

RUSSIA

TRADE SUMMARY

The U.S. goods trade deficit with Russia was \$26.3 billion in 2011, up \$6.6 billion from 2010. U.S. goods exports in 2011 were \$8.3 billion, up 37.8 percent from the previous year. Corresponding U.S. imports from Russia were \$34.6 billion, up 34.6 percent. Russia is currently the 31st largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Russia was \$9.9 billion in 2010 (latest data available), down from \$19.9 billion in 2009. U.S. FDI in Russia is led by the manufacturing, banking, and mining sectors.

WTO Accession

On December 16, 2011, at the Eighth Ministerial Conference of the WTO, Trade Ministers adopted the terms and conditions of Russia's WTO accession and extended an invitation to Russia to join the organization. Thirty days after Russia notifies the WTO that it has accepted the terms for accession, Russia will become a WTO Member. Before then, both houses of Russia's legislature must ratify the terms of accession through the enactment of a law and Russia's President must sign the law.

Russia's WTO accession is expected to improve market access for U.S. exports of goods and services. If, however, by the time that Russia becomes a WTO Member, the United States has not terminated the application of the Jackson-Vanik Amendment and extended permanent normal trade relations to Russia, U.S. businesses will not be able to enjoy the full benefits of Russia's accession and the United States will not be able to use WTO dispute settlement procedures to deal with issues that may arise with Russia's implementation of its WTO obligations.

IMPORT POLICIES

On January 1, 2010, the Russia-Kazakhstan-Belarus Customs Union (the Customs Union or CU) adopted a common external tariff (CET) with the majority of the tariff rates established at the level that Russia applied at that time. On July 1, 2010, a common CU Customs Code entered into effect. On July 1, 2011, the CU Parties abolished all customs posts on their internal borders, allowing for the free flow of most goods between the CU countries. As a consequence, Russia's import tariff levels, trade in transit rules, nontariff import measures (*e.g.*, tariff-rate quotas, import licensing, and trade remedy procedures) and customs policies (*e.g.*, customs valuation, customs fees, and country of origin determinations) are based on CU legal instruments. On these and other issues involving goods, CU Agreements and CU Commission Decisions establish the basic principles that are implemented at the national level through domestic laws, regulations, and other measures. CU Agreements and CU Commission Decisions also cover issues such as border enforcement of intellectual property rights, trade remedy determinations, establishment and administration of special economic and industrial zones, and the development of technical regulations and sanitary and phytosanitary measures.

Since September 2010, the three CU Parties have consolidated customs duties into a single account, dividing the money among Russia (receiving 87.97 percent of the funds), Kazakhstan (7.33 percent), and Belarus (4.7 percent). On May 19, 2011, Kazakhstan and Belarus adopted Russia's nine antidumping and safeguard measures. While the CU Commission will issue any future antidumping orders, during a transition period, the administering authorities of each CU Party will actually conduct the investigations.

Russia continues to maintain a number of import restrictions, such as customs charges and fees that exceed the cost of the service provided, and valuation procedures that result in artificially high total tariff charges. Compliance with licensing, registration, and certification regimes is burdensome. As part of its WTO accession package, Russia agreed to cut its maximum customs fee by about two-thirds, establish lower fixed fees for the customs clearance of goods using electronic format or other simplified filing methods, and implement the WTO Agreement on Customs Valuation. The United States will monitor Russia's customs procedures to ensure compliance with its WTO commitments.

Tariff-Rate Quotas

Since 2010, the CU Commission has assumed responsibility for determining the overall tariff-rate quota (TRQ) volume for a product and its allocation among the three CU Parties. Each CU Party then decides whether to make country-specific allocations of the TRQ volume and issues the import licenses used to administer the TRQ. In 2012, the CU Commission is maintaining access under the TRQ for beef for Russia at the same volume levels as in 2011, while substantially lowering the TRQ volumes for both pork and poultry. In January 2012, Russia removed all country-specific allocations for pork, and instituted a global TRQ. Also in 2012, the United States is receiving increased country-specific frozen beef access. Once Russia becomes a WTO Member, the United States will have access to Russia's high quality beef market through a U.S. country-specific definition. High quality beef imports are not covered under the TRQ and will be subject to a 15 percent tariff. In addition, the total poultry and fresh/chilled beef TRQ volumes will be increased over currently prescribed 2012 levels, the in-quota pork duty will be eliminated, and over-quota duties on pork and poultry will be marginally lowered while the duties on beef will be marginally increased. Additionally, for 2012, Russia has divided the single global poultry TRQ into three separate TRQs, two of which remain global and a third which provides country-specific allocations to the European Union and "other countries." Finally, a new TRQ will be established for select whey products, with in-quota and out-of-quota rates of 10 percent and 15 percent, respectively.

Import and Activity Licenses

Import licenses and/or activity licenses to engage in wholesale and manufacturing activities are necessary for the importation of certain products, including alcoholic beverages, pharmaceuticals, products with encryption technology, explosive substances, narcotics, nuclear substances, equipment to be used at nuclear installations and corresponding services, hazardous wastes (including radioactive waste), and some food products (e.g., unprocessed products of animal origin).

