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Navigating The Minefields of Russian Joint Venture Law and Tax Regulations: A Procedural Compass

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Abstract

In this Article, Professor Osakwe explores the precarious field of Russian joint venture law and tax regulation. The author gives detailed accounts of the major laws, discusses their evolution, and projects their future course. Additionally, the author notes the continuing influence of USSR law on current Russian joint venture practice. Throughout his analysis, the author provides specific and pragmatic advice for businesses and entrepreneurs considering joint ventures in Russia.

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I. MODERN RUSSIAN JOINT VENTURE LAW AS A LEGACY OF *PERESTROIKA*

Gorbachev's *perestroika*[1] ended one tragedy but began another. It created a bridge between two abysses so fathomless and dark that one can scarcely write about it without getting sucked into the two adjoining whirlpools. Born amidst the despair of Soviet communism, this short-lived experiment in social engineering was a burst of righteous indignation against an obsolete economic order and an outmoded political ideology. It fervently expressed faith in a new market system. The most unfortunate thing about *perestroika* is not that it failed. After all, one could argue that its demise cannot be described as a failure because it was never really intended to be a success. Rather, the saddest legacy of *perestroika* is that its spontaneous demise ushered in a new tragedy which, for purposes of this Article, will be referred to as Yeltsin's *nerazbirikha*.[2]

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1. Its architect explains the thrust of the reform program of *perestroika* in MIKHAIL GORBACHEV, PERESTROIKA: NEW THINKING FOR OUR COUNTRY AND THE WORLD (1987). A distillation of the cardinal principles of this policy may be found in Christopher Osakwe, *The Death of Ideology in Soviet Foreign Investment Policy: A Clinical Examination of the Soviet Joint Venture Law of 1987*, 22 VAND. J. TRANSNAT'L L. 1, 5-12 (1989).

2. The Russian term *nerazbirikha* roughly means confusion or muddle. It refers to Yeltsin's indecision as to whether or not he should fully embrace free-market principles. His administration's vacillation over major economic reform legislation that has been handed down since he came to power reflects this indecision. The typical scenario is as follows: Russia adopts a new law which takes one bold step forward; a few months later they repeal or substantially modify that same law with amendments that take two timid steps backwards. This creates absolute confusion in the marketplace. Another manifestation of this indecision is that Yeltsin's privatization program is running far behind schedule. Thus, for example, "[m]ore than four months into the year, the [Russian] government has managed to turn over to private entrepreneurs, worker collectives and management teams only 5% of the $720 million worth of the state holdings scheduled for sale this year." *See* Michael Parks, *Russian Privatization Far Behind Schedule*, L.A. TIMES, May 22, 1992, at A16. The new law on minerals offers a more dramatic illustration of the instability of Russian law. Russia adopted this law on February 21, 1992. It went into effect on the same date, see 16 VED. S'EZDA NAR. DEP. RF Items 834, 185 (1992), and was subjected to its first amendments on June 26, 1992. *See* Law of the Russian Federation No. 3134-1, *On the Incorporation of Amendments and Additions to the Law of the Russian Federation 'On Minerals,'* ROSSIKAYA GAZETA, Sept. 8, 1992, at 6. The text of the June amendments differed from the drafts of the proposed amendments that were published on May 18, 1992. *See* 23 VED. S'EZDA NAR. DEP. RF Item 1249 (1992). If Russian law had a tort of misgovernment, the current situation in Russian joint venture law would have qualified. Notwithstanding this *nerazbirikha*, however, the number of newly established joint ventures in Russia continues to grow at a

The international community celebrated *perestroika* for its modernism and its restless experimentation with new laws and economic principles. The abrupt demise of inherited beliefs created a vacuum in which old inhibitions vanished and forbidden thoughts and feelings surfaced. Under *perestroika* many new economic and social institutions emerged to form a virtual laboratory for Yeltsin's reforms. Yeltsin's reform program has aspirations similar to those of *perestroika*: it seeks to privatize the economy, westernize its business laws, and lift all legal restrictions to foreign investment. Unfortunately, however, like *perestroika*, inexperienced henchmen, operating without a game plan and lacking the spirit to swim against the popular tides, plague Yetsin's reform efforts. Consequently, the whim of the citizens often impedes components of this program that would yield beneficial results if allowed to operate for a longer period of time.

Under this new tragedy, the modernity that so excites the citizens of Russia has aroused their anxiety as well. Russian citizens have begun to shrink from the sudden modernization of their society and the accelerated tempo of change. For these cheerless souls, the new tragedy seems like a lapse into utter confusion rather than a healthy restoration of sound values. Change overwhelmed the people, and they have begun to seek psychic relief from the stress which, most astonishingly, they seem to find in their oblivion to Yeltsin's totalitarian politics.[3]

Post-*perestroika* Soviet society packs its strains and stresses with formidable Slavic density and weight into modern Russian joint venture law.[4] Like Yeltsin's *nerazbirikha*, this law is replete with good intention but it lacks good design. The joint venture law prevents stability. It is artificial. At best, it is fashionable and driven by the need to placate the

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rapid rate. This can only be explained by the attractiveness of the Russian market to foreign investors.

3. Despite his enormous popularity as a political leader of his country, some seriously doubt President Yeltsin's deep commitments to democratic principles. A recent report indicates that President Yeltsin is "frustrated by the slowness of Russia's political and economic reforms" and is seeking a national referendum that would grant him "unlimited powers in a "vote of trust" that would allow him to suspend the elected parliament as well as grant him "the authority to implement by decree all the fundamental reforms that he says are now blocked by conservative lawmakers." *See* Michael Parks, *Rally Calls for Giving Yeltsin 'Vote of Trust,'* L.A. TIMES, April 20, 1992, at 1.

4. This Article uses the term "modern Russian joint venture law" interchangeably with the term "post-*perestroika* Russian joint venture law" to refer to the new body of joint venture law put in place in the Russian Federation after the demise of the Soviet federal state on December 25, 1991. Section 11 discusses the gradual process of assembling this new law, which predates the disintegration of the USSR. A detailed analysis of the old USSR joint venture law may be found in Osakwe, *supra* note 1.

citizens. It can always be challenged and superseded.[5] This law changes in the direction in which the political wind blows. Good design, on the other hand, lasts through the ages. At the present time, it appears that the Russian legislature has neither the luxury of time nor the experience of patience to design a stable law for the evolving Russian Federation marketplace.

Every participant in any commercial transaction in the new Russian marketplace must live with this painful reality. However, this new reality differs from the problems that plagued Soviet joint venture law during the *perestroika* period.[6] To a remarkable extent, Yeltsin's reforms have avoided many of the hazards of pre-*perestroika* Soviet joint venture.[7] Modern Russian joint venture law may eventually overcome all of its present problems. Joint ventures have become a permanent fixture in the economic landscape of Russia.[8] The rate at which joint ventures are

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5. The law on privatization represents a good example of the zigzag development of modern Russian law. Russia promulgated the first comprehensive law on privatization on July 3, 1991. *See* Law of the Russian Soviet Federated Socialist Republic (RSFSR), *On the Privatization of State and Municipal Enterprises in the RSFSR*, VEDOMOSTI RSFSR Issue No. 27, Item No. 927 (1991) [hereinafter VED. S'EZDA NAR. DEP. RF]. On June 5, 1992, Russia amended more than 80 percent of the original privatization law of July 3, 1992. *See* Law of the Russian Federation, *On Amendments and Additions to the Law of the Russian Federation 'On the Privatization of State and Municipal Enterprises in the RSFSR,'* ROSSISKAYA GAZETA, July 3, 1992, at 3. Just before the June 5, 1992 amendment settled down, the President of the Russian Federation promulgated a new decree that preempted the law of July 3, 1991 as amended on June 25, 1992. This decree unveiled a brand new law on privatization. *See* Statute, *On the Commercialization of State Enterprises to be Converted into Joint Stock Companies of the Open Type*, ROSSISKAYA GAZETA, July 7, 1992, at 4.

6. The legal defects in the Soviet joint venture law of the period between 1985 and 1991 are discussed in great detail in Osakwe, *supra* note 1, at 26-50, 96-100.

7. In an earlier article I suggested ways in which the structural defects in Soviet joint venture law could be remedied. *Id.* at 100-08. Practically all of my recommendations have been incorporated into post-1991 Russian joint venture law.

8. Reports of newly registered international joint ventures in Russia have been quite good. Thus, for example, for the period between March 4-24, 1992, a total of 28 new international joint ventures were registered in the Russian Federation. The capital for all of these 27 joint ventures totaled 43.1 million rubles, using the Russian Central Bank exchange rate (then in effect) of $1.00 = 100 rubles. The single largest of these was the U.S.-Russian joint venture "Surgut Development" which had a charter capital of ten million rubles. *See New Firms with Foreign Participation*, KOMMERSANT, March 23-30, 1992, at 4. During this same period, Russia formed twelve newly registered wholly owned subsidiaries of foreign companies. Of these twelve, eleven were subsidiaries of United States companies. *Id.*

Between June 28 and July 3, 1992, a similar report noted that the Russian Federation registered 20 new international joint ventures with a total capital of 110.8 million rubles.

established in Russia has grown steadily since 1991.[9] Things can only get better from this point on.

Against this backdrop, any United States corporation or entrepreneur that wishes to sail in the uncharted waters of Russian joint venture law and practice must bear in mind the following navigational commandments: be prepared to adjust your business operations to conform with sudden changes in Russian law;[10] expect to encounter local and regional

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The spheres of activities of these new joint ventures ranged from agricultural production, construction, manufacture of construction materials, to electronics. The 20 foreign partners in these joint ventures included companies from the United States (3), Canada (2), Italy (2), India (1), South Korea (1), Republic of China (1), Poland (1), Estonia (1). This number includes one joint venturė with foreign participants—a joint venture between All AG of Switzerland and Texilkroan Gimblt of Germany called All General Services Ltd. with a capital of 9 million rubles. *See New Firms with Foreign Participation*, KOMMERSANT, June 29-July 6, 1992, at 4.

By way of a comparison, the report for June 9-17, 1992 noted 14 registered Russian new joint ventures with foreign participation during this period. The amount of foreign investment in these fourteen new ventures totaled 3.38 billion rubles. Of this amount just one U.S.-Russian joint venture, "White Nights," accounted for 3.357 billion rubles. *See New Firms with Foreign Participation*, KOMMERSANT, June 15-22, 1992, at 4.

9. At the end of 1991, official figures placed the number of international joint ventures at 3,000; foreign participants in these joint ventures came from 70 countries; the total capital fund of these joint ventures exceeded 6 billion rubles, out of which sum more than 2 billion rubles were foreign capital investment. *See Vystavki i Iamarki: Sovmestnye Predpriiatia '92,* 27 VNESH. TORG. 4-5 (1992) [*Exhibitions and Trade Fairs: Joint Ventures '92*] . This same survey showed, however, that only one-third of these joint ventures were engaged in the production of goods. All the others were providing services, including brokerage operations. *Id.*

10. The government reacts to new problems or crisis situations by making these sudden changes in Russian law. Sometimes government makes temporary changes just to cope with a given situation. At other times, these changes become permanent. One example of a very sudden change in Russian business law is a decree of the President of the Russian Federation that was aimed at reducing cash transactions in Russia. The President believed that many enterprises were not paying taxes and were making it difficult for the banks to monitor their tax evasion activities by refusing to make payments through bank transfers. To combat this problem, the President issued a decree limiting the amount of cash transactions and requiring all transactions in excess of a stipulated amount to be made through bank transfers. *See* Decree of the President of the Russian Federation, *On Additional Measures Aimed at Limiting Cash Transactions*, Law of June 14, 1992, ROSSISKAYA GAZETA, June 15, 1992, at 2.

During the same month, the President of the Russian Federation perceived another problem in the Russian marketplace, i.e., the government was not earning enough hard currency from foreign trade transactions because many of these transactions were carried out in rubles. To respond to the crisis, the President issued a decree requiring all payments and accounting in all foreign trade transactions to be collected in hard currency. *See* Decree of the President of the Russian Federation, *On Payment-Accounting Proce-*

variations in Russian law; be prepared to operate within the gray zones of the law; retain the services of competent legal counsel, preferably Western counsel; select a form of business organization that involves the sharing of your investment risks with a local partner; expect to encounter a substantial disparity between the laws on the books and the law in action; negotiate the best tax concessions possible from all levels of tax authorities, and if that fails to lower your tax burden, resort to artful bookkeeping and creative tax planning; be forewarned that a contract signed with the central government authority may be frustrated by legal impediments of regional or local government authorities;[11] always have a

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dures in Foreign Economic Relations of the Russian Federation in 1992, Law of June 12, 1992, VED. S'EZDA NAR. DEP. RF, Issue No. 25, Item No. 1411 (1992).

Perhaps the best known example of a sudden reactive change in Russian governmental regulation of the marketplace is the law of June 14, 1992, which required all enterprises to sell a fixed portion of their hard currency export earnings to the government at an exchange rate to be determined by the state. Russia intended this fiscal measure, discussed in detail in Part VII of this Article, to remain in effect and during the 1992 fiscal year.

