars and transfer, upon expiry of 5 years, a total amount of taxes to the St. Petersburg budget of no less than the total amount accrued in the year when the capital investments in the amount of 5 million USD were made.

B) *Granting tax concessions on special bases:*

City legislation provides for granting considerable tax concessions available to foreign investors establishing large joint-stock ventures with the participation of St. Petersburg.

Tax payment exemptions with respect to land tax are granted for **up to seven years**. The obligatory condition for granting tax concessions in St. Petersburg is contribution of not less than **USD 1 million** to the registered capital of the enterprise to be established by an investor, or capital investments by a foreign participant of a legal entity in capital production categories of St. Petersburg in an amount of at least **USD 10 million**.

Tax concessions are granted only to legal entities established with St. Petersburg and foreign investors participating on the bases of international agreements between St. Petersburg and governments of foreign countries.

Tax concessions as of January 1, 2006

At the end of 2004 amendments to the Law "On Tax Concessions" were made that could not enter into force as of the beginning of 2005 due to the date of adoption of a respective legal act concerning the granting of tax concessions to investors and legal entities performing particular types of production activities.

A) *Concessions for investors*

Concessions on organizations' profits tax

For investors who, starting from January 1, 2005, make investments to acquire fixed assets (with the exception of acquiring fixed assets under leasing agreements), 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 (for own production of goods (works, services)):

- 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 5 million US dollars to 10 million US dollars);

- 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 10 million US dollars).

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 (5 million US dollars).

Concessions on organizations' property tax

For investors that have invested at least 150 million rubles (5 million US dollars) 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.

B) Concessions for organizations performing particular types of production activities

The rate of the organizations' 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;
- ultra-high frequency production;
- 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 (1.7 million US dollars) 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.

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

Tax	Tax rates	Tax concessions	Notes
Profits tax			
Federal	6.5%		
Regional	17.5%	Profits tax concessions are granted as a reduction of the tax rate by 2% and 4% for different categories of organizations	The bases for concessions are set forth in Section 3.2.5.1.
Organizations' property tax			
	2.2%	The tax rate has been reduced to 1.1%	Concessions are granted on the bases set forth in point 3.2.5.1
Land tax			
	The specific tax rate depends on the type of land plot in use*)	100% of amounts payable to the city budget	Concessions are granted on the bases set forth in point 3.2.5.1
Vehicle tax			
	From 14 to 150 rubles (approximately 0.5 – 5 US dollars) per annum per horsepower of a vehicle's engine.	100%	The new St. Petersburg Law "On Vehicle Tax" does not provide for granting investors concessions with respect to this tax. Amendments to the Law "On State Support of Investment Activities in the Territory of St. Petersburg" have not been introduced.

*) Until January 1, 2006, the old Federal Law "On Payment for Land" will remain in force. As of January 1, 2006, the tax shall be calculated and paid at the following rates:

- 0.3% on agricultural land used for agricultural production and land plots occupied by residential premises and engineering infrastructure objects or granted for residential construction;
- 1.5% on all other land plots.

The tax base will be the cadastre value of the particular land plot.

3.2.5.3 Investment tax loans

In St. Petersburg 2002 the Law "On Investment Tax Loan" was adopted which provides for the possibility of granting investment tax loans. 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 two taxes:

- profits tax, in the amounts payable to the St. Petersburg budget;
- property tax, in the amounts payable to the St. Petersburg budget.

Investment tax loans on the organizations' profits tax may be granted for a term of 1 to 5 years. The interest rate on such a loan may be set at 1/2 to 3/4 of the refinancing rate of the Bank of Russia (from 6.5% to 9.75% as of this writing). Investment tax loans can be granted in cases provided for by federal legislation. These include:

- conducting scientific or research and development works, or technically re-equipping its own production facility;
- carrying out introductory and innovational activities;
- fulfilling a particularly important function for the social and economic development of the region, or providing very important services to the public.

With respect to the organizations' property tax, investment tax loans can be granted for a longer term: from 1 to 10 years at a rate of 1/8 to 1 refinancing rate of the Central Bank (1.6% - 13%), provided that an investment project is being implemented (as of January 1, 2002, as well as within the term of the investment loan tax granted) which envisages investing more than USD 100 thousand in fixed and intangible assets used for the production of goods in the territory of St. Petersburg.

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. Investment tax loans are granted on the basis of an agreement on the pledge of property or a guarantee agreement concluded with the tax body of St. Petersburg.

Decisions on granting investment tax loans are adopted by the financial body of St. Petersburg (Committee of finance of the Administration of St. Petersburg) 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:

- expenditures, implemented or planned, for financing investments in fixed and intangible assets, used for manufacturing goods (works, services) in the territory of St. Petersburg in amounts exceeding USD 100 thousand;
- 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 maximum amount of funding provided for granting investment tax loans. In 2005 the Law set the limit for investment tax loans at 121 million rubles (~ 4 million US dollars).