As of December 2011, in order to obtain a license to import alcohol or alcoholic products into the Russian Federation, an importer must also obtain an activity/wholesale license to warehouse and distribute alcohol and alcoholic products even though those activities are not related to importation. In early 2011 many importers of alcohol products had to renew their five year activity/wholesale import licenses. This activity license was required in order to obtain an import license from the Ministry of Industry and Trade, which in turn was required to acquire excise stamps from the Federal Customs Service and secure a bank guarantee. Initially the Federal Service for Regulation of the Alcohol Market (FSR) would consider renewal applications only during the 18 days prior to expiration of the current license, raising concerns among industry participants that their licenses would expire. The direct and repeated intervention of the United States and EU during 2011 averted the expiration of any licenses, and the FSR has extended the period in which license holders can file for renewal. Nevertheless, delays in the process have forced some companies to draw down inventory; for others it has caused a disruption in imports. Furthermore, pursuant to the new CU licensing regime, importers must obtain an import license for each type of alcoholic product (a requirement previously applied only to imports of vodka, tequila, grappa, and pure ethyl alcohol) under what the industry asserts is a burdensome and time-consuming process. Cumulatively, U.S. industry estimates that Russia's regulations on importation of alcoholic products have

resulted in lost sales of up to \$60 million annually on U.S. exports. However, upon accession to the WTO, Russia will remove the requirement for an import license to import alcoholic beverages.

In a November 2006 bilateral agreement, the Russian government agreed to establish a streamlined import licensing system for the importation of goods containing encryption technology (encryption products) through the implementation of transparent, nondiscriminatory procedures. Among other elements, the Russian government agreed to allow the importation of many commercially-traded electronic goods containing encryption technology after a one-time notification, including, specifically, “mass market” goods, or in some cases, with the application of no licensing or notification requirements. While the new import licensing regime for encryption products introduced by the CU Commission on January 1, 2010 has somewhat eased the import process, leading U.S. technology companies assert that problems remain. The current system, they contend, impedes imports, delays the creation of an innovative and knowledge-based economy in Russia, and hampers the further development of research and development centers in Russia. The United States continues to work actively with the Russian government on its import licensing requirements for goods containing encryption technology in order to ensure the full implementation of the terms of the bilateral agreement. For example, in 2011, U.S. Government officials worked with Russia’s Federal Security Service to include the definition of “mass market goods” in the CU regulations’ list of products subject to a one-time notification. The United States will monitor implementation of the CU regulations closely.

Customs Issues, Taxes, and Tariffs

As noted above, on January 1, 2010, Russia, Kazakhstan, and Belarus adopted a CET. According to the WTO, in 2010, Russia’s simple average applied tariff rate was 9.5 percent. More specifically, agricultural exports to Russia faced an average applied tariff of 13.5 percent, while industrial and consumer goods exports to Russia faced an average applied rate of 8.9 percent. Import tariffs on automobiles and agricultural and construction equipment continued to present particular obstacles to U.S. exports to Russia in 2011. Tariffs on many of these items will decrease to five percent upon full implementation of Russia’s WTO commitments and when the other CU Parties adopt Russia’s bound tariff levels as the CET.

With the adoption of the CET, Russia can no longer unilaterally change tariff rates, but rather must submit proposed import tariff changes to the CU Commission for approval. In 2011, the CU Commission authorized increased import tariffs on 124 types of products. Products subject to tariff increases included continuous-action elevators and conveyors specially designed for underground use (from zero percent to 5 percent); liquid-filled radiators (from the *ad valorem* rate of 10 percent to a new specific tariff rate of €5 per piece); some drilling machines (from zero percent to the combined rate of 10 percent, but not less than €2.5 per kilogram); disc harrows, ordinary seeding machines and balers (from zero percent to 5 percent); sprayers and powder distributors designed to be mounted on or drawn by tractors, beet-topping machines and beet harvesters and other harvesting machinery (from zero percent to 5 percent); and other products.

Russia imposes excise taxes on a number of “luxury” goods, such as liquor and cigarettes, as well as passenger automobiles, motor fuel, and lubricants. Excise tax rates on cars are assessed by horsepower, with higher taxes for more powerful engines (above 150 horsepower). The excise tax rate for motor fuel depends on its ecological class. Excise tax rates for alcoholic beverages have increased significantly: in 2011, excise tax rates rose 10 percent on spirits of more than 9 percent ethyl alcohol. In 2012, the Russian government will change its excise tax for alcohol and set those excise tax rates on a half-yearly basis. As of January 1, 2012, excise tax rates on spirits of more than 9 percent ethyl alcohol will increase by an additional 10 percent. For spirits of 9 percent and less ethyl alcohol, excise tax rates increased 20.2 percent in 2011. They increased another 21 percent on January 1, 2012, and will increase again on July 1, 2012 by an additional 17.4 percent. The excise tax rates in 2011 for table wine, sparkling wine, and beer

rose 42.8 percent, 28.6 percent, and 11.1 percent, respectively, from 2010 levels. In 2012, those rates are set to rise further by 20 percent, 22.2 percent, and 20 percent, respectively, from 2011 levels. The rate on filter cigarettes will increase by 64 percent in 2013 compared to the 2011 level.