11. A local government authority can frustrate a foreign investor's aspirations in Russia, as painfully dramatized by the French Company ELF Aquitaine situation. Russia granted the first oil concession since 1917 in February 1992 to a joint venture (Interneft) in which ELF Aquitaine is the foreign partner. Other partners in the joint stock company include the regional governments of Volgograd and Saratov. As of late June 1992, the joint venture had not commenced operations under the concession simply because the regional authorities of Volgograd and Saratov had placed stumbling blocks in its path. The central government of Russia granted the concession by which the joint venture received the exclusive right to explore for and drill oil in the mineral land stipulated in the concession on the condition of production sharing, i.e., sharing the extracted oil between the joint venture and the central Russian government. Notwithstanding the fact that the joint venture had in its possession the concession from the Russian central government and a decree of the President of Russia expressing his approval of the concession, operations on the concession cannot proceed until the Supreme Soviet of the Russian Federation ratifies the concession. The Supreme Soviet of the Russian Federation cannot commence ratification proceedings until the respective ministries and departments of the Russian central government can scrutinize and approve the concession. In turn, the ministries and departments of the Russian central government are saying no statutory authority exists for the concession granted to Interneft because such concession can only be authorized by the passage of four new laws, i.e., the laws on foreign investment in Russia, on minerals, on oil and gas, and on concessions. The first two of these laws have been adopted. *See* Law of the Russian Federation of July 4, 1991, *On Foreign Investment in the Russian Federation*, VED. S'EZDA NAR. DEP. RF, Issue No. 29, Item No. 1008 (1991); Law of the Russian Federation of February 21, 1992, VED. S'EZDA NAR. DEP. RF, Issue No. 16, Item No. 834 (1992). The latter two have not. The officials of the respective ministries and departments of the Russian central government all agreed that the Interneft concession could be approved without these latter laws if all parties treat the concession as a ground-breaking precedent. That put the ball back in the

contingency plan just in case the political authorities decide to interfere with a contract that you have just signed with a Russian party;[12] take

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court of the regional government authorities of Volgograd and Saratov. As of late June 1992, the regional governments of Volgograd and Saratov stated that even though they are parties to the joint venture (Interneft), they had doubts as to the propriety "of allowing foreigners into our land." The regional government claims that the official reason for withholding their approval of the concession is that they are gravely "concerned about the undesirable ecological consequences of oil exploration" in their territory. ELF Aquitaine reportedly plans to spend $500 million on oil exploration under this concession. If ELF Aquitaine finds no oil, it will have to absorb these up-front costs. But, if the French company finds oil, it plans to invest an amount in the range of $2-4 billion into this project. *See Bor'ba za Neft': Elf Aquitaine ne Berut v Razvedki,* KOMMERSANT, June 15-22, 1992, at 9 [*The Battle for Oil: Elf Aquitaine is Not Accepted for Exploration*]. It should be noted that a concession similar to the one granted to Interneft in Russia was granted to Chevron in Kazakhstan. The latter concession is experiencing smoother sailing with Kazakh law and better cooperation with all levels of governmental authorities in the Kazakh Republic. *See* Michael Parrish, *Chevron to Pump Billions into Tengiz,* L.A. TIMES, May 19, 1992, at D3.

12. A troubling phenomenon in modern Russian joint venture law is the instability of contracts. Typically, if a Russian party is unhappy with a contract that it has just signed it will trigger a process that would enable Russian political authorities to interfere with the contract in flagrant disregard for the entrenched principle of sanctity of contracts under Russian law. The situation in which a German pharmaceutical company recently found itself best illustrates this new trend in Russian contract practice. On May 25, 1991, the Ministry of Health of the Russian Federation signed a contract with Philips Medezin Systeme of Germany. Under the terms of this agreement, Philips was to supply medical equipment and install it at military factories in Russia. A consortium of German banks granted credit for the project in the amount of one billion German marks. Russia was to pay for the credit through the supply of diesel fuel to Germany. After the deal had been signed, the Russian Federation Minister of Health himself (Mr. Andrei Vorob'ev) began "to entertain doubts as to the advantages of this contract" to Russia. At the request of Mr. Vorob'ev, the Institute for the Development of Moscow (IDM)—an independent consulting company—began an economic review of the contract. The review concluded that the contract is not in the best interest of Russia because Philips would provide the medical equipment and technology to Russia at a price that is higher than world market price and the industries that receive this equipment will be henceforth dependent on Philips for the supply of parts. As expected, Mr. Vorob'ev agreed with the conclusions of the review and issued a statement saying that in light of these findings further cooperation with Philips would stifle the development of Russian medical technology. Mr. Wolfgang Rosenbauer, the Commercial Director of the East European division of Philips, responded by saying that Philips's price is not higher than the current world market price; the parliaments of both nations investigated all aspects of the transaction before the contract was signed. Prior to the signing of both of the contracts, President Yeltsin and numerous Russian experts held direct talks with the contracting parties. Philips blamed the opposition to the contract on "the change of leadership at the Russian Federation Ministry of Health and the influence of political infighting." Not only is the contract threatened with cancellation, but it has been suggested that certain documents

additional precautionary measures when you sign any contract that purports to grant you an "exclusive" right to market a product or services in the West, because Russian practice suggests that your Russian partner may have concluded a similar agreement for the very same goods or services with at least one other third party; and, finally, because you will be operating within a system of institutionalized corruption, come fully prepared to swim against the tides. Otherwise, you will run afoul of the Foreign Corrupt Practices Act (FCPA) of the United States. This last admonition may prove to be the most difficult of all because Russia's new business codes make Al Capoine's Chicago look like the Bank of England. More than anywhwere else in the world, the United States businessperson will feel the threatening long arms of the FCPA in all business dealings at every level of government in Russia.

In addition to heeding the foregoing precautions, any United States investor must bear in mind that Russian law uses the term joint venture in a manner totally alien to United States law. Under United States law, a joint venture or joint enterprise is virtually synonymous with a partnership, perhaps a partnership of a more limited duration. Under United States law, a joint venture is distinctly a noncorporate form of business organization. United States federal income tax laws treat a joint venture like a partnership. By contrast, Russian law uses the term joint venture generically to include both corporate and noncorporate forms of business organization. The legal and tax status of a Russian joint venture will depend on the specific form in which it is organized. Thus, when a United States investor speaks of participating in the creation of a Russian joint venture, the investor is not saying very much about the nature of the business organization under Russian law.

In Russian usage the term "joint venture" has two meanings—the technical meaning under Russian joint venture law and the common meaning under Russian joint venture practice. Under Russian joint venture law, discussed in detail in Part IV below, a joint venture is any joint enterprise with two or more investors acting as its co-owners. This could be a joint stock company of an open type, a joint stock company of a closed type, a general partnership, a limited partnership, or an employee-owned enterprise. Depending on the nationality of the participants, a joint venture, under Russian joint venture law, could be wholly Russian (with only Russian participants), wholly foreign (with only for-

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obtained during the review of the contract by IDM may be turned over to the Russian investigative agencies for possible criminal prosecution. *See Minzdrav Preduprezhdaet: Philips Rossii ne po Karmany*, KOMMERSANT, June 22-29, 1992, at 3 [*The Ministry of Health Warns: Philips Cannot Fit Russia into Its Pocket*].

eign participants) or mixed (with Russian and foreign partners). Russian law generally refers to the latter two types as international joint ventures. By contrast, in Russian joint venture practice, the term "joint venture" generally refers only to international joint ventures. Thus, a Russian report speaking of Russian joint ventures refers to international joint ventures. Another term commonly used in Russian joint venture practice is "firms with foreign capital." A leading Russian weekly business report, *Kommersant*,[13] publishes a weekly column called "Firms with Foreign Capital." The term refers to three types of business organizations: wholly foreign joint ventures, mixed joint ventures, and wholly owned subsidiaries of foreign corporations. Thus, for example, a *Kommersant* report on the number of joint ventures registered during a given period refers to the number of newly formed international joint ventures.[14]

The remaining portions of this Article discuss different angles of modern Russian joint venture law. Part II will trace the evolution of that law from 1990 through 1992. Following a chronological listing of the major Russian joint venture laws in Part III, Parts IV and V, respectively, will provide an in-depth examination of the law *On Enterprises and Entrepreneurial Activities* and the law *On Joint Stock Companies.* Part VI provides a probing analysis of the changing pattern of the Russian Federation law on the taxation of joint ventures. The December 1990 Presidential decree *On the Formation of a Republican Hard Currency Reserve Fund of the Russian Republic* constitutes the subject matter for the discussion in Part VII. Part VIII concludes the study with some reflections on the past, present, and future of Russian joint venture law and tax regulations.

II. RUSSIAN FEDERATION JOINT VENTURE LAW: AN OVERVIEW OF POST-*PERESTROIKA* DEVELOPMENTS

Modern Russian joint venture law differs from its USSR federal antecedent. But the differences between them are few and quantitative rather than pervasive and qualitative. The old USSR federal joint venture law progressed to the modern Russian joint venture law in an incremental and evolutionary manner rather than a jolty and revolutionary one. In fact, one could say that post-*perestroika* Russian joint venture law did

13. Until August 31, 1992, *Kommersant* was published as a weekly newspaper. Beginning with the September 7, 1992 issue, the newspaper was turned into a daily and is now called *Kommersant-Daily.* It continues, however, to publish a weekly supplement containing all the major news of the given week.

14. *See, e.g.*, the figures cited *supra* note 8.

not sever its umbilical cord with its USSR federal predecessor.

The gradual but methodical dismantling of USSR federal joint venture law in the territory of the Russian Republic began long before the disintegration of the Soviet federal state on December 25, 1991.[15] During the famous "war of laws" that started during the first quarter of 1990, some union republics expressed their dissatisfaction with USSR federal laws by adopting laws directly contradicting their federal counterparts and asserting the supremacy of union republic laws over federal laws in their respective territories. Russia took the lead in this rebellious movement.[16]

This "war of laws" manifested itself in two different forms: the displacement of federal laws with preemptive union republic laws and the superimposition of union republic policy over federal legislation that remained on the books. The laws of each one of the union republics embodied both forms of defiance of federal law but tended to emphasize one form over the other. The republics that emphasized the former style adopted a series of new legislation that directly and specifically preempted any and all federal laws that dealt with the same matter. Those that chose to emphasize the latter style stopped at the passage of a general law which simply stated that "all existing USSR federal laws shall continue to be applied in this republic to the extent that they are not

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15. The trend that culminated in the final break between USSR and Russian laws predated the demise of the Soviet federal state on December 25, 1991. A close analysis of the evolution of modern Russian law suggests that the trend began on June 12, 1990, which is the date when the Russian parliament defiantly proclaimed the sovereignty of Russia. *See* Declaration of the Supreme Soviet of the Russian Federation, *On State Sovereignty of the Russian Federation*, Law of June 12, 1990, VED. S'EZDA NAR. DEP. RF, Issue No. 2, Item No. 22 (1990). Various laws of the Russian Federation that extend the validity of USSR federal laws in the territory of Russia beyond December 25, 1991 use this cutoff date to determine the point from which compatibility between USSR and Russian laws would render the former applicable in the Russian Federation. See, for example, the law of July 14, 1992, which granted conditional validity to the fundamental principles of civil legislation of the USSR and the Union Republics beyond December 25, 1992. Decree of the Supreme Soviet of the Russian Federation, *On the Regulation of Civil Law Relations During the Period of Economic Reform*, ROSSISKAYA GAZETA, July 24, 1992, at 4.

16. Examples of Russian Federation laws that overtly defied the USSR federal authorities include the Declaration of the Supreme Soviet of the Russian Federation, *On the State Sovereignty of Russia*, Law of June 12, 1990, VED. S'EZDA NAR. DEP. RF, Issue No. 2, Item No. 22 (1990), and the Decree of the Presidium of the Supreme Soviet of the Russian Federation, *On the Defense of the Economic Foundations of the Sovereignty of Russia*, Law of August 9, 1990, VED. S'EZDA NAR. DEP. RF, Issue No. 10, Item No. 133 (1990).

inconsistent with the legislative policy of this republic."[17] The republics considered this latter method less confrontational than the former.

The Russian Federation[18] was one of the few of the Commonwealth of Independent States (CIS) that embraced the more confrontational form of "war of laws." Russia's preemptive legislation, remarkably, did not contemplate a blanket repudiation of the general principles of the USSR federal law whose specific legislative rules they sought to displace. Rather, the preemptive statutes always contained precautionary language to the effect that even though local law displaces federal law in the territory of the Russian Federation, federal law shall continue to provide an interpretative backdrop to Russian Republic laws. The Supreme Court of the Russian Federation recently agreed with this approach in its handling of the laws of the former USSR and decisions of the Supreme Court of the former USSR.[19] Russia's efforts to displace federal law con-

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17. The Republic of Kazakhstan is the best representative of this approach.

18. Perhaps the most far-reaching change in Russian law since the demise of the USSR federal state is the change in the name of the republic itself. By law of the RSFSR of December 25, 1991, *On the Changing of the Designation of the State of the RSFSR*, VED. S'EZDA NAR. DEP. RF, Issue No. 2, Item No. 62 (1991) the name of this republic changed from RSFSR, Russian Soviet Federative Socialist Republic, to RF, Russian Federation. The law provided that effective immediately and henceforth the official designation of the RSFSR shall be the "Russian Federation" or, for short, "Russia." The law further provided that through the end of 1992, official state documents and letterheads were allowed to refer to the Russian state as the RSFSR. Now all references to the RSFSR must cease. Thus, throughout this study the new name of the Russian state is referred to variously as the Russian Federation, the Russian Republic, or Russia.

19. On April 22, 1992 the *Plenum* (en banc session) of the Supreme Court of the Russian Federation handed down its Decree No. 8, *On the Application by the Court of the Russian Federation of Decrees of the Plenum of the Supreme Court of the USSR*, 7 BULL. S. CT. RF 11-12 (1992). The decree states:

> In connection with the requests that have been received from the [lower] courts relating to the propriety of the application by such courts, in the course of deciding civil and criminal cases, of interpretative rulings that were handed down by the Plenum of the Supreme Court of the USSR, the Plenum of the Supreme Court for the Russian Federation hereby decrees: Pursuant to the provision of Section 2 of the Supreme Soviet of the Russian Federation of December 12, 1991, *On the Ratification of the Agreement on the Establishment of the Commonwealth of Independent States*, up until the adoption of the corresponding legislative acts of the Russian Federation, laws of the former USSR as well as interpretative rulings of the Plenum of the USSR Supreme Court relating to the application of such laws may be applied by courts of the Russian Federation to the extent that the former are not inconsistent with the Constitution of the Russian Federation, legislation of the Russian Federation, and the Agreement on the Establishment of the Commonwealth of Independent States."