3.2.5.4 State guarantees of St. Petersburg in case of implementation of investment projects

The granting of state guarantees by St. Petersburg is regulated by the Decree of the St. Petersburg Government "On Granting State Guarantees of St. Petersburg" and the 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." The maximum amount of funds allocated for guarantees of St. Petersburg is approved by the city law on budget for the following financial year. In the budget for the year 2005 the maximum amount of funds for state guarantees is 1 billion rubles (approximately 33.3 million US dollars).

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 in the total volume of investments necessary for implementation of investment projects must not exceed 50 percent.

The term of a state guarantee depends on the term of fulfillment of obligations for which the state guarantee is granted.

State guarantees are granted for a fee, provided that the investor puts property (real estate, movable property, issuable securities) up as security in an amount equal to no less than 100% of the amount of the guarantor's obligations under the state guarantee. Interest on a loan granted to an investor under a state guarantee may not exceed the rate of St. Petersburg's borrowings for the same term. Moreover, it is required that the estimated payback period of the total amount of investments under the investment project not exceed 5 years.

All other conditions being equal, those candidates have priority whose founder or owner is St. Petersburg and those:

- having maximum share of their own funds in the total volume 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 are determined by the joint Order of the St. Petersburg Government and the Financial Committee of St. Petersburg specified at the beginning of this subsection.

3.3 Investment activities in St. Petersburg

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

Due to activities of the Administration of St. Petersburg aimed at improving the investment climate and co-operation of the Administration with international business circles, the amount of foreign investments has been steadily growing. In 2004 the inflow of investment in fixed assets equaled 103.7 billion rubles (approximately 3.5 billion US dollars). The amount of foreign investment increased by 41.6% over that of 2003, reaching 985.1 million US dollars, of which 760.3 million US dollars were invested in industry (77.2% of the total amount of foreign investments).

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

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

In 2004 the amount of loans issued by foreign banks significantly increased, evidencing the reduced risk of investing in St. Petersburg.

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

1. Law of St. Petersburg "On the 2006 Budget of St. Petersburg," No. 608-84 dated November 28, 2005;
2. St. Petersburg Law "On Budget of St. Petersburg for the year 2005" № 578-81 dated November 29, 2004, as last amended on July 11, 2005;
3. St. Petersburg Law "On State Support of Investment Activities in the Territory of St. Petersburg" № 185-36 dated July 30, 1998, as last amended on December 9, 2003;
4. St. Petersburg Law "On Amendments to Particular Laws of St. Petersburg on Taxes and Levies as well as on Invalidation of Particular Laws of St. Petersburg" № 646-97 dated December 22, 2004;
5. Current version of the St. Petersburg Law "On Tax Concessions" № 81-11 dated July 14, 1995;
6. St. Petersburg Law "On Tax Concessions" № 81-11 dated July 14, 1995, as last amended on December 16, 2004;
7. St. Petersburg Law "On Procedure and Conditions for Granting and Abolishing Tax Concessions" № 24-7 dated February 25, 1997, as last amended on December 22, 2004;
8. St. Petersburg Law "On Investment Tax Loan" № 316-28 dated July 12, 2002, as last amended on November 26, 2003;
9. Regulation "On Investment Tax Loans" approved by Order of the St. Petersburg Administration Finance Committee № 56-r dated August 6, 2002;
10. St. Petersburg Law "On the Procedure for Granting Real Estate Objects Owned by St. Petersburg for Construction and Reconstruction" № 282-43 dated May 26, 2004, as last amended on December 22, 2004;
11. 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 December 30, 2005;
12. 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 amended on September 2, 2004;
13. Decree of the St. Petersburg Government "On Strategic Investment Projects of St. Petersburg" № 216 dated March 1, 2005;
14. 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;
15. 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 amended on February 8, 2005;
16. St. Petersburg Law "On Establishment of Price of Land in St. Petersburg" dated December 29, 2004;
17. Decree of the St. Petersburg Government "On Granting State Guarantees of St. Petersburg" № 138 dated August 17, 2004;
18. 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" № 23-p dated February 28, 2005;
19. St. Petersburg Law "On Vehicle Tax" № 487-53 dated November 04, 2002, as last amended December 22, 2004;

20. Decree of the St. Petersburg Government "On Methods for Determining Rent for Land Plots" № 1561 dated September 14, 2004, in the latest version № 192 dated February 25, 2005;
21. Other legislative acts applicable in St. Petersburg and information available on the official website of St. Petersburg, see www.spb.ru.

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