Customs authorities in Russia continue to assess duties on the royalty amounts for the domestic use of imported audiovisual materials, such as television master tapes. U.S. industry has complained that this practice represents a form of double taxation, since royalties are also subject to withholding, income, value-added, and remittance taxes. U.S. consumer goods companies have also reported that Russian Customs calculates customs duties based on a value that includes royalty payments made by the companies' Russian subsidiaries to their overseas parent companies for the use of parent company-owned product trademarks. U.S. companies contend this methodology leads to incorrect assessments.

Russian importers continue to report that Russian customs officials challenge declared import values. In these instances, customs officials cite reference prices contradicting the invoice valuation, and this practice results in the application of higher import values, and hence higher duty payments. U.S. Government officials have raised concerns about valuation practices with Russian Customs, and will monitor Russia's implementation of the WTO Agreement on Customs Valuation after Russia becomes a WTO Member.

U.S. industry also reports that Russia does not publish all regulations, judicial decisions, and administrative rulings of general application to customs matters. In addition, U.S. exporters report that customs enforcement varies by region and port of entry, and that frequent changes in regulations are unpredictable, adding to costs and delays at the border. In its WTO commitments, Russia has committed to publish all trade-related measures and implement notification, public comment, and other transparency requirements for a broad range of trade-related measures.

U.S. companies continue to face a wide array of other nontariff trade barriers when exporting to Russia. Russian nontariff barriers have been a topic of detailed discussions in Russia's WTO accession negotiations as well as in bilateral United States-Russia discussions.

Pharmaceuticals

Foreign pharmaceutical firms have concerns regarding implementation of data protection regulations that are being developed in connection with Russia's accession to the WTO and government calls to support development of a domestic pharmaceutical industry. In 2010, Russia passed amendments to the Law on the Circulation of Medicines that provide six years of regulatory data protection, but that protection will not come into effect until Russia becomes a WTO Member. Russian government officials have called for more local production of pharmaceuticals, including with foreign active ingredients and formulations. The government's long-term pharmaceutical industry development plan calls for Russian manufacturers to account for at least 50 percent of total sales (based on value) by 2020. A new federal law on the Fundamentals of Health Protection took effect on January 1, 2012. Although the law initially included a proposal to restrict communications between pharmaceutical and medical equipment companies with medical practitioners that would have disadvantaged new entrants into the Russian market, following a joint effort by industry and the U.S. Government, the draft legislation was amended to allow for a more balanced approach, permitting contact for informational and educational purposes.

Alcohol

In addition to the burdensome import licensing regime described above, importers of alcohol face a variety of other regulatory measures in the Russian Federation. A long-standing challenge faced by importers is the requirement that all customs duties, excise taxes, and value-added taxes on alcohol be

paid in advance using a bank guarantee and deposit. Because the actual amount of the duties and fees may not be known when the guarantees are obtained, the government of Russia has established fixed guarantee amounts. On occasion, these amounts exceed the final actual amounts due, especially for lower value products. In addition, industry has reported that refunds of these guarantees are sometimes delayed for as long as seven months. The advance payment requirement for duties and taxes, and the length of time the bank guarantee refund is held open, may limit trade volumes due to the amount of money that must be dedicated to these guarantees. In addition, in 2010 Russia adopted technical conditions governing warehousing of alcoholic products. U.S. industry representatives have voiced concerns that enforcement of these new regulations has resulted in inconsistencies and a lack of transparency in the review of applications, causing delays and the need for multiple re-applications for activity licenses, and in some cases threatened entire operations. The U.S. Government will continue to work with industry and the FSR in an effort to ensure that the regulations are applied in a transparent and predictable manner.

EXPORT POLICIES

Although Russia has eliminated export duties on a few products, it maintains export duties on 240 types of products for both revenue and policy purposes. For example, a variety of agricultural products are subject to export tariffs, such as certain fish products, oilseeds, fertilizers, and wood products. Russia has indicated that it intends to eliminate gradually most of these duties, except for products deemed as strategic, such as hydrocarbons and scrap metals.

In April 2011, the Russian government introduced a progressive scale of export duties on nickel that is linked to the London Metal Exchange nickel price. This floating rate replaced a flat 10 percent export duty. Russia has also announced plans to peg its export tariff for copper, currently fixed at 10 percent of the customs value of the metal, to London Metal Exchange prices. As part of its WTO accession, however, Russia agreed to eliminate export duties on nickel, copper and aluminum within four years of joining the WTO. During the transition period, Russia will establish export duties of 5 percent on nickel and 10 percent on copper, while reserving the right to introduce a 5 percent export duty on aluminum. Russia will cut export duties on ferrous waste and scrap from the lower of 15 percent or €15 per ton in the year of accession to 5 percent or €5 per ton over 5 years.