Id.

tained a second precautionary edict that federal legislation shall remain in force in the territory of the Russian Republic until a similarly denominated republic law supercedes it.[20]

For example, if a USSR federal statute dealt with six matters and a subsequent Russian Federation preemptive legislation dealt with only four of the matters, the provisions of the USSR federal law with regard to the remaining two matters will continue to be applicable in the territory of the Russian Federation to the extent that they do not conflict. One must remember this point while examining the new law of joint ventures in the Russian Federation. By way of a summary to this discussion, the old USSR federal law continues to exert its influence on modern Russian law in three distinct ways: it provides a philosophical backdrop to modern law; it fills any gaps that may be present in modern

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20. Perhaps the most poignant example of the reluctance of the Russian parliament to sever all links with USSR federal law may be found in the July 14, 1992 decree of the Supreme Soviet of the Russian Federation, which sought to avoid any gaps in Russian contract law during the transition period. This decree specifically extended the validity of USSR federal law dealing with civil law matters beyond the demise of the Soviet federal state. It also extended the validity of those laws of the Russian Federation that were infused with the principles of USSR federal law. With regard to both categories of old (i.e., pre-June 12, 1990) law, their extended validity is predicated on two conditions: only those provisions of these laws that are not inconsistent with modern Russian law shall be deemed valid and the extended validity of such provisions shall remain in effect until the latter are superseded by a new Russian Federation law. Here is a full text of the decree's one-paragraph preamble and two short articles.

> During the period of economic reform it is desirable that civil legislation that regulates economic relations must be uniformly applied. In the interest of securing such uniform application of these legislative acts, the Supreme Soviet of the Russian Federation decrees as follows:
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> 1). Until such a time when a new Civil Code of the Russian Federation is adopted, the Fundamental Principles of Civil Legislation of the USSR and the Union Republics, RF SSSR, Issue No. 26, Item No. 733 (1991), which were promulgated on May 31, 1991, shall remain applicable in the territory of the Russian Federation, with the exception of those provisions which deal with the jurisdiction of the USSR in civil matters, as long as they do not conflict with the Constitution of the Russian Federation and any laws of the Russian Federation that were adopted after June 12, 1990;
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> 2). Provisions of the Civil Code of the Russian Federation that were adopted by a law of the Russian Federation of June 11, 1964, VED. VERKH. SOV. RSFSR Item 406 (1964), shall continue to be applied to civil law relations so long as they are not in conflict with the legislation of the Russian Federation that were adopted after June 12, 1990 and any other properly enacted acts that are in effect in the territory of the Russian Federation.

Decree No. 3301-1 of July 14, 1992 entitled *On the Regulation of Civil Law Relations During the Period of Economic Reform,* ROSSISKAYA GAZETA, July 24, 1992, at 4.

Russian law; and it provides the immediate source from which modern Russian law derives its general principles and specific rules.

A juxtaposition of the old USSR federal joint venture law and its modern Russian counterpart indicates that six principal differences[21] exist between them: unlike the modern Russian joint venture law, the old USSR law contemplated a preformation joint venture approval procedure that required the prospective partners to submit a copy of the joint venture's feasibility study as well as a draft of its foundation documents (i.e., contract and charter) to a designated governmental authority for approval; contrary to the stipulation in modern Russian joint venture law, the old USSR joint venture law recognized a nominate joint venture as a separate form of business organization; modern Russian joint venture law allows natural persons (Russian as well as foreign) to be partners in a joint venture; the tax regimes of joint ventures differ radically under both laws; as a direct repudiation of the rule under the old USSR law, modern Russian law does not require that a majority of the joint venture's employees be Russian citizens; and in recognition of the recent changes that have taken place in Eastern Europe, modern Russian law rejects the old USSR federal law's classification of joint ventures into two baskets—one joint venture in which there are Soviet and Council on Mutual Economic Assistance (COMECON) state participants, and another that holds joint ventures in which Soviet participants team up with partners from capitalist or developing countries.

By contrast, the similarities between both joint venture laws are more profound. A partial listing of such similarities would include the following eight common features of both laws: a decentralized registration system that allows newly established joint ventures to be registered either with central or local government authorities; a rule that allows the partners in a joint venture to decide the ratio for the allocation of equity shares in the enterprise's capital fund to the respective Russian and foreign participants; the recognition of a corporate joint venture[22] as a legal entity separate and distinct from its participants; a rule that limits the liability of a corporate joint venture partner to its contribution to the

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21. Each of the six aspects of the old USSR federal joint venture law listed here is discussed in extensive detail in Osakwe, *supra* note 1, at 50-96.

22. Modern Russian law recognizes five types of joint ventures: joint stock company of the open type, joint stock company of the closed type, limited partnership, general partnership, and employee-owned enterprise. Russian law endows only the first three of these four types with separate legal personality. Russian law does not treat the general partnership as a separate legal person. Depending on whether the employee-owned enterprise is organized as a limited or general partnership, it could be a legal person. For a full discussion of this point, see Part IV.

capital fund of the enterprise; a joint venture endowed with a separate legal personality attains such status at the moment of its registration with the proper governmental authorities; to the extent that they are not contrary to public policy or in conflict with a specific law, the stipulations of the parties in a joint venture contract shall constitute the operational (i.e., internal governing) law of such joint venture regardless of the level of government with which they are registered; all newly created joint ventures must be listed in the national register of joint ventures maintained by the central government authorities, notably the Ministry of Finance;[23] and the partners may define the forms (i.e., money, property, or other things of value) in which they shall make their respective contributions to the capital fund of the joint venture.

A second set of similarities between both laws would include the following eight uniform rules: all contributions by the partners to the capital fund of the joint venture must be valued in Russian rubles; if its founding instruments so permit, a joint venture may establish subsidiaries, branch, or representation offices inside or outside the Russian Federation; each joint venture may stipulate in its founding instruments the elected procedure for the settlement of disputes, including international commercial arbitration; the partners in a joint venture may agree on a management style for the enterprise as well as select the nationals of any country to hold any office in the company; a joint venture does not need any further governmental permission in order to enter into direct economic relations with foreign partners;[24] joint venture partners may select any accounting and bookkeeping system for their enterprise as well as nominate any outside auditors, including foreign accounting firms;[25] all

23. In March 1992 the Ministry of Finance transferred its responsibility for the registration of joint ventures to a newly created Committee on Foreign Investments within the Ministry of Finance. The committee is located at the new building of the Ministry of Finance at Georgevsky Pereulok. *See New Firms with Foreign Participation*, KOMMERSANT, March 23-30, 1992, at 4.

24. This rule was partially modified by a Presidential decree of June 14, 1992 that requires all enterprises, including joint ventures, to obtain the permission of the Ministry of Foreign Economic Relations of the Russian Federation in order to export certain important strategic goods. *See* Decree of the President of the Russian Federation, *On the Procedure for the Export of Important Strategic Goods*, No. 628, June 14, 1992, 7 VNESH. TORG. 2-3 (1992).

25. In February 1992 the Moscow Tax Inspectorate released its list of accounting firms with which it recommended enterprises should do business. In the words of the Moscow Tax Inspectorate, the accounting firms on this list have "satisfied our highest standards and professional competence and reliability as well as knowledge of Russian Federation tax and accounting laws and practices." KOMMERSANT, Feb. 17-24, 1992, at 16. The list includes: Mosaudit, Inaudit A/O, Crowd, Assistent Inaudit S/P, Coopers

joint ventures must permit their employees to establish trade unions and participate in the activities of such organizations; and both laws have similar grounds for the termination of a joint venture.

The remarkable similarities between both sets of laws are also manifested in their incorporation of the following common principles: the partners may determine the scope of activities for their enterprise as well as set the employment policy of the joint venture; joint ventures that conduct their activities within a specifically defined free economic zone (FEZ) shall enjoy various privileges ranging from tax concessions to a relaxed application of labor laws; each joint venture shall select the insurance carrier (Russian or foreign) that will insure its property, but the law shall stipulate which joint venture assets must be insured against ordinary risks; and each joint venture shall determine whether the shares of the partners are freely transferable to third parties.

The foregoing analysis demonstrates that there are more similarities (a total of twenty) between the old USSR federal law of joint venture and its post-*perestroika* Russian successor than there are differences (a total of six). Fine tuning of the old law by the Russian lawmakers created the latter differences. As such, one cannot gain a true understanding of the new Russian law without having a firm grasp of the principles of the old USSR federal law of joint ventures.

III. A CHRONOLOGY OF RUSSIAN FEDERATION LAWS RELATING TO THE ESTABLISHMENT, OPERATION, AND GOVERNANCE OF JOINT VENTURES

The incremental growth of modern Russian joint venture law did not develop along a straight line. Rather, it zigzagged its way from its rebellious infancy in the middle of 1990, when Russia issued the joint venture legislation as a form of defiance of USSR federal authorities. At some point during the third quarter of 1991, the growth pattern of this law became even more erratic as the Russian legislature began to spout laws much faster than the government printing presses could print them. All these laws have the common features that characterize Russian regulations, i.e., incoherence, inconsistency, and utter confusion. Many of the laws regulating joint ventures, while amended inumerable times, remain in effect.[26]

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and Lybrand, Ernst and Young, Arthur Anderson, and Price Waterhouse. *Id.* The list, however, noted that Price Waterhouse was not licensed to do business in the Russian Federation, but nevertheless "is known to be a very reputable firm." *Id.* at 16. The list even includes telephone numbers of all recommended firms.

26. Declaration of the Supreme Soviet of the Russian Federation, *On the State Sov-*

Two laws, the law *On Enterprises and Entrepenurial Activities in*

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ereignty of Russia, Law of June 12, 1990, VED. S'EZDA NAR. DEP. RF, Issue No. 2, Item No. 22 (1990); Decree of the Presidium of the Supreme Soviet of the Russian Federation, *On the Defense of the Economic Foundations of the Sovereignty of Russia*, Law of August 9, 1990, VED. S'EZDA NAR. DEP. RF, Issue No. 10, Item No. 133 (1990); Law of the Russian Federation, *On Securing the Economic Foundations of the Sovereignty of Russia*, Law of October 30, 1990, VED. S'EZDA NAR. DEP. RF, Issue No. 22, Item No. 260 (1990); Law of the Russian Federation, *On Ownership in the Russian Federation*, Law of December 24, 1990, VED. S'EZDA NAR. DEP. RF, Issue No. 30, Item No. 416 (1990); Law of the Russian Federation, *On Enterprises and Entrepreneurial Activities in the Russian Federation*, Law of December 25, 1990, VED. S'EZDA NAR. DEP. RF, Issue No. 30, Item No. 1008 (1991); Law of the Russian Federation, *On Foreign Investment in the Russian Federation*, Law of July 4, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 29, Item No. 272 (1991); Decree of the Presidium of the Supreme Soviet of the Russian Federation, *On the State Fee for the Registration of Enterprises in the Russian Federation*, Law of March 4, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 29, Item No. 272 (1991); Decree of the President of the Russian Federation, *On the Liberalization of Foreign Economic Activities on the Territory of the Russian Federation*, Law of November 15, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 47, Item No. 1612 (1991). Amended by Presidential Decree No. 629 of June 14, 1992. *See* ROSSISKAYA GAZETA, June 18, 1992, at 4. Decree of the President of the Russian Federation, *On the Extraction of Precious Metals and Diamonds in the Territory of the Russian Federation*, Law of November 15, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 47, Item No. 1613 (1991); Decree of the Presidium of the Supreme Soviet of the Russian Federation, *On the Establishment of a Free Economic Zone in Sakhalin*, Law of May 27, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 22, Item No. 793 (1991); Law of the Russian Federation, *On Investment Activities in the Russian Federation*, Law of June 26, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 29, Item No. 1005 (1991); Law of the Russian Federation, *On the Protection of the Environment*, Law of December 19, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 10, Item No. 457 (1992). Amended on February 21, 1992. *See* VED. S'EZDA NAR. DEP. RF, Issue No. 10, Item No. 459 (1992); Law of the Russian Federation, *On Local Government in the Russian Federation*, Law of July 6, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 2, Item No. 100 (1991); Law of the Russian Federation, *On the Administrative Authority of the Regional (Krai, Oblast') Councils of People's Deputies*, Law of March 5, 1992, VED. S'EZDA NAR. DEP. RF, Issue No. 13, Item No. 663 (1992); Decree of the Council of Ministers of the Russian Federation, *On Joint Stock Companies*; Decree No. 601 of December 25, 1990. Decree of the President of the Russian Federation, *On the Formation of a Republican Hard Currency Reserve Fund of the Russian Republic in 1992*, Law of December 30, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 2, Item No. 76 (1992), with amendments of June 14, 1992. *See* ROSSISKAYA GAZETA, June 18, 1992, at 4. Decree of the President of the Russian Republic, *On Additional Measures Aimed at Limiting Cash Transactions*, Law of June 14, 1992, ROSSISKAYA GAZETA, June 14, 1992, at 2; Law of the Russian Federation, *On Mortgages*, Law of the Russian Federation, *On Mortgage*, VED. S'EZDA NAR. DEP. RF, Issue No. 23, Item No. 1239 (1992) (Law No. 2872-1 of May 9, 1992); Law of the Russian Federation, *On the Central Bank of Russia*, Law of the Russian Federation, *On the Central Bank of Russia (Bank of Russia)*, VED. S'EZDA NAR. DEP. RF, Issue No. 27, Item No. 356 (1990) (Law of

the Russian Federation and the decree of the Council of Ministers of the Russian Federation *On Joint Stock Companies*, constitute the core of the joint venture law of the Russian Federation. They define in great detail the organizational structure and internal management of joint ventures in general and joint stock companies in particular. Equally importantly, they embody the mandatory governmental regulations applicable to all joint ventures in the Russian Federation. For the foregoing reasons, a separate segment of this Article discusses each of them. Because of its chilling effect on the operation of joint ventures in the Russian Federation, Part VII below examines the presidential decree *On the Formation of a Republican Hard Currency Reserve Fund of the Russian Republic in 1992* separately.