Historically, Russia's government has established high export duties on crude oil to encourage domestic refining. However, priority fields in Eastern Siberia and the Caspian Sea enjoy a significant discount on the crude oil export duty. In October 2011, the Russian government announced a new system of duties on oil exports that lowered export duties of crude oil from 65 percent to 60 percent and increased the export tax rate for heavy fuel oil and other refined products. Separately, the government maintains a 90 percent export duty on gasoline. These changes are intended to spur production by making it more profitable for oil exploration and extraction, to ensure adequate gasoline supplies to the Russian market, and to encourage the development of domestic refining capacity by raising the cost of exporting heavy fuel.

At the end of 2010, following intense negotiations with the EU, Russia agreed to postpone through 2011 a planned increase in export duties on raw timber from the current rate of 25 percent to 80 percent. Initially, the primary objective of the measure was to stimulate the development of a domestic wood processing industry and to encourage the export of sawn lumber and value-added wood products. The government has indicated that it will continue its moratorium on increasing export tariffs on coniferous logs and round wood in 2012. Upon accession to the WTO, Russia is expected to decrease export duties on timber to levels between 5 percent and 15 percent.

Severe drought and wild fires led to extensive crop damage in 2010, and on August 15, 2010, the government instituted a ban on all grain and flour exports. This ban was removed on July 1, 2011.

Russia also has burdensome procedures for obtaining export certificates for some items, including samples collected during research expeditions and raw data. Additionally, Russia has strict licenses to control the export of cultural goods, as well as precious stones and metals.

INTELLECTUAL PROPERTY RIGHTS PROTECTION

Russia remained on the Priority Watch List in the 2011 Special 301 Report. Key concerns cited included piracy on the Internet, the absence of Internet service provider (ISP) liability legislation, and enforcement generally. With respect to piracy over the Internet, significant gaps exist in Russian law enforcement efforts. This failure to protect intellectual property rights (IPR) creates obstacles to Russia's ability to keep pace with evolving technology.

In 2010, Russia implemented the legislative commitments of the November 2006 Agreement between the Government of the United States of America and the Government of the Russian Federation on Protection and Enforcement of Intellectual Property Rights (the 2006 IPR Agreement) by passing amendments to Russia's IP law, Part IV of the Civil Code, required to implement the TRIPS Agreement. These legislative changes included granting *ex officio* authority to Russian customs officials to enforce IPRs at the border in the new Law on Customs Regulation, and amending the Law on Circulation of Medicines to provide six years of regulatory data protection, which will become effective when Russia becomes a WTO Member. In the context of the Customs Union, Russia signed a CU agreement authorizing the creation of a Unified Customs Union IPR Register. The agreement establishes a procedure for registering trademarks as well as a framework for the customs authorities of each of the CU Parties to cooperate with each other, and with rights holders, on border enforcement.

Notwithstanding this progress, concerns remain over lack of action regarding the enforcement-related commitments in the 2006 IPR Agreement, in particular, the need for such actions as the imposition of criminal penalties to deter piracy and counterfeiting, and increased Internet-related IPR enforcement. While Russia met its 2006 IPR Agreement commitment to establish an accredited royalty collecting society for the Performers and Phonogram Producers category in 2008, U.S. industry has raised concerns regarding the transparency of how royalties are collected and distributed. The U.S. and Russian governments have an ongoing dialogue to obtain the full implementation of this agreement and to help ensure that Russia's legislation is consistent with international norms, as well as to generally promote strong IPR protection and enforcement in Russia.

In recent years, Russia's optical disc production capacity continued to exceed domestic demand, raising concerns regarding optical disc piracy. U.S. copyright industries estimate that approximately 65 percent of sound recordings on the Russian market are pirated, resulting in reported losses of nearly \$2 billion in 2009. However, legitimate DVD sales are on the rise, in part due to increased law enforcement action against pirates, including a 2008 ban on camcording in movie theaters, and a growing preference for high quality products. Within the copyright industry, the software sector has enjoyed the benefits of increased enforcement. The Business Software Alliance (BSA) estimated that from 2004 to 2010 the software piracy rate decreased in Russia from 87 percent to 65 percent, the steepest drop in that time period for any country in the world. According to BSA's Eighth Annual Global Software Piracy Study (published May 2011), the average piracy rate in Russia was 65 percent, just about the average rate for Eastern Europe.

Piracy over the Internet remains a serious and growing concern. Authorities have begun criminal investigations against operators of Russia-based websites. Notably, some progress has been made on the Interfilm Case. In 2009, Russia opened a criminal case against the administrators of interfilm.ru, a website offering pirated copies of movies before or immediately after they open in Russian theaters. Government investigators involved in the case estimate that the site had caused approximately 38.7 billion rubles (\$1.25 billion) in damages. In October 2011, charges were finally brought against the

administrators of the infringing file-sharing website and the criminal case was sent to the Office of Prosecutor General. The charges, following a lengthy investigation, mark Russia's first major Internet anti-piracy case focused on films. Western and Russian recording companies have won several civil suits against Internet pirates, although resulting damage awards have been minimal by U.S. standards. Gaps remain in Russian legal and enforcement efforts to address Internet piracy, particularly with respect to sound recordings and movies.

U.S. and multinational companies continue to report counterfeiting of trademarked goods, especially of consumer goods, distilled spirits, agricultural chemicals and biotechnology, and pharmaceuticals. In the past U.S. firms complained about "trademark squatting" by Russian enterprises attempting to appropriate well-known trademarks not active or registered in Russia. The number of such complaints has been declining, as some rights holders have been successful in countering trademark squatting schemes through the Russian court system or the Russian Federal Service for Intellectual Property (Rospatent). Nevertheless, some examples of trademark squatting are still present. Some of these cases arise when U.S. companies fail to duly register their trademarks in Russia in accordance with Russian legislation prior to entering the market and/or doing business in the country.

Enforcement

Weak enforcement of IPR in the Russian Federation is a continuing problem. In the November 2006 IPR Agreement, Russia agreed to improve IPR enforcement while the United States agreed to step up IPR training programs and technical assistance for Russian customs and law enforcement officials. In 2011, the U.S. Patent and Trademark Office conducted several IPR training programs for Russian police, investigators, prosecutors, judges, and customs officials, and trained approximately 180 Russian law enforcement officials. These training and capacity building programs were primarily focused on copyright enforcement in the digital environment and Internet piracy. Additional training programs are planned for 2012.

In 2011, Russian law enforcement agencies continued to carry out raids on optical disc production facilities suspected of engaging in pirate activities, including major raids in Moscow and surrounding regions. However, many surprise raids are not fully effective as the details of pending raids are often leaked to the optical disc plant in advance. Russian police continue to carry out end-user raids against businesses using pirated products. However, non-governmental organizations report that police have used IPR enforcement as a bullying tactic to elicit bribes or harass them. For the copyright industry, key enforcement goals include the introduction and enforcement of ISP liability legislation in Russia, improved oversight and transparency of collecting societies, a crackdown on illegal websites, such as allofmp3.com clones, and enhanced measures against online social networks, such as vKontakte and Odnoklassniki, that facilitate Internet piracy.

As part of the presidential initiative to liberalize Russian criminal law and decriminalize some "white-collar" crimes, the Russian government proposed an increase in criminal copyright infringement thresholds in June 2011. In essence, the relevant amendment to Russia's Criminal Code proposed a five-fold increase (from 50,000 rubles to 250,000 rubles) to the threshold for initiating criminal actions against copyright infringement. This amendment raised serious concerns among copyright intensive industries about a likely decrease in overall criminal enforcement in Russia. However, after hearing industry concerns, the relevant State Duma committee revised the threshold constituting a "large scale crime" to just 100,000 rubles (approximately \$3,400). On December 7, 2011, the bill introducing the amendment with the 100,000 ruble threshold level was signed into law.

The Supreme Arbitration Court addressed the issue of civil IPR enforcement by submitting to the Duma in 2010 a draft law that would create a specialized intellectual property rights court. In November 2011,

the bill passed the final reading in the Duma and was approved by the Federation Council. Once it is signed into law, Russia's first-ever specialized IPR court could begin its work as early as 2013. The creation of a specialized IPR court would have a positive impact on civil IPR enforcement in Russia. The court's judges would come from within the arbitration court system and have expertise in intellectual property rights cases. In an effort to address this proposed initiative, the U.S. Patent and Trademark Office organized and conducted a "study tour" in the United States for Russia's Judiciary in November 2011, during which a cadre of judges engaged in a series of high-level consultations with select judges in the United States. The program focused on the practical challenges in adjudicating IP cases and included discussions on the role of specialized IP courts. It also provided an opportunity to exchange views and share best practices in adjudicating IP disputes.

Domain Names

In September 2011, the Russian Coordination Center of the National Internet Domain (the Coordination Center) issued an updated version of the "Regulations for Domain Names Registration in .RU and .PФ domains," effective November 11, 2011. This step was taken in an effort to harmonize the procedure for national domain registration in both .RU and .PФ domains. Having entered into force, these regulations have lifted a number of restrictions imposed in the previous versions, such as the former restriction on non-Russian residents from registering domain names in the .PФ domain. Currently, not only Russian citizens and businesses registered in the country (as was the case with the second stage of the registration for Cyrillic domain names, November 11, 2010, to November 10, 2011), but also non-Russian residents are able to purchase .PФ domain names.

The new Regulations provide that the domain name registrar has no right independently to make decisions regarding third party claims related to domain names (including those involving trademarks, brand names, etc.), and suggest rights holders file a claim with the administrator of the domain, or file a corresponding legal statement in court. The Regulations do not give any further clarification on the possible settlement of IPR-related disputes within this field, or provide for any procedure to be undertaken in case of an IPR violation. However, in order to prevent possible infringement of intellectual property rights, the registrant is recommended to ensure prior to filing a registration application that the domain name submitted for registration is not similar to any existing trademark or other object of intellectual property.

To date, the Coordination Center has registered over 930,000 domain names in the .PФ domain, which constitutes nearly a five-fold increase since the second stage of the registration for Cyrillic domain names began.

SERVICES BARRIERS

Russia's services market is relatively open to U.S. services suppliers, including in areas such as financial services, education, legal services, and distribution, although specific problems remain in particular areas. The ability to provide services to public utilities and certain energy-related services remains limited (*see the discussion on energy in the section on Investment Barriers*). The process for an individual or a company to obtain a license to provide a service remains difficult, and limitations on the form of commercial establishment affect some sectors.