IV. AN ANATOMY OF THE LAW *ON ENTERPRISES AND ENTREPRENEURIAL ACTIVITIES IN THE RUSSIAN FEDERATION*

A. *Introduction*

On December 25, 1990 the Russian Supreme Soviet promulgated the all-encompassing, new law *On Enterprises and Entrepreneurial Activities in the Russian Federation.*[27] Unlike any previous law of the USSR, this law regulates all forms of business organization permitted under

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December 2, 1990); Decree of the Presidium of the Supreme Soviet of the Russian Federation, *On the Adoption of the Charter of the Central Bank of Russia,* Decree of the Presidium of the Supreme Soviet of the Russian Federation, *On the Adoption of the Charter of the Central Bank of Russia*, VED. S'EZDA NAR. DEP. RF, Issue No. 29, Item No. 1012 (1991) (Law of June 24, 1991); Law of the Russian Federation, *On Banks and Banking Activities in the Russian Federation,* Law of the Russian Federation, *On Banks and Banking Activities in the Russian Federation*, VED. S'EZDA NAR. DEP. RF, Issue No. 27, Items No. 357, 358 (1990) (Law of December 2, 1990); Decree of the Supreme Soviet of the Russian Federation, *On the Adoption of a Statute on Bank Checks,* Decree of the Supreme Soviet of the Russian Federation, *On the Adoption of a Statute on Bank Checks,* VED. S'EZDA NAR. DEP. RF, Issue No. 24, Item No. 1283 (1992) (Law of February 13, 1992); Decree of the President of the Russian Federation, *On the Organizational Measures for the Reorganization of State Enterprises and Amalgamations of State Enterprises into Joint Stock Companies,* ROSSISKAYA GAZETA, July 7, 1992, at 4; Law of the Russian Federation, *On Minerals,* Law of the Russian Federation, *On Minerals,* VED. S'EZDA NAR. DEP. RF, Issue No. 16, Item No. 834 (1992) (Law No. 2395-1 of February 21, 1992); Decree of the President of the Russian Federation, *On the Activization of a System of Privatization Vouchers in the Russian Federation,* ROSSISKAYA GAZETA, August 27, 1992, at 6.

27. Decree of the Supreme Soviet of the Russian Federation, *On the Procedure for the Implementation of the Law of the Russian Federation 'On Enterprises and Entrepreneurial Activities,'* Law of December 25, 1990, VED. S'EZDA NAR. DEP. RF, Issue No. 30, Item No. 419 (1990) [hereinafter Law on Enterprises].

Russian law. It radically departs from the USSR style of enacting a separate statute for each form of business enterprise. In addition to this structural difference, this law introduces to Russian law new forms of business organization unknown to the old USSR federal law.[28]

This law did not abolish joint ventures from Russian practice. It merely altered the meaning of the term "joint venture" under Russian law. Thus, under this new law, the joint venture is no longer recognized as a nominate form of business enterprise. But "joint venture" under this law continues to refer to a group of business associations that share a few common traits. In other words, the law of December 25, 1990 abolished nominate joint ventures as a form of business organization in Russia, but introduced to Russian law the new concept of generic joint ventures that this Article will discuss later.

The legislature has made relatively few amendments to this law, most of which have been cosmetic rather than substantive. In thirty-eight lengthy articles and a two-paragraph preamble, this law sets out the rules governing the establishment, operation, and internal management of all forms of business organization in the territory of the Russian Federation. Some of the business organizations listed in this law must comply with further detailed regulations in specific statutes devoted solely to such business entities.

An accompanying Implementation Decree[29] of the Russian Supreme Soviet, issued on the same day as the law on enterprises, stipulated that: this law shall go into effect on January 1, 1991; in connection with the adoption of this law, all laws of the USSR that deal with the same subject matter, including the laws *On Enterprises in the USSR*, *On Individual Labor Activities*, and *On Cooperatives in the USSR*, are repealed in the territory of the Russian Republic not in their entirety but only "to the extent that they are in conflict with" this law of the Russian Federation.

The Implementation Decree called upon the Russian Federation Council of Ministers to review all existing laws of the Russian Federation to ensure that they conform with this new law. All Russian Federation laws found to be in conflict with this law must be realigned with it by February 1, 1991. Article 4 of the Implementation Decree specifically directs the Russian Federation Ministry of Justice to review the Russian Federation labor code to ensure that its provisions are consistent with this new law. If any amendments to the Russian Federation labor code

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28. For example, old USSR law did not recognize the closely held private family enterprise as a form of business organization.

29. Law on Enterprises, *supra* note 27.

are necessary to realign it with this law, all proposals for such modifications must be submitted to the Russian Federation Supreme Soviet by February 15, 1991.

This law is so important to the new economic policy of the Russian government that they elevated it to the status of a constitutional statute. As such, it preempts any and all provisions of any competing laws of the Russian Federation and the USSR found to be inconsistent with it. The following section examines the key provisions of this constitutional legislation of the Russian Federation in all matters relating to the organization, operation, and internal governance of all forms of business organizations, including joint enterprises, in the territory of the Russian Federation. The discussion uses the terms "joint venture" and "joint enterprise" interchangeably to mean a business enterprise involving the participation of two or more investors as its co-owners, other than a closely held family enterprise.

B. *General Provisions*

This law governs the general legal, economic, and social foundations of all enterprises in the territory of the Russian Federation, including but not limited to the forms in which a business may be organized, rights and obligations of all participants in such organizations, and their protection under the law. This law encourages and promotes entrepreneurial activities in the Russian Federation.[30] It governs only for-profit organizations and profit-making sole proprietorships. Any person who wishes to establish a nonprofit (charitable) organization must do so pursuant to different legislation of the Russian Federation.

The provisions of this law apply, without exception, to all forms of business organization in the Russian Federation regardless of their form of ownership, their spheres of activities, or the participation of foreign citizens therein. Except in those instances in which the law specifically prohibits such participation, foreign citizens, including legal entities and natural persons, may participate in business organizations organized under the laws of the Russian Federation.[31] They may do so either in association with local (Russian) citizens or as partners with other foreigners. At their option, they may even form a business association with Russian or foreign legal entities.

Because this law applies only to for-profit business organizations (hereinafter referred to generically as enterprises), a nonprofit (charita-

30. Law on Enterprises, *supra* note 27, pmbl.
31. *Id.*

ble) organization may not be denominated as an enterprise. In other words, nonprofit enterprises cannot exist under Russian law.[32]

This law defines entrepreneurial activity, a term synonymous with business activity, as any voluntary business venture or undertaking engaged in by an individual or a group of individuals for the sole purpose of making profit. All such activities involve attendant risks and exposure to liability which the entrepreneurs assume.[33] Per se, an entrepreneur initiates as well as manages a business venture along with all its attendant risks.

All persons (including legal as well as natural persons, citizens of the Russian Federation, or of other countries as well as stateless persons) may freely participate in entrepreneurial activities in the Russian Federation. An entrepreneur may organize a business either in the form of a sole proprietorship (in which case the entrepreneur may not employ the labor of anyone outside his or her immediate family) or as a business enterprise (in which case the entrepreneur may hire employees).[34] From this provision flow the following general principles of Russian business law: the term "enterprise" includes sole proprietorship, partnership, and corporation; as such, not all enterprises have the attributes of a corporation; an entrepreneur has the freedom to form the business organization so that one person owns all the assets and is solely liable for all the obligations of the enterprise; to qualify as a sole proprietorship, an entrepreneur may not under this law employ the services of any person other than members of the person's immediate family.

All persons who intend to engage in entrepreneurial activity, regardless of the form of organization, must first obtain a permit to do so. The law forbids engaging in any form of entrepreneurial activity in the Russian Federation without a governmental permit.[35] Typically, this permit procedure requires all applicants to register their business with a designated government agency, pay a registration fee, and receive a registration number. The government uses this number to monitor the activities of the enterprise and to ensure compliance with the tax and other regulatory laws. This permit requirement applies to any and all forms of entrepreneurial activities, not just those that require an additional professional license (e.g., lawyers, accountants, architects, physicians, etc.).

This law provides that if an entrepreneurial activity is organized in the form of a business enterprise, other than a sole proprietorship, the

32. *Id.*
33. *Id.* arts. 1, 2.
34. *Id.* art. 3.
35. *Id.* art. 2.

relationship among the participants of such organization shall be governed by its foundation agreement. This law recognizes freedom of contract as a fundamental principle of Russian business law. It virtually frees all business partners to stipulate the law that would govern their relationship. They typically would do this by drawing up an instrument (contract or articles of association) that defines the nature of their relationship, their rights and obligations, and the governance of their business organization. To the extent that the stipulations of such an instrument are not contrary to Russian public policy or contravened by any specific legislation, it would operate as the governing law for the enterprise.

Russian law defines an enterprise as a self-administering, financially autonomous, self-accounting business undertaking organized under the laws of the Russian Federation either for the purpose of producing goods or providing services. In order to qualify as an enterprise under this law, the entity must contemplate making profits for its owners.[36]

An enterprise may be organized on the basis of private ownership, state ownership (i.e., ownership by the Russian federal and regional governments), municipal ownership (i.e., ownership by city governments), or ownership by a nongovernmental organization.[37] Russian Federation law also permits the formation of an enterprise on the basis of a mixed ownership, i.e., a mixture of any two or more of the four forms of ownership enumerated in article 5, paragraph 1 of this law.[38] Thus, for example, this law does not preclude a municipal enterprise from selling shares to a private interest or establishing a joint venture with a foreign entity or individual. This law also would not frown on an arrangement by which a private entity or individual would form a business organization with the participation of state enterprise. Russian law permits any mixture of forms of ownership in a Russian business enterprise.

Under this law a business enterprise may be organized in any one of the following eleven[39] forms: state enterprise,[40] municipal enterprise,[41]

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36. *Id.* art. 4, para. 1.

37. *Id.* art. 5, para. 1.

38. *Id.* art. 5, para. 2.

39. Prominently left out of this list are several eminent fixtures in pre-1990 USSR law of enterprise organization, such as cooperatives, small enterprises, state farms, collective farms, and nominate joint ventures. Elsewhere in this analysis I have interpreted the omission of the latter three forms of business organization from this list as tantamount to their abolition from modern Russian law. See the discussion below for the current status of these three forms of business organizations under modern Russian law. The term "small enterprises" continues to be used in modern Russian law in the same manner that it was used under pre-1990 USSR law, i.e., to refer to the size of the enterprise rather

closely held family enterprise,[42] general partnership,[43] mixed partnership (a term used interchangeably with limited partnership),[44] joint stock company of a closed type,[45] joint stock company of an open type,[46] association of enterprises,[47] branch office and representation office of an enterprise,[48] employee-owned enterprise,[49] and sole proprietorship.[50] To this list some people would like to add the wholly owned subsidiary of a foreign corporation, also permissible under Russian law. But, because a wholly owned subsidiary of a foreign corporation can be organized in the form of a Russian joint stock company, the wholly owned subsidiary is not listed here as a separate twelfth form of business organization under Russian law. This law uses the term "joint venture" interchangeably with "joint enterprise" to refer generically to five types of business organizations: general partnership, mixed partnership (limited partnership), employee-owned enterprise, joint stock company of a closed type, and joint stock company of an open type. This Article will refer hereinafter to these five forms of business organization as generic joint ventures. Notably, this list specifically eliminates the nominate joint venture as a separate form of business organization. A subsequent law of the Russian Federation, discussed in Part V below, requires that all enterprises organized as nominate joint ventures under the laws of the USSR must be reorganized and re-registered as a generic joint venture under the 1990 law of the Russian Federation. The laws of those CIS states that follow the model of the USSR federal joint venture law of 1987, however, may

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than to its legal form. The decree of the USSR Council of Ministers of August 8, 1990, *On Measures Aimed at the Creation and Encouragement of Small Enterprises*, 19 SP SSR Item 1001 (1990), defines a small enterprise (depending on the given industry) as any enterprise employing up to but not more than 15 persons (in the case of the retail industry) or any heavy industry and construction enterprise employing up to but not more than 200 persons. The legal status of the cooperative under USSR law was defined by a 1988 statute. *See* Law of the USSR of May 26, 1988, *On Cooperatives in the USSR*, 22 VEDOMOSTI SSSR, Item 355 (1988). The cooperative is no longer recognized as a form of business organization under modern Russian law.

40. *Id.* art. 6.
41. *Id.* art. 7.
42. *Id.* art. 8.
43. *Id.* art. 9.
44. *Id.* art. 10.
45. *Id.* art. 11.
46. *Id.* art. 12.
47. *Id.* art. 13.
48. *Id.* art. 50.
49. *Id.* art. 51.
50. *Id.* art. 3.

still recognize the nominate joint venture as a specific form of business organization.

One must remember that not all Russian generic joint ventures are endowed with corporate attributes such as limited liability, legal personality, and double taxation. Russian Federation law specifically denies all three of these attributes to general partnerships.[51] By contrast, both types of joint stock companies as well as limited partnerships (mixed partnerships) possess all of these three corporate features. Depending on whether an employee-owned enterprise is organized as a general or limited partnership, it may or may not have some of these corporate attributes. Of the eleven forms of business organization listed in articles 6-15 of this law, foreign investors most commonly use the joint stock company (the closed as well as the open type).