Financial Services and Insurance

The 1996 federal law "On Banks and Banking Activity" permits foreign banks to establish subsidiaries in Russia. However, foreign banks are not allowed to establish branches in Russia. There is no cap on foreign charter capital in the banking sector.

In the insurance sector, Russia allows foreign firms to establish subsidiaries but not branches. Insurance firms are individually subject to a cap of 49 percent foreign capital. Additionally, there is a 25 percent quota on the aggregate share of foreign capital in the insurance sector. The sector reached this maximum for a short period early in 2011, but near the end of 2011 foreign capital fell back to under 25 percent.

Russia's membership in the WTO will provide increased market access to foreign insurance companies, including 100 percent foreign ownership of non-life insurance companies upon accession. Limits on the number of life insurance licenses granted to foreign insurance firms, as well as foreign participation in a small number of mandatory insurance lines will be phased out five years from the date of accession. Russia will allow foreign insurance companies to open direct branches for life and non-life insurance, reinsurance, and services auxiliary to insurance nine years from the date of its accession.

Telecommunications

Many in the telecommunications industry criticize the lack of transparency in the licensing process in Russia, as well as the five year to ten year license validity period, which they argue does not allow sufficient time to recoup investments. The scarcity of civilian frequencies has led to competition among Russian mobile operators and impeded the development of new wireless networks in Russia, such as 4G and WiMAX. (Reportedly, only about 20 percent of Russia's assigned communication frequencies are used for civilian purposes, while 80 percent are reserved for military use.) The government of Russia's efforts to free up and allocate spectrum in order to spur the development of advanced telecommunications are in their initial stages and proceeding slowly. Although Rostelecom, a state-owned telecommunications operator, initially won 39 of the 40 licenses for frequencies at 2.3 gigahertz (GHz) to 2.4 GHz in February and March 2010, according to press reports, in November 2011, Rostelecom received all the required approvals from the Ministry of Defense for these frequencies. In September 2011, the State Commission on Radio Frequencies decided to license 4G networks using Long Term Evolution (LTE) technology. According to the draft resolution, the first stage of 4G LTE networks will be developed in the frequency bands of 791 megahertz (MHz) to 862MHz and 2.5 GHz to 2.7GHz. Originally scheduled to take place in the first quarter of 2012, the nationwide frequency tenders for 4G LTE networks have reportedly been postponed and will most likely be held no earlier than the second quarter of 2012, following the Russian presidential elections in March 2012. Reportedly, Yota, and Osnova Telecom, associated with the Ministry of Defense, were authorized to launch 4G LTE networks in Russia without competition. Yota was awarded LTE-compatible frequencies in 2010, but not allowed to use them until September of this year. In December, Yota launched the first 4G LTE network in Novosibirsk though it is still in testing stages. While there have been a number of back and forth actions during the course of 2011, the terms and conditions for allocation of 4G mobile spectrum in Russia remain unclear, hampering investment in the sector.

In May 2010, Russia issued Directive No. 858 tasking Russia's Ministry of Industry and Trade with developing parameters for telecommunications equipment to ensure that all telecommunications equipment sold in the Russian market was manufactured within the territory of Russia. Such mandates are consistent with Russia's broad industrial policy of requiring companies to localize their production and use local suppliers. Currently, the amount of Russian-produced telecommunication equipment is quite limited, and many sectors and consumers continue to rely on imported products.

In August 2011, the Ministry of Economic Development and the Ministry of Industry and Trade set the parameters determining what constitutes domestic telecommunications equipment. The level of production localization in Russia was set as the main parameter. The localization level depends on the scope of the research activities and technological operations carried out in Russia. For different types of equipment, the localization level varies from 60 percent to 70 percent. Moreover, a company

manufacturing telecommunications equipment needs to be a Russian resident with no less than 50 percent owned by the Russian party. Also, the manufacturer needs to have legal rights for technologies and software, possess its own production base, manufacture printing boards, and carry out final assembly of the telecommunications equipment in Russia. Relaxing Russia's often stringent localization requirements in select sectors of the Russian economy was a key point of discussion in its WTO accession negotiations.

Companies in the satellite industry state that there is a lack of transparency in the licensing process for obtaining access to a foreign satellite and that the process itself is overly burdensome. Further, they claim that some of the legal requirements and administrative responsibilities associated with the provision of satellite services appear to be discriminatory, with the Russian government granting a preference for Russian satellite communications systems.

In order to promote GLONASS, the Russian satellite navigation system, the government of Russia has been considering a 25 percent import tariff on equipment that does not have the capability to receive signals from the Russian GLONASS system, while imported dual or multi-system receivers would enter with no tariff. However, no official decision has yet been made whether to impose such a tariff (as noted above, a tariff increase would have to be approved by the CU, not just Russia). Exporters of satellite navigation systems to Russia may also face market restrictions as a result of government regulations requiring the installation of GLONASS-compatible systems in certain vehicles. The U.S. government will monitor Russia's actions to support GLONASS to ensure compliance with its WTO commitments under the Technical Barriers to Trade Agreement.

INVESTMENT BARRIERS

Russia's foreign investment regulations and notification requirements can be confusing and contradictory, which has an adverse effect on foreign investment. The Russian government has made improving Russia's investment climate a priority, but U.S. investors and others continue to cite corruption in commercial and bureaucratic transactions as a barrier to investment. An Anti-Corruption Council was created in the summer of 2008 and significant anticorruption legislation was passed in May 2011. However, little progress has been made on implementation.

Telecommunications and media services companies report specific investment restrictions. Article 19 of the Mass Media Law (last amended on November 10, 2011) limits foreign investment in the broadcast business by foreign entities, Russian entities that are more than 50 percent foreign-owned, and Russian citizens holding dual citizenship. The Law also prevents foreigners, stateless citizens, and Russian legal entities that are more than 50 percent foreign-owned from establishing television companies and owning shares in television broadcasting companies that broadcast to more than half of Russia's regions or have a potential audience of over half the nation's population. Even tighter investment restrictions have recently been imposed on security firms. As of January 1, 2010, the Law on Private Detective and Security Activities in the Russian Federation prohibits the participation of any foreign capital in a private security operation. The U.S. Government will monitor Russia's investment restrictions to ensure compliance with its WTO commitments to open its services market.

Further obstacles to investment in Russia include inadequate dispute resolution mechanisms, weak protection of minority stockholder rights, the absence of requirements for all companies and banks to adhere to accounting standards consistent with international norms, and the absence of sufficient government incentives to adopt and adhere to business codes of conduct. Initiatives to address these shortcomings, through regulation, administrative reform, or government-sponsored voluntary codes of conduct, have made little progress. In July 2010, Russia passed the Law on Consolidated Financial Accounting which requires that, as of 2011, credit, insurance organizations, and other publicly traded companies prepare their consolidated financial accounting in accordance with international financial

reporting standards. In 2011, Russia took a number of technical steps towards ensuring effective implementation and enforcement of the law. Inadequate transparency in the implementation of customs, taxation, licensing, and other administrative regulations also discourages investment.

National Treatment

Telecommunications and media services companies report specific investment restrictions. Article 19 of the Mass Media Law (amended on November 10, 2011) limits foreign investment in the broadcast business by foreign entities, Russian entities that are more than 50 percent foreign-owned, and Russian citizens holding dual citizenship. The Law also prevents foreigners, stateless citizens, and Russian legal entities that are more than 50 percent foreign-owned from establishing television companies and owning shares in TV broadcasting companies that broadcast to more than half of Russia's regions or have a potential audience of over half the nation's population.

Even tighter investment restrictions have recently been imposed on security firms. As of January 1, 2010, the Law on Private Detective and Security Activities in the Russian Federation prohibits the participation of any foreign capital in a private security operation. The U.S. Government will monitor Russia's investment restrictions to ensure compliance with its WTO commitments to open its services market.

The 1999 Investment Law is, in many ways, consistent with the principles of national treatment for foreign investors. Accordingly, the law provides foreign investors the right to purchase securities, transfer property rights, pursue rights in Russian courts, repatriate funds abroad after payment of duties and taxes, and receive compensation for nationalizations or illegal acts of Russian government bodies. However, the law also states that federal law may provide for a number of exceptions, including, where necessary, "the protection of the constitution, public morals and health, and the rights and lawful interest of other persons and the defense of the state." These broadly defined exceptions give the Russian government considerable discretion in prohibiting or inhibiting foreign investment in a discriminatory fashion. The Investment Law includes a "grandfather clause" that stipulates that existing (as of 1999) "priority" foreign investment projects with foreign participation of over 25 percent be protected from unforeseeable changes in the tax regime or new limitations on foreign investment. The law defines "priority" projects as those with a foreign charter capital of more than \$4.1 million and with a total investment of more than \$41 million. However, the lack of corresponding tax and customs regulations means that any protection afforded investors by this clause is, at most, very limited.

The government enacted the Strategic Sectors Law (SSL) in May 2008. The SSL introduces a list of 42 "strategic" sectors in which purchases of "controlling interests" by foreign investors must be preapproved by Russia's Commission on Control of Foreign Investment. Many observers have criticized the SSL for being overly broad in the number of sectors it covers, and raised concerns regarding the approval process. During 2010, Russian government officials, including Prime Minister Putin, called for further liberalization and streamlining of the law. On November 1, 2011, the State Duma approved amendments to the SSL that simplify the review process, exclude some activities from the list of strategic operations and eliminate certain administrative barriers for foreign investors in the food industry and the "strategic" natural resources sector. The amendments also exempt from government review investment deals where international organizations, such as European Bank for Reconstruction and Development and the International Finance Corporation, are the investor. Additionally, the SSL will no longer be applied to transactions between organizations under the control of Russian citizens who are also Russian tax residents (except for Russia's citizens who have dual citizenship).

According to Russian officials, the Government Commission on Control of Foreign Investment has approved 128 of 136 applications for foreign investment since its creation in 2008. However, the majority of the approved transactions actually involved Russian investors using foreign offshore holding

companies. Public information was available on the following foreign companies that received approval under the SSL: French Alstom (manufacturing); Canada's Kupol Ventures (mining); Cyprus' Omirico (port facilities); France's TOTAL (liquid natural gas); and France's Atos (services for the 2014 Olympics and 2018 World Cup).