An administrative organ of the central government of the Russian Federation or of any of its subdivisions (up to the level of the regional government but excluding municipal governments) organizes a state enterprise, a term synonymous with a state corporation, for the purpose of managing state property. As a separate legal entity, a state enterprise is neither responsible for the obligations of the state nor vice versa. The liability of a state enterprise shall be limited to the full extent of the state property assigned to its operational management. Even though such property belongs to the state, the enterprise controlling the property shall exercise all rights of ownership over it, including the rights of use, possession, and disposition.[52] A new Russian Federation law on mortgage allows a state enterprise to mortgage any state property assigned to its operational management, subject to any restrictions specifically stipulated by legislation.[53]

A municipal enterprise is similar in every critical respect to a state enterprise except a municipal goverment organizes it on the basis of property belonging to the municipal authority. Like the state enterprise, a municipal enterprise is a separate legal entity distinct from its creator. Technically speaking, a municipal enterprise is a state enterprise in the sense that a governmental authority organizes and operates it on the basis of state property assigned to its operational management. However,

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51. Under Russian Federation law, the general partnership lacks legal personality, does not confer limited liability upon its members, and (with one exception) is not a taxable entity. The only Russian statute that treats the general partnership as a taxable entity is the law on the taxation of added value. *See infra* subpart VI(D).

52. Law on Enterprises, *supra* note 27, art. 6.

53. Law of the Russian Federation, *On Mortgage*, Law of May 29, 1992, VED. S'EZDA NAR. DEP. RF, Issue No. 23, Item No. 1239 (1992).

article 7 of this law singles it out for a separate treatment similar to the treatment accorded to state enterprises under article 6.[54]

A closely held private family enterprise belongs to an individual or to family members each of whom shares in the common ownership of the property of the enterprise. To qualify as a family enterprise, only members of the family, including spouses, children (natural or adopted), ancestors, and lineal descendants may participate in the enterprise. Unlike a United States family partnership, Russian law recognizes a family enterprise as a corporate organization. Like any other corporate enterprise, the law limits liability of a closely held family enterprise only to the full extent of its assets. As a legal entity, a closely held family enterprise is neither liable for the personal obligations of its owner(s), nor vice versa. Unlike a sole proprietorship, but like any other enterprise listed under this law, a closely held family enterprise may hire third-party employees.[55]

Article 9 of this law defines a general partnership as a contractual association of two or more persons for the purpose of engaging in a profit-making joint economic activity. All members of this association subject themselves to unlimited liability (liability *in solido*) for the obligations of the partnership. Thus, upon depletion of the assets of the partnership, a creditor may proceed against the personal assets of its partners. A general partnership is not a legal entity. Subject to one qualification, it also is not a taxable entity. The VAT Law of December 6, 1991 (discussed in section VI(D) below) treats a general partnership as a taxable entity for purposes of value added tax only. If any of the participants in a general partnership is a legal entity, the latter shall maintain its legal personality throughout its association with the partnership. Thus, a general partner organized as a corporation (enterprise) shall limit its liability for the obligations of the partnership to the full extent of its corporate assets. A general partnership shall have its own name, which must include the name of at least one of its partners.[56] Other attributes of a general partnership may be pieced together from Russian law as follows: the participants in a general partnership need not contribute equally to the capital stock; all partners shall participate equally in the management of the enterprise even though their capital contributions might vary; and regardless of the ratio of their participation in the capital stock of the enterprise, all partners shall equally share losses of the enterprise.

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54. Law on Enterprises, *supra* note 27, art. 7.
55. *Id.* art. 8.
56. *Id.* art. 9.

A mixed partnership, a term used interchangeably with a limited partnership, is a contractual association of two or more persons for the purpose of engaging in a profit-making joint economic activity. A mixed partnership shall include one or more limited partners, but must also have one or more general partners. The general partners shall be held jointly and severally liable for the obligations of the partnership. By contrast, the limited partners shall be liable for the obligations of the partnership only to the extent of their investment therein. Typically, the limited partner does not wish to participate in the management of the partnership but uses it merely as a vehicle for investment. To qualify as a limited or special partner in a limited partnership, an investor must relinquish his right to participate in the management of the enterprise and may not so participate. If the investor participates in the management of the enterprise, the investor's status shall be downgraded to that of a general partner. Unlike the general partnership, Russian Federation law recognizes the limited partnership as a legal person.[57]

A joint stock company (JSC) of a closed type (formerly called limited liability company under pre-1991 USSR federal law) is a contractual association of individuals or legal entities organized for the purpose of engaging in a profit-making joint economic activity. Typically, this sort of business organization has two or more participants. But, as an exception to the multi-party JSC, Russian Federation law allows just one investor to organize a one-party JSC. Regardless of whether it is multi-party or one-party, all JSCs shall be organized solely on the basis of contributions by their founding members. All shares in such a company shall be owned only by its founding members and, unless the participants otherwise stipulate, these shares may not be freely assigned to any third party. Members of this enterprise shall be liable for the obligations of the company only to the extent of their contribution to the charter capital of the enterprise. A member of the company may assign shares to an outside third party only with the explicit consent of all the other participants. The procedure for such restricted assignments of shares shall be specifically stipulated in the charter of the company. A JSC is a separate and distinct legal person. It must have its own name and shall be governed by a charter adopted by its members at their foundation meeting. Under Russian law, a closed joint stock company is only minimally distinguishable from a limited partnership. The principal difference between them is that a limited partnership must have at least one general partner who is not protected by the limited liability shield. In a

57. *Id.* art. 10.

closed joint stock company, all the members enjoy limited liability. Any legal entity that becomes a participant in a joint stock company of a closed type shall retain its corporate personality throughout the existence of the company.[58] A separate law of the Russian Federation dealing specifically with joint stock companies[59] provides a more detailed regulation of all types of joint stock companies.

Except for the four points of difference between them, discussed in Part V, a joint stock company of an open type has many of the attributes of a JSC of a closed type.[60]

Article 13 of this law permits two or more enterprises to form an association, which is the same thing as a consortium or an amalgamation, in order to maximize their economic potential. All enterprises that join such an association retain their corporate status and operational autonomy. The governing bodies of such an association exercise only those limited powers specifically delegated to them by their members. The establishment and operation of all such associations shall be subject to any restrictions that may be imposed by the antitrust laws of the Russian Federation.[61]

Article 14 authorizes any enterprise to establish branch offices, representation offices, or any other operational units it deems fit at any location in the territory of the Russian Federation. The parent enterprise shall determine the scope of authority of any such units. An enterprise organized under the laws of the Russian Federation may establish its branch office or representation office outside the territory of the Russian Federation pursuant to the laws of the place where it wishes to create such a unit. The difference between a branch office and a representation office boils down to the scope of their respective authority. Generally, Russian law endows a branch office with a wider scope of authority than a representation office.

The employees of an enterprise—whether state, municipal, or mixed ownership enterprise—may purchase or lease the enterprise from its owners and manage it as an employee-owned enterprise. If they are merely leasing such enterprise, they shall, during the entire duration of such lease, function as its operational owners. The agreement between the employee-managers and the enterprise owners shall stipulate the formula for sharing any profits received from such a lease arrangement. During the term of the lease, the owners of the enterprise shall not inter-

58. *Id.* art. 11.
59. *See infra* Part V.
60. Law on Enterprises, *supra* note 27, art. 12.
61. *Id.* art. 13.

fere in the management of its affairs. To enable them to manage this enterprise, the employees shall first organize themselves into a partnership (general or limited) that will lease or buy the enterprise. In effect, the employees organize this enterprise as a partnership. The articles of partnership must specify the relationship among the participating employees. All the participating employees may not be able to participate in the management of the enterprise. The scope of liability of each employee for the obligations of the enterprise shall depend on whether they are classified as general or limited partners in the enterprise. During the term of the lease, the owners of the enterprise shall not be liable for any of its obligations.[62] Technically speaking, this form of business organization is also a joint enterprise because it involves the participation of two or more interested parties, either as co-owners or co-lessees of the enterprise.

Other notable provisions of this law include: a definition of the rights of an entrepreneur;[63] the obligations and responsibilities of an entrepreneur;[64] legal protections extended to all entrepreneurial activities;[65] the spheres of activities open to entrepreneurial exploitation;[66] the regulation of labor relations within the enterprise;[67] governmental oversight over entrepreneurial activities in the Russian Federation;[68] management of the enterprise;[69] the procedure for the formation of business enterprises;[70] and the procedures for the liquidation and reorganization of enterprises.[71]

One of the least heralded innovations of this law of December 25, 1990 was that it sounded the death knell for two prominent fixtures in the Soviet agricultural landscape since the early 1920s, i.e., state farms and collective farms. By failing to list state farms and collective farms as forms of business organizations and by refusing to grant these farm organizations any "grandfather" protection, this law served notice to existing state and collective farms that they must be reorganized. One year later this implied message was restated quite categorically in the decree of the President of the Russian Federation *On the Procedure for the Reorgani-*

62. *Id.* art. 15.
63. *Id.* art. 16.
64. *Id.* arts. 17, 18.
65. *Id.* art. 66.
66. *Id.* art. 21.
67. *Id.* art. 26.
68. *Id.* art. 28.
69. *Id.* arts. 30, 32.
70. *Id.* arts. 33, 36.
71. *Id.* arts. 37, 38.

zation of State Farms and Collective Farms.[72] Among its other provisions, this later law: set an absolute deadline of January 1, 1993 by which all state and collective farms must be reorganized into one of the eleven forms of business organizations enumerated in the law of December 25, 1990; stipulated the procedures that must be followed in such reorganizations; and granted the state and collective farms the discretion either to transfer their social services infrastructure (i.e., residential buildings, roads, power lines, water supply systems, gas pipelines, telephone network, etc.) to the local governmental authorities or to sell them to other third parties. The clearly articulated intention of this law is for state and collective farms to be reorganized not into state enterprises, but to be privatized, i.e., transformed into one of the private forms of business organization under the law of December 25, 1990. In short, on December 31, 1992 the sun set on these two venerable Soviet-era institutions, the most glaring reminders of Stalin's agricultural policy.

C. *Some General Conclusions*

This law intends that foreign citizens, including foreign corporations, shall participate in the economic life of Russia on equal terms with citizens of the Russian Federation. To that effect article 2 specifically provides that foreigners may, as investors, team up with local or foreign partners to establish a joint enterprise in the Russian Federation. The right of a foreign citizen or corporation to participate in a joint enterprise includes the right to become a partner in such an enterprise (either by teaming up with a local partner or with another foreign partner). This law also grants to the foreign investor the right to become the sole owner of all the interests in a Russian business enterprise. Thus, for example, a foreign entity might begin as a fifty percent investor in a joint stock company and end up buying out its local partner to become a one hundred percent owner of the company. Russian Federation law permits such buy-out arrangements but leaves it to the JSC partners to stipulate the procedure for it. The partners must stipulate such a takeover procedure in the charter of the company. By contrast, a foreign corporation that wishes to set up its wholly owned subsidiary in the Russian Federation may do so right away by following the incorporation procedures set forth in Russian law. Because Russian law organizes the subsidiary, it will be treated as a Russian enterprise.

Article 21, paragraph 1 stipulates that an enterprise may engage in

72. Law of Dec. 29, 1991, 1-2 SOBRAINE POSTANOVLENII PRAVITEL'STVA ROSSISKOI FEDERATSII [SP-RF] Item 9 (1991).

any activities within any sector of the economy of the Russian Federation. Three other more restrictive provisions of the same clause qualify this open-sky formulation of the scope of activities of enterprises as follows: an enterprise may engage in any spheres of activities not specifically prohibited by law;[73] only state enterprises may engage in the seven activities enumerated in the next paragraph;[74] and certain types of activities may require a special permit.[75]

In short, this Russian Federation law organizes all economic activities into three baskets: basket one includes all those activities that any enterprise may engage in without the need for any additional special permit; basket two encompasses all those economic activities requiring a special governmental permit; and basket three holds all those activities open only to state enterprises. The seven activities reserved for state enterprises under this law include: the manufacture and repair of all types of weapons or explosive devices; the manufacture of all types of narcotic or poisonous materials; the cultivation of all plants that contain narcotic or poisonous substances; the production of all radioactive materials; the treatment of all patients suffering from infectious or psychiatric illness; the manufacture of all types of liquor and tobacco products; and the manufacture of all metals. A law of November 18, 1992 added an eighth item to this list, i.e., the issuance of mandatory insurance policies.[76] No rational basis exists for closing some of these activities to private participation. The next wave of amendments to this law will probably lift some of the these restrictions.

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73. Law on Enterprises, *supra* note 27, art. 21, para. 2.

74. *Id.* art. 21, para. 3.

75. *Id.* art. 21, para. 4. Among the activities that require a special license is building construction. A decree of Council of Ministers of the Russian Federation of November 8, 1991 introduced this requirement. *On the Introduction of State Licensing Requirement for Building Construction Activities in the Territory of the Russian Federation,* 3 SP-RF Item 18 (1992). Appended to this decree of November 8, 1992 is a *Polozhenie* (Regulation), *On the State Licensing of Building Construction Activities in the Territory of the Russian Federation.* This decree defines "building construction activities" to include the manufacture of building materials. *Id.* art. 1.

76. On November 18, 1992, the state insurance company (Gosstrakh of Russia) was reorganized from a state enterprise in a joint stock company in which all the stocks are held by the state. Even though an earlier law had abandoned the old state monopoly over the insurance industry, the 1992 reorganization contained one important provision that stipulates that only Gosstrakh (the new state-owned joint stock company) may underwrite compulsory insurance policies in the Russian Federation. *See Grosstrakh is Reorganized into a Joint Stock Company,* IZVESTIIA, Nov. 10, 1992, at 2.

V. AN ANATOMY OF THE RUSSIAN CONFEDERATION COUNCIL OF MINISTERS DECREE *ON JOINT STOCK COMPANIES*

A. *Introduction*

A discussion of the legal status of a Russian joint stock company should begin perhaps with a juxtaposition of a Russian joint stock company and its counterpart under United States law. Under United States law, a joint stock company or association is either of the common-law type or the statutory type. The common-law type is an unincorporated business organization in which shares in stocks represent ownership interests. The organization resembles a corporation, but the law treats it like a partnership. Unlike the ordinary partnership, membership of a United States joint stock company may change, its shares are freely transferable, its members do not necessarily know each other, and its members cannot act or speak for the company. Some United States jurisdictions regulate statutory joint stock companies like corporations and give them more powers than their common-law counterparts. Under the prevailing law in most United States jurisdictions, a joint stock company is not a corporate form of business organization. Russian law considers the joint stock company a corporate form of business organization. This differing view accounts for the most basic distinction in the treatment of joint stock companies under the laws of the Russian Federation and the United States. Beyond these opening remarks, all further discussions of the status of joint stock companies in this Article will refer to Russian law.

The joint stock company is a specific type of Russian joint venture and only one of the eleven forms of business organization permitted under Russian Federation law. A discussion of the legal status and structure of the other forms of business organization may be found in Section IV. The joint stock company is the form of business organization favored by the 1992 privatization decree of the Russian Federation.[77] To regulate

77. The special procedure for the reorganization of state enterprises into joint stock companies is stipulated in a Presidential decree of July 1, 1992, which calls for the privatization by November 1, 1992 of all state enterprises that employ more than 1,000 employees or whose capital fund as reflected on their balance sheet on January 1, 1992 exceeds 50 million rubles. *See* Decree of the President of the Russian Federation, *On Organizational Measures for the Reorganization of State Enterprises into Joint Stock Companies*, Law No. 721 of July 1, 1992, ROSSISKAYA GAZETA, July 7, 1992, at 4. Among other things, this law laid down the following rules: the administration of the process of privatization of state enterprises shall be the responsibility of the State Committee of the Russian Federation for the Management of State Property (at the level of the Russian Federation) and the State Committee for the Management of Property Be-

this most popular form of joint enterprise, the Council of Ministers of the Russian Federation adopted a new law, *On Joint Stock Companies,* on December 25, 1990 (Decree No. 601). Like most of the other laws adopted either before or after December 25, 1991, the Russian Federation modeled this law after its USSR federal counterpart. The discussion that follows identifies the highlights of Decree 601, clarifies the relationship between this law and any other laws (including any relevant pre-1991 USSR federal law) operating within the territory of the Russian Federation, and offers an article-for-article analysis of the general provisions of this law.

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longing to the Krai, Oblast, Autonomous Okrug, and the Cities of Moscow and St. Petersburg (art. 1); by "privatization" is meant the reorganization into open joint stock companies of all state enterprises including those that had previously been reorganized into closed joint stock companies (art. 1); those state enterprises that are specifically exempted from privatization may not be reorganized under the provision of this decree (art. 1); shares in any joint stock company that is created as a result of the privatization of state enterprises shall be sold or transferred only in strict accordance with the laws of the Russian Federation (art. 2); the founding members of any such joint stock companies shall be the respective state property committees referred to in article 1 of this decree (art. 3); the structure and provisions of the charter of any such joint stock company must conform with those of the model open joint stock company charter that is recommended for use in connection with the privatization of state enterprises (art. 3); the administrative head of the state enterprise to be so reorganized shall bear personal responsibility for ensuring full conformance of the charter of the newly created open joint stock company with the model joint stock company charter (art. 4, para. 2); the reorganization of state enterprises that is mandated in this decree must be completed by November 1, 1992 (art. 1, para. 3). The specific details of this decree as well as the exact procedures to be followed in privatizing state enterprises are spelled out in a statute (*polozhenie*) which is attached to this decree. *See* Statute, *On the Commercialization of State Enterprises by Way of Their Transformation into Open Joint Stock Companies.* The three distinct features of this law are that the founding members of any such joint stock company must include the respective state property committee, the JSC to be created under this law must be of the open type, and the provision and structure of the charter of the JSC must parallel those of the model JSC charter that was approved for use in the privatization of state enterprises. The state property committees are organized like a pyramind—beginning from the local property committees at the bottom and culminating with the State Property Committee of the Russian Federation at the top. This pyramidal structure was put in place by the Decree of the President of the Russian Federation, *On the Adoption of the Model Statute on the Committee for the Management of Property Belonging to the Krai, Oblast, Autonomous Oblast, Autonomous Okrug and the Cities of Moscow and St. Petersburg with the Authority of the Local Agent of the State Property Committee of the Russian Federation,* Decree No. 1231 of Oct. 14, 1992, 43 VED. S'EZDA NAR. DEP. RF, Item 2430 (1992).

B. *Highlights of Decree 601*

This law requires that all joint stock companies formed prior to December 25, 1990 under the old USSR law, *On Joint Stock Companies and Limited Liability Companies*,[78] that are currently operating inside the territory of the Russian Federation as such must be reorganized into Russian joint stock companies and undergo a re-registration with the governmental authorities of the Russian Federation.[79] All such pre-December 1990 JSCs must henceforth conform their structure and practices to this new Russian law, which becomes the governing law of all JSCs in the Russian Federation. This means that all enterprises organized as nominate joint ventures under the USSR federal law of 1987, or as joint stock companies under the USSR federal law of 1990, must not only reorganize and re-register under Russian law, but must also be restructured, if necessary, to fall within one of the specific forms of joint ventures permitted under Russian Federation law. Thus, for example, if an enterprise elects to be reorganized as joint stock company, it must elect between the open or the closed forms of JSC.

The formation and operation of certain types of JSCs require a special permit from the Russian Federation Council of Ministers. These include JSCs intending to engage in the extraction of rare resources, such as oil, precious metals, precious stones, and natural gas.[80]

In the conduct of its business, a JSC may exceed the specifically enumerated activities in its charter as long as such ultra vires activities are not illegal under Russian Federation law. Thus, for example, a joint stock company formed specifically for the purpose of providing telecommunications services may, in the course of its activities, if the officers so decide, provide services not related to telecommunications.

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78. Law of the USSR, *On Joint Stock Companies and Limited Liability Companies*, Law of June 19, 1990, 15 SP SSSR Item 82 (1990).

79. By the middle of February 1992, the Russian government noted that many of the JSCs organized under the laws of the USSR had not complied with the Russian re-registration law and warned them of the serious consequences of further delay in complying with that law. The Russian government threatened immediate closure of all such defiant joint stock companies. *See Aktsionernye Obshchestva Ne Proshli Pereregistratsiiu,* IZVESTIIA, February 17, 1992, at 2 [*Joint Stock Companies Fail to Re-Register*]. Similarly, special permission of the Russian Federation Ministry of Foreign Economic Relations is required in order for a JSC to engage in the export of certain important strategic goods. *See supra* note 24.

80. The Russian Federation promulgated a special law governing the issuance of licenses for the exploration and/or extraction of minerals in February 1992. *See* Law of the Russian Federation, *On Minerals*, Law of February 21, 1992, VED. S'EZDA NAR. DEP. RF, Issue No. 16, Item No. 834 (1992).

Two types of JSCs exist under this law, closed and open. In the closed type, the founding members shall be the only contributors to the charter fund, the participants may not freely transfer shares to an outside third party unless the charter stipulates otherwise, the charter fund must contain at lease 10,000 rubles,[81] and the board of directors must have at least three members. By contrast, in the open type, a portion of the charter fund may be raised through the sale of shares to nonfounding parties, participants may freely transfer shares to an outside third party unless the charter stipulates otherwise, the charter fund must contain at least 100,000 rubles, and the board of directors must have at least five members. In all other critical respects these two types of JSCs are similar. The participants may decide whether they wish to form a closed or an open type of JSC.

There is no minimum or maximum limit to the number of participants in a JSC. A multi-party JSC may have as few as two participants or as many as the founding participants decide. A one-party JSC has only one participant who is the sole owner of all stocks in the company.

C. *Implementation of Decree 601*

The Russian Federation Council of Ministers adopted an Implementation Decree on the same day that it promulgated the law on joint stock companies. Among other things, this decree asserts the supremacy of Decree 601 over all existing laws of the Russian Federation to the extent that they are inconsistent with the former. The supremacy status of Decree 601 also extends to all preexisting (i.e., as of December 25, 1990) and future (i.e., post-December 25, 1990) USSR federal laws to the extent that they are inconsistent with this law. Prominent among the provisions of this implementation decree are the following stipulations:

1. This Implementation Decree adopts and puts into force the attached regulations *On Joint Stock Companies.*

2. These new regulations repeal the Russian Federation Council of Ministers Decree of July 14, 1990 [Decree No. 857].

3. The Russian Federation Ministries of Finance and Justice shall promulgate the Procedure for the Implementation of these regulations.

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81. Even though the statutory floor for the capital fund of a JSC of the closed type is 10,000 rubles, the Committee on Foreign Investment announced on March 1, 1992 that it would no longer list in the national register of joint enterprises those joint enterprises with a capital fund of less than 100,000 rubles. Presumably, this new policy extends to all categories of JSC of the open type, i.e., wholly Russian, wholly foreign, as well as mixed. *See New Firms with Foreign Participation*, KOMMERSANT, March 23-30, 1992, at 4.

4. The Russian Federation Ministry of Finance shall be responsible for regulating the securities market as well as for overseeing the establishment and activities of JSCs in the territory of the Russian Federation.

5. The Russian Federation Ministry of Finance shall administer the registration of JSCs and shall also maintain a uniform register of all JSCs operating within the territory of the Russian Federation. Working closely with the Ministry of Justice, the Ministry of Finance shall, within a period of one month from the promulgation of this Implementation Decree, establish the format for such a register.

6. By January 1, 1991, the State Committee on Economic Reform of the Russian Federation Ministry of Finance shall present to the Russian Federation Council of Ministers a draft statute *On the Reorganization of State Enterprises into JSCs* as well as a draft statute *On the Issuance of Stocks and Stock Markets.*

7. The Russian Federation Ministry of Finance shall promulgate instructions on accounting and bookkeeping by JSCs.

8. All JSCs formed prior to December 25, 1990 under the laws of the USSR shall be re-registered with the Ministry of Finance by April 1, 1991.

9. All JSCs that operate in the territory of the Russian Federation shall be subject to the provisions of these regulations on JSCs.

D. *General Provisions of Decree 601*

Decree 601 contains 156 articles arranged under 22 sections denominated as follows: the general concept of the joint stock company; the formation of JSCs; application for the registration of JSCs; the foundation document (Charter) of JSCs; the meeting of founding members of JSCs; the registration of JSCs; the charter capital; stocks; the registration of stockholders; stock certificates; borrowing capital of JSCs; profits of JSCs; taxation of JSCs; dividends; reserves; stock options; accounting of JSCs; administrative bodies of JSCs and the meetings of stockholders; directors of JSCs; management of JSCs; audit commission; termination and reorganization of JSCs; subsidiaries, branch offices, and representation offices of JSCs; and audit.

Article 1 defines a joint stock company as a for-profit voluntary contractual arrangement among its participants for the purpose of engaging in common economic activities. Membership in a JSC shall be open to both legal entities and physical persons, including foreign entities and

nationals.[82] Thus, article 1 reveals the following four critical features of a joint stock company: it is a voluntary business arrangement among participants that may include entities as well as individuals, founded on a contractual basis, by which the participants intend to engage in lawful profit-making activities.

This provision, in effect, allows the formation of JSCs by two or more legal entities, two or more physical persons, or a mixture of legal entities and natural persons. As an exception to this general rule, article 13 of this law (discussed below) allows just one investor to form a JSC and thus own all the shares in the company. In other words, this law contemplates two types of joint stock companies: one-party and multi-party. Depending on whether the multi-party JSC has a foreign participant, three sub-types of JSC exist under this law—a purely domestic JSC, a mixed JSC, and a wholly foreign-owned JSC. Thus, for example, a Western company may organize its Russian subsidiaries in the form of a wholly owned JSC with all the shares owned by the non-Russian Federation subsidiaries of the same Western company. In addition to being able to establish a wholly foreign-owned, multi-party JSC, a foreign company may also establish a one-party, wholly foreign-owned JSC.

A JSC may engage in any and all types of activities unless otherwise specifically prohibited by law. In order to engage in activities connected with the defense industry, the extraction of rare minerals or certain other raw materials, forestry, and the harvesting of fur, a JSC must obtain a special permit from the Russian Federation Council of Ministers. The Council reserves the right to expand the spheres of activities for which a special permit may be required.[83]

This special licensing procedure does not specify whether it imposes more stringent requirements on these JSCs or whether it merely adds an additional bureaucratic hurdle which must be overcome by JSCs that intend to engage in these special activities. This additional procedure would allow the licensing authority in these special situations to take a much closer look at the contractual arrangements among the JSC partners to ensure the protection of the Russian Federation's national interest. The licensing authorities will look closely at the JSC provisions dealing with the intensity of the activities of the enterprise and the form in which the participants, especially the foreign participants, receive their dividends (that is, in products produced by the JSC or in cash).

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82. Decree of the Council of Ministers of the Russian Federation, *On Joint Stock Companies*, Decree No. 601 of December 25, 1990, art. 1 [hereinafter Joint Stock Company Decree].

83. *Id.* art. 2.

Article 5 of this law (discussed below), however, recognizes the autonomy of the JSC in determining the amount, ratio, and form of its profit sharing. One would hope that the Russian Federation Council of Ministers will respect the spirit and language of article 5 of this statute whenever it is requested to license the establishment of a JSC requiring a special permit.

Unless otherwise stipulated in its charter, a JSC may be established for an unlimited duration.[84] Most stockholders establish a JSC for a fixed term, rather than in perpetuity. For some joint stock companies, however, compelling reasons may lead to electing the unlimited term. The decision regarding this matter must be made on a case-by-case basis.

A JSC is a legal person separate and distinct from its members. It acquires its status as a legal person from the moment of its registration by Russian Federation governmental authorities.[85]

A JSC shall enjoy full autonomy in the management of its business affairs and freedom from all forms of governmental meddling in all of its economic activities, including the determination of its internal management style, economic decision-making process, pricing of its products, compensation of its officers and employees, and distribution of profits. The JSC may engage in any and all activities not contrary to Russian Federation law. A JSC may engage in activities not specifically stipulated in its charter as long as Russian law permits such activities.[86]

This rule adds a new twist to the concept of ultra vires activities. Under this provision, an activity engaged in by a JSC could be ultra vires under its charter but nevertheless valid under Russian Federation law. Thus, for example, if the JSC charter stipulates that it may engage only in activities *A*, *B*, and *C*, nothing under Russian law would prevent its officers, acting without further authorization, to also engage in activities *X*, *Y*, and *Z* so long as Russian law does not forbid these activities. Russian law, therefore, invites JSC officers to engage in ultra vires activities on behalf of the enterprise. To prevent this policy from becoming a problem, each JSC must establish other effective checks on the authority of its officers to enter into ultra vires commitments in the name of the company.

In Russian legal literature there is debate as to whether this provision of the JSC *Polozhenie* (Regulation) is in conflict with another provision of a hierarchically superior Russian law that takes a more restrictive

84. *Id.* art. 4.
85. *Id.* art. 5.
86. *Id.* art. 5.

view of the contractual capacity of a joint enterprise.[87] On this point, Professor Riasentsev, a leading Russian commentator, noted that even though the enterprise legislation (which is an act of the legislature and thus superior to an act of the executive branch of government) limits the contractual capacity of an enterprise to matters that fall within the spheres of activities enumerated in its charter, a decree of the Council of Ministers of the Russian Federation is a legitimate exercise of a legislatively granted discretion that authorizes the Council of Ministers to expand the contractual capacity of enterprises to include even ultra vires contracts. I agree with Professor Riasentsev on this point.

A JSC may establish subsidiaries, branch offices, or representation offices either in the territory of the Russian Federation or abroad. It may also invest in other enterprises as a participant.[88] Therefore, a JSC could be an investor in another JSC or in any other business organization as long as its charter authorizes it to do so.

Depending on the wishes of the participants, a JSC may be organized as a closed type or an open type. In an open JSC, unless the charter stipulates otherwise, a shareholder may freely transfer shares to an outside third party without the consent or over the objection of the other stockholders. In this business arrangement, the stockholder sees its shares in the company as an investment that it may wish to sell at any opportune moment to the highest outside bidder. Russian law, however, allows the participants in an open joint stock company to impose restrictions on themselves, preferably in the form of stipulations in the charter of the

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87. Professor Riasentsev opined:

> [A] joint stock company, by virtue of Article 5 of the Statute on Joint Stock Companies which was promulgated by the Council of Ministers of the Russian Federation on December 25, 1990, is authorized to conclude contracts dealing with matters that lie outside the spheres of activities stipulated in the charter, as long as such ultra vires contracts do not violate any applicable legislation. Such a provision, in essence, does not conflict with the provision of para. 2, article 21 of the Law of the Russian Federation on Enterprises and Entrepreneurial Activities, even though there is a stipulation in the latter law which provides that an enterprise is authorized to engage only in those activities that are listed in its charter. The point is that the Council of Ministers of the Russian Federation in para. 4, article 21 of the Law on Enterprises and Entrepreneurial Activities is statutorily authorized to expand the list of activities which an enterprise may engage in; the provision of the Polozhenie on Joint Enterprises which takes an expansive view of the activities that an enterprise may engage in is a direct exercise [by the Council of Ministers of the Russian Federation] of this legislative authority.

V. Riasentsev, *Sovremennoe Rossiiskoe Zakonodatel'stvo o Nedeistvitel'nykh Sdelkakh,* 7-8 SOV. IUST. 7 (1992) [*Modern Russian Law on Invalid Contracts*].

88. Joint Stock Company Decree, *supra* note 82, art. 6.

enterprise regarding the transfer of shares in the company to outside parties. Such restrictions may range from mere notice requirements to the need to obtain the consent of all the other participants before shares are transferred to outside parties to the requirement that the prospective third party transferee of such shares must first be approved by the other participants in the company. If the JSC participants elect to exercise all of the three options listed here, they will be creating in effect an impure, open joint stock company, but nevertheless still an open joint stock company. In other words, the critical difference between an open and a closed joint stock company does not hinge upon just one factor, i.e., the free assignment of shares to third parties. In a closed JSC, quite clearly a participant may only transfer shares to an outside third party with the consent of a majority of the stockholders, unless the charter of the JSC stipulates otherwise.[89]

In short, on the question of the assignment of shares in the enterprise to outside third parties, the difference between the open and closed joint stock companies may be reduced to the following formula: In an open joint stock company there is a rebuttable presumption that shares are freely transferable to outside third parties; in a closed joint stock company there is a reverse rebuttable presumption. Put differently, if one uses the transferability of company shares to outside third parties as a standard for classification, there are four permutations of joint stock companies under this Russian law—the open joint stock company of the pure and impure types as well as the closed joint stock company of the pure and impure types. An impure open JSC is an open JSC nevertheless, just as much of an impure closed JSC is still a closed JSC in the eyes of Russian law. The other difference between a closed and an open JSC will be discussed later in this Article.

Stockholders in a JSC shall be subject to limited liability, which means that they are liable only to the extent of their shares in the enterprise.[90] Separate and distinct from its participants, a JSC shall not be held liable for the personal and separate obligations of its stockholders.[91] The JSC shall be liable for its obligations to the full extent of its property. If the "unconscionable actions" (*nedobrosovestnye deistviia*) of its directors or officers cause damage, a court may impose on such directors or officers the duty to compensate the enterprise for the damage caused.[92] To do so, the court must first determine that the director or official acted

89. *Id.* art. 7.
90. *Id.* art. 8.
91. *Id.* art. 9.
92. *Id.* art. 10.

unconscionably. The general principles of Russian law shall determine the measure of unconscionability.

The founding members of a JSC may include legal entities, as well as natural persons or any mixture thereof, Russian participants as well as foreign investors or any mixture thereof.[93] No minimum or maximum limit to the number of founding participants exists in a JSC. It may even have only one founding participant. In the latter instance, the statutory requirement of a meeting of shareholders shall not apply.[94]

The foundation documents of a JSC (i.e., documents to be filed at the time of registration) shall include: the registration application, the minutes of the meeting of the founding members (except in the case of a JSC with only one founding participant), and the charter of the JSC. This law does not list a contract of foundation as one of the foundation documents of a JSC. Article 1 of this law, however, refers to a joint stock company as a contractual arrangement. The implication of that provision is that a preformation contract among the JSC participants is required. Founding members of a JSC should execute a preformation agreement;

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93. *Id.* art. 11. Under this law, only a legal or natural person may be a participant in a joint stock company. Technically speaking, the Russian state is neither a legal nor a natural person. This means that if the Russian state wishes to participate in a JSC it must do so through one of its instrumentalities that is organized as a legal person, e.g., an enterprise, institution, organization, committee or a department. Such an instrumentality may be a preexisting body or one that is specifically created for that purpose. Also, if the Russian Republic decides to participate in a joint stock company it has the right to stipulate the percentage of shares in the company that the state must hold. Thus, for example, the decree of July 17, 1992 by which the Russian government consented to be a participant in a newly created JSC ("The Moscow-St. Petersburg High Speed Train Link Corp.") that would operate a high speed train link between Moscow and St. Petersburg stipulated the form in which the Russian state shall make its contribution to the capital fund of the JSC as well as mandated that the state's share in the company may not be less than 51 percent. *See* Decree of the President of the Russian Federation, *On the Construction of a High Speed Passenger Train Track Between St. Petersburg and Moscow and the Manufacture of the Electrical Components Thereof,* Law of July 17, 1992, ROSSISKAYA GAZETA, July 24, 1992, at 4. A Russian Federation statute that contemplates the participation of the Russian state in a joint enterprise may also stipulate the specific state entity that may represent the interests of the state in such a joint enterprise. That was the case with the law of July 1, 1992 that called for the reorganization (privatization) of state enterprises into joint stock companies but mandated that whenever a state enterprise is so privatized, only the appropriate state property committee may participate on behalf of the state in any joint stock company created as a result of such reorganization. *See* Decree of the President of the Russian Federation, *On Organizational Measures for the Reorganization of State Enterprises and Amalgamations of State Enterprises into Joint Stock Companies,* Law No. 721 of July 1, 1992, ROSSISKAYA GAZETA, July 7, 1992, at 4.

94. Joint Stock Company Decree, *supra* note 82, art. 13.

these agreements have become a permanent fixture in the process leading to the establishment of a JSC in Russian joint venture practice.

Technically speaking, the legal character and functions of the contract of foundation of a joint stock company are fundamentally different from those of the charter of the enterprise. Typically, the former precedes the latter and sets forth the financial-business arrangements between or among the joint stock company participants even before they convene as shareholders to adopt the charter of the enterprise; the former is contractual in nature while the latter is quasi-legislative in character. Because the former is, as the name suggests, a contract, it must be signed by authorized representatives of the parties thereto in order to be valid. By contrast, the charter must, in addition to bearing the signatures of the respective parties, insert a statement indicating when it was adopted by the meeting of shareholders of the enterprise.

In other words, what Russian law refers to as the charter of a joint stock company is the functional equivalent of the bylaws of an association or a corporation under United States law. Such Russian bylaws are adopted by a vote of the participants at the foundation meeting of the shareholders of the enterprise. The purpose of these bylaws is to regulate the internal governance of the enterprise by stipulating the rights and duties of the officers of the organization as well as establishing the procedure for handling routine matters that arise during the life of the enterprise. Bylaws are a form of subordinate legislation of the enterprise.

At this point I would like to address the lingering question of the applicability of the famous Soviet two-signature rule to the foundation documents of a Russian joint stock company. The two-signature rule is a legacy of the USSR (federal) foreign trade law. The original two-signature rule was promulgated by an October 14, 1978 decree of the USSR Council of Ministers entitled *On the Procedure for Signing Foreign Trade Contracts* [95] Article 1 of this decree requires that all "foreign trade contracts that are concluded by those Soviet organizations that are authorized to engage in foreign trade operations must be signed by two persons.[96] The director of that given enterprise, directors of the firms which fall within the structure of such organizations, as well as persons who are furnished with properly executed powers of attorney, may sign such contracts.

Article 1, paragraph 2 of this 1978 decree goes on to designate those persons who are entitled to sign promissory notes and other financial instruments issued by Soviet enterprises and organizations that are au-

95. SP SSSR, Issue No. 6, Item No. 35 (1978).
96. *Id.* art. 1.

thorized to engage in foreign trade operations, i.e., director or deputy director and chief accountant of the enterprise.[97] In articles 2 and 3, respectively, this decree specifically exempts three groups of foreign trade contracts from the two-signature rule, i.e., foreign trade contracts concluded at public auctions or at stock markets (which should be signed according to the rules applicable to such public auctions and stock markets), foreign trade contracts concluded by or in the name of the State Bank of the USSR and the USSR Bank for Foreign Economic Relations, as well as foreign insurance policy contracts. Added to these de jure exemptions to the two-signature rule is one that has evolved in Soviet practice: the foundation documents (contract and charter) of joint ventures are signed by only one representative of the respective participants, including the Soviet parties.

Because post-1990 Russian law did not specifically repudiate this USSR (federal) two-signature rule, it implicitly adopted it along with all of the de jure and de facto exceptions thereto. What this means is that modern Russian law follows the previous USSR (federal) practice of not requiring two signatures for each party to a joint stock company foundation contract or charter. Therefore, the famous Soviet two-signature rule does not apply to Russian joint stock company foundation documents. This practice is confirmed by my own personal experience dating back to 1988 relating to the drafting and registration of Soviet joint venture foundation instruments, both under the pre-1991 USSR (federal) and post-1990 Russian laws.

An application for the registration of a JSC shall be filed with the Russian Federation Ministry of Finance not later than thirty days from the date the founding members first meeting of the enterprise was held.[98] Subsequent amendments to this law now permit the registration of certain JSC with local government authorities.[99] The application for regis-

97. *Id.* art. 1, para. 2.

98. Joint Stock Company Decree, *supra* note 82, art. 15.

99. A November 28, 1991 decree of the President of the Russian Federation modified the provision of article 15 of the 1990 Joint Stock Company Decree on the registration of joint ventures. *See* Decree of the President of the Russian Federation, *On the Registration of Enterprises with the Participation of Foreign Investment*, Law of November 28, 1991, Decree No. 26, 1-2 SP-RF Item 6 (1991). Under this new law, the procedure for the registration of international joint ventures is as follows: except for oil extracting, oil refining, and coal mining enterprises, if the amount of foreign investment in the enterprise is up to but not more than 100 million rubles, the enterprise shall be registered with the local government authorities of the levels of the Krai, Oblast, autonomous Oblast, autonomous Okrug, and the cities of Moscow and St. Petersburg; the procedure for the registration of oil extracting, oil refining, and coal mining enterprises in which

tration shall provide the following information: the name of the JSC, its location, its purpose and spheres of activities, the extent of the liability of the stockholders, amount of its charter capital, directory information about the individual stockholders (i.e., name, domicile, citizenship or, in the case of a legal entity, the law under which it is organized and the number of shares held).[100]

The application for registration shall be signed by all founding participants and notarized. It shall constitute a contract between the founding participants.[101] Even though this law views the registration application as an enforceable contract between the participants, and, as already noted above, does not require the founding members of a JSC to conclude a separate contract of foundation of the enterprise, all founding shareholders in a newly created JSC routinely and advisedly enter into a separate preregistration contract spelling out the details of their financial arrangements. Registration authorities do not see this additional contract, but it does place the legal relationship between the JSC founding participants on a sound footing.

Prior to the registration of the JSC, the participants have no legal

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the amount of the foreign investment does not exceed 100 million rubles shall be stipulated by the Russian Federation Ministry of Economy and Finance; if the amount of foreign investment is in excess of 100 million rubles, the enterprise shall be registered by the Russian Federation Ministry of Finance with the advice and consent of the local government authorities at the levels of the Krai, Oblast, autonomous Oblast, autonomous Okrug, and the cities of Mosocw and St. Petersburg; regardless of which agency is responsible for the registration of the enterprise, the procedure for handling all such registration shall be uniform throughout the territory of the Russian Federation.

In 1992 the government of the Russian Federation issued yet another decree, *On Certain Questions Relating to the Government Register of Enterprises*, May 28, 1992, 7 VNESH. TORG. 55 (1992). Among its other provisions this decree stipulates that: the Committee on Foreign Investment attached to the Russian Federation Ministry of Fiance (CFI-MinFin) shall undertake the registration of enterprises with foreign participation involved in oil and gas production as well as coal mining regardless of the amount of the capital fund of the enterprise; CFI-MinFin shall also handle the registration of all joint enterprises in which the amount of the foreign investment exceeds 100 million rubles; and CFI-MinFin shall be responsible for maintaining that portion of the State Register of Enterprises dealing with joint enterprises operating in the territory of the Russian Federation. In effect, this decree supplements as well as modifies certain provisions of the earlier Presidential decree of November 28, 1991. *See supra* note 23. Acting within its authority, CFI-MinFin anounced on March 1, 1992 that it would no longer list in the national register of enterprises joint ventures with a capital found in an amount less than 100,000 rubles. *See New Firms with Foreign Participation*, KOMMERSANT, March 23-30, 1992 at 4.

100. *Id.* art. 16.

101. *Id.* art. 17.

authority to enter into any transactions in the name of the enterprise.[102] Technically speaking, the JSC comes into existence as a legal person only at the time of its registration. As such, it cannot grant authority to anyone prior to the time when it acquires the legal capacity to do so. If a need, however, exists for the founding participants to enter into any transaction for the benefit of the JSC prior to its formation (e.g., to rent space or to hire skeleton staff), they may do so but they must submit all such preregistration contracts to the newly formed JSC for its ratification. The contracting participant enters into such preregistration contracts in its own name and not in the name of the nonexistent JSC. Upon ratification, these contracts become the contract of the JSC, and the JSC assumes all obligations flowing therefrom.

Prior to the registration of the JSC, the founding participants shall draw up its charter with provisions consistent with the stipulations of this statute.[103] The founding members of the JSC shall formally adopt the charter at the foundation meeting.[104] Among other things, the charter must contain specific stipulations relating to the following matters: type of JSC (i.e., open or closed); purpose and sphere of the JSC's activities; the composition of its founding participants; the name and location of the JSC; the amount of the charter capital; the types of stocks that the JSC will issue; the nominal value of the shares; the relationship among the various types of stocks; the consequences of a participant's failure to purchase the agreed amount of stocks; the formula for profit sharing and compensation of losses; the structure, designation, and powers of the respective administrative bodies, and decision-making processes, including a listing of those matters that require a unanimous or special majority vote.[105] This provision merely stipulates the minimum requirements that must be met by all JSC charters. The participants may incorporate other specific provisions to meet their special needs or suit their special circumstances. Thus, for example, most JSC charters should include provisions on the confidentiality of business information,[106] protection of intellectual

102. *Id.* art. 18, para. 2.

103. *Id.* art. 19.

104. *Id.* art. 21.

105. *Id.* art. 20.

106. Even if the parties to a joint venture contract agree on the nondisclosure of confidential business information to third parties, such a private agreement shall not constitute ground for nondisclosure of a business secret of an enterprise to a state agency that seeks such information for a legitimate purpose. To make sure that such information not withheld from the government, the President of the Russian Federation issued a decree, *On the Enumeration of Inforamtion That May Not be Treated as a Business Secret*, Law of December 5, 1991, No. 35, 1-2 SP-RF Item 7 (1991). This decree pro-

property, assignment of interests, settlement of disputes, force majeure circumstances, etc. I have available a model JSC charter and a model preformation contract of foundation of a JSC.

A unit within the Russian Federation Ministry of Finance or any other designated local governmental authority shall handle the registration of all JSCs. At the time of registration, it shall require the following documents: a notarized application for registration, a notarized copy of the charter of the JSC, and a notarized copy of the minutes of the founding members of the JSC. Russian law does not require the latter documents if only one individual or entity founds JSC.[107] The founders of a JSC must file this application not later than thirty days after founding.[108] As already noted, a subsequent amendment to this law allows local councils to handle the registration of certain categories of joint ventures.[109] This decentralized registration procedure takes the pressure off the Ministry of Finance, which continues to handle the registration of certain joint enterprises.

Except for those documents listed in article 25 of this statute, the Ministry of Finance or any other registration authorities may not request any other documents from the founding members of the JSC.[110]

Not later than thirty days after its registration, the JSC must present to the Ministry of Finance documentary evidence indicating that the individual participants have paid fifty percent of their respective shares in the charter capital of the JSC into the account of the JSC. If any partic-

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vides as follows: if demanded by a state agency (i.e., tax authorities, law enforcement agencies, and public health agencies), the information listed in this law may not be withheld by an enterprise on the ground that the information is a business secret; the items listed here include, but are not limited to, foundation documents of the enterprise, licenses to engage in certain activities, patents, registration papers, balance sheets, evidence of environmental pollution, evidence of antitrust violation, evidence of violation of occupational safety and health regulations, evidence of the manufacture of sale of unsafe products, evidence of solvency, lists of employees and their salary, tax returns, and evidence of the size of the assets of the enterpise. Upon request by an official of any of the government agencies listed above, all information contained in this law must be presented by the responsible officials of enterprise regardless of whether such enterprises are owned by the state, privately or jointly by state and private interests. Exempted from the operation of this law is information that is treated as business secrets by an international treaty to which the Russian Federation is a party or is regarded by legislation of the Russian Federation as a trade secret. If one reverses the logic of this decree, one could say that items listed in this law could be treated by parties to a joint venture contract as business secrets for purposes of their disclosure to third parties.

107. *Id.* art. 25.

108. *Id.* art. 25.

109. *See supra* note 99.

110. *Id.* art. 26.

ular participant is supposed to make its capital contribution in the form of property transfer to the company, such transfer must be executed within this thirty-day deadline. This requirement applies to both the foreign and the Russian participants. Failure to comply with it shall result in the invalidation of the registration.[111] This provision ensures that the participants do not postpone indefinitely the actual capitalization of the enterprise. Within thirty days from the registration of the enterprise, the Ministry of Finance wants to see documentary evidence that the participants have paid up at least half of their shares in the capital fund of the company. A receipt from a bank in the Russian Federation indicating that the stipulated amount has been deposited into an account to be maintained in the name of the JSC constitutes acceptable documentary evidence of compliance with this provision. In order to open such an account, the JSC must tender to the bank its temporary registration certificate (the original) and a notarized copy of its charter.[112]

At the time of registration, the Ministry of Finance shall collect a one-time, nonrefundable registration fee. The amount of such registration fee may vary according to the size of the charter capital of the enterprise.[113] Since the promulgation of this law, the Ministry of Finance has set the registration fee at a flat rate of 2000 rubles for all JSCs.[114]

The Ministry of Finance shall maintain and publish an official government register listing all newly organized JSCs. If and when a JSC winds up its activities and terminates it existence, the register shall note that fact.[115]

The Central Bank of Russia shall register JSCs engaged in banking

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111. *Id.* art. 27.

112. If compliance with this law requires the transfer of property to the enterprise, a properly executed act of transfer of such property shall constitute evidence thereof. One question that sometimes arises in practice is how to comply with this thirty-day rule if the full amount of a participant's capital fund contribution is represented by the value of one piece of property that the participant has pledged to transfer to the enterprise. If the participant transfers title of the entire property to the enterprise within the thirty-day deadline, it would in effect be making its full contribution to the enterprise, when all that the law requires it to do is to contribute only fifty percent of its share to the capital fund at this time. The rule of thumb in such a situation is that a transfer of the title to the entire property must be executed within the thirty-day deadline to the extent that title to such property is not divisible. Failure to do so would put such participant in direct violation of the thirty-day rule and thus pose a threat to the existence of the entire enterprise.

113. *Id.* art. 28.

114. *See* Decree of the Presidium of the Supreme Soviet of the Russian Federation, *On the State Fee for the Registration of Enterprises in the Russian Federation*, Law of March 4, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 20, Item No. 272 (1991).

115. Joint Stock Company Decree, *supra* note 82, art. 29.

or other financial services, but the Ministry of Finance shall list them in its national JSC register.[116] The Ministry of Finance must grant registration within thirty days from the application filing date. An application may be denied only if it fails to comply with the requirements of this statute. Applicants may appeal any such denial to a court of law.[117]

Upon registration, the Ministry of Finance shall issue the JSC a temporary certificate of registration. The Minstry of Finance shall then issue an official certificate of registration to the JSC when the JSC pays fifty percent of the charter fund into the account of the enterprise.[118] Some local registration authorities issue only one certificate of registration to a newly registered enterprise. This certificate, even though final on its face, is conditional upon the enterprise's compliance with all attendant requirements of the law, including those relating to the time limit for the contribution of the participants' shares to the capital fund of the joint venture.

The JSC must report any and all changes in the charter to the Ministry of Finance within fifteen days of any such changes.[119]

At the time of the formation, the JSC charter fund shall be expressed in terms of a specific number of shares, each with the same nominal value. The nominal value of each share shall be expressed in tens or multiples of ten.[120]

The charter capital of a closed JSC may not be less than 10,000 rubles. In the case of an open JSC, the charter capital may not be less than 100,000 rubles.[121] The capital fund of a JSC must be expressed in rubles, not in United States dollars or any other foreign currency. If the foreign participant in a JSC is expected to contribute all or a portion of its shares in a foreign currency, the amount to be so contributed must be expressed in rubles using the market exchange rate published by the Central Bank of Russia. The problem with this arrangement is that because the market exchange rate of the ruble fluctuates from one period to another, the foreign participant who agreed in January to contribute the ruble equivalent of US $200,000 in two installments over a one-year period at a fixed par value of each share based on the market exchange rate in January may wind up having more or less shares in the company at the time of the second contribution in December, depending on which

116. *Id.* art. 30.
117. *Id.* art. 32.
118. *Id.* art. 33.
119. *Id.* art. 35.
120. *Id.* art. 35.
121. *Id.* art. 36.

way the exchange rate goes. If the company is fully capitalized at the time of registration, this currency conversion problem would be eliminated.

Unless the participants otherwise stipulate, the capital fund of a JSC may not be used to cover the operational expenses of the enterprise. In that case, the full amount will be left dormant in a bank account to be maintained in the name of the enterprise. The charter may stipulate the participants' wishes as to the disposition of the capital fund. My recommendation, however, is that the contract of foundation of the enterprise should include these stipulations.

Judging by the law on the books there are four apparent differences between open and closed joint stock companies: difference in the minimum amount of their respective capital funds (10,000 rubles as opposed to 100,000 rubles); minimum size of their respective boards of directors (three as opposed to five); rebuttable presumptions as to the free assignment of shares to an outside third party (rebuttable presumption against the free transfer of shares to third parties versus rebuttable presumption of free transferability of shares to third parties); and the source of the capital fund (full contribution of the capital fund solely by the founding participants as opposed to the ability of the founding members to sell some of the shares of the original capital amount to third parties).

In actual practice, the first three differences have been virtually eliminated: The Committee on Foreign Investment, which is attached to the Ministry of Finance, will not register any JSC with a capital fund of less than 100,000 rubles;[122] virtually every JSC has a board of directors consisting of five or more members; founding participants in many open joint stock companies exercise their option to require the consent of all participants in order for one shareholder to assign its shares to an outside third party; conversely, founding participants in many supposedly closed joint stock companies dilute the consent requirements for the transfer of shares to third parties to the point of creating an entity that resembles an open joint stock company. The real and only practical difference between these two types of joint stock companies lies in the fourth feature listed above, the source of the capital fund. To qualify as a true closed JSC under Russian law, the founding participants must contribute all of the capital fund of the enterprise. By contrast, the founding participants of an open JSC routinely reserve the right to sell a prorated portion of their respective shares of the capital fund to outside third parties or, alternatively, allocate a portion of the capital fund to

122. *See supra* note 99.

themselves (e.g., eighty percent), while reserving the balance (e.g., twenty percent) for third-party purchasers.

The participants in a JSC may make their capital contributions in whatever form they agree. Such forms include, but are not limited to, real property, equipment, stocks, right of land use, rent-free lease, right to water use, right to the use of any other natural resources, intellectual property rights, or cash (in rubles or hard currency). All noncash contributions shall be valued by mutual agreement of the participants and such value, to be expressed in rubles, shall be credited to the contributing participant's share of the charter fund of the enterprise.[123]

Within thirty days from the date of the registration of the JSC, each participant must pay at lease fifty percent of that participant's contribution to the charter capital. Within the first year of the existence of the enterprise, all participants must pay the remaining fifty percent of the charter capital.[124] In other words, the enterprise must be fully capitalized within one year from the date of its registration.

The shareholders of a JSC may, as needed, increase the amount of the charter capital, consolidate existing stocks, reduce the nominal value of the existing stocks, or reduce the amount of the charter capital either by reducing the nominal value of each stock or by an outright reduction in the total amount of the charter capital.[125] If the capital fund is increased beyond the original amount stated at the time of the foundation of the enterprise, new shares shall be issued to the participants in proportions that are commensurate with their additional contributions. All unallocated stocks in the joint stock company shall be placed at the disposal of the board of directors of the enterprise[126] and may be traded to third parties at the discretion of the board.

This provision runs counter to the entrenched United States practice of expressing the par value of each corporate stock as one dollar. In Russian joint venture practice the custom is to express the nominal (par) value of JSC stocks in denominations of .100 rubles, 1000 rubles, or 10,000 rubles. Because of the creeping devaluation of the ruble, the general preference in Russian joint venture practice is to value each JSC stock at 10,000 rubles.

A JSC may issue only nominated stocks (*imennye aktsii*), i.e., stocks sold to specific holders and must enter their names in a register main-

123. Joint Stock Company Decree, *supra* note 82. art. 37.
124. *Id.* art. 38.
125. *Id.* art. 39.
126. *Id.* art. 40.

tained by the company.[127] The JSC may issue ordinary stocks (stocks that grant voting rights to the holders) or privileged stocks (