Privatization

The Russian government is pursuing steps to privatize state assets, both to increase market forces in the economy and to raise revenue for the federal budget. Separate from the SSL, the government maintains a list of state companies that cannot be privatized due to their national significance. Over the last two years, the list of such companies has been reduced from 438 to 196, allowing for the privatization of hundreds of previously restricted enterprises. On August 3, 2011, an expanded privatization plan was approved through 2017 that the Ministry of Economic Development expects will lead to the sale of roughly \$10 billion in shares per year. The government of Russia will retain controlling stakes in major Russian companies such as Rosneft, Transneft, the Federal Grid Company, Russia Railways, and banking giants Sberbank and VTB. Moreover, in some of the companies to be fully privatized, the state will keep what is referred to as a "golden share," a nominal holding that allows the state to retain certain veto powers.

Privatization efforts have stalled, however, due to internal resistance, concerns over market valuation, and high oil prices, which have reduced the government's need to raise additional revenue. The government's previous privatization plan is behind schedule; only 10 percent of the companies scheduled to be privatized in 2010 were actually sold.

Taxes

Companies report that VAT refunds to Russia-based exporters, which should be provided within three months of a claim's submission, often do not occur on time, with customs and tax authorities applying a number of burdensome additional requirements. In addition, leasing companies find that VAT assessed on inputs to exported final products is often not refunded at all, for a number of reasons. In some cases, local tax inspectorates have initiated audits and attempted to seize bank accounts of the leasing companies, thus forcing exporters to seek very expensive and time-consuming court enforcement. In fact, anecdotal reports from a variety of Russian and U.S. companies indicate that in many cases, companies have to resort to court action to receive their VAT reimbursements. VAT refunds on exports are also the source of significant fraud, making it even more difficult for legitimate exporters to obtain refunds.

U.S. companies have also raised concerns about Russian tax authorities' scrutiny of payments that cross Russia's border, but remain within the structure of the same legal entity. This tax issue has arisen chiefly in two contexts: (1) when a multinational company transfers an employee temporarily to the company's Russian office from another office outside Russia; and (2) in intra-company payments for the use of intellectual property. Under internationally accepted accounting standards, these normal business practices are handled as an intra-firm payment from one office to the other, or to the headquarters in the case of royalty payments. However, tax inspectors have in the past disputed such expenses as "economically unjustified" and, consequently, not permissible under the Russian Tax Code. In consultation with foreign firms, Russia developed and adopted a new Law on Transfer Pricing that took effect on January 1, 2012. While certain provisions of the new law show promise, having been drafted in accordance with OECD principles, some experts warn that other provisions may lead to additional disputes with tax authorities. Ultimately, the new law's impact will depend on its implementation.

Energy Sector

The Strategic Sectors Law and Russian subsoil legislation require government approval for foreign investment in excess of 10 percent in companies operating subsoil plots of “federal significance,” as well as for foreign investment in excess of five percent if the target company is state-owned. “Federal significance” is defined as oil fields with 510 million barrels or more of reserves and natural gas fields with 1.8 trillion cubic feet or more. An amendment that takes effect starting in 2012 will raise the foreign investment threshold for non-state companies from 10 percent to 25 percent.

In addition, subsoil legislation limits the licensing of strategic fields located on the continental shelf to Russian legal entities at least 50 percent controlled by the Russian government and with at least five years of experience in the development of fields on the continental shelf. Foreign companies may participate in shelf projects as a minority partner.

Automotive Sector

Russia has maintained an investment incentive regime in the automotive sector since 2005 with domestic content requirements and production targets. In 2011, Russia added a second program that imposes conditions that are more stringent and required much higher domestic production volumes (300,000/350,000 units as compared with 25,000 units) under the original program for each manufacturer. The second program, however, alters the approach to the domestic content requirement. Under the regime that went into effect in 2011, automobile producers in Russia that manufacture motor vehicles whose ex-factory value results from a specified percentage of domestic inputs, *e.g.*, labor, overhead expenses, domestic components, and meet certain annual production levels, may import certain automotive parts duty free. As part of its WTO accession, Russia agreed to limit the WTO-inconsistent elements of these programs (the requirements to use domestically produced goods) and to end the WTO-inconsistent elements of both programs by July 1, 2018.

ELECTRONIC COMMERCE

Electronic commerce is growing rapidly in Russia, and was estimated at \$20 billion in 2010. The volume of online commerce is expected to exceed \$25 billion by 2012. The tax aspects of electronic commerce are virtually unexplored, and this area of the law is still developing.

The new Law on Electronic Signatures came into force on April 8, 2011, and has the potential to transform electronic commerce and information management in Russia. The law should considerably widen the sphere of application of electronic signatures, and envisages that foreign electronic signatures will also be valid. The law states that electronic documents signed by electronic signatures will have the same legal effect as paper documents signed by hand, provided that in case of simple electronic signatures and advanced signatures the parties have explicitly agreed to it or the use of electronic signatures is provided for by Russian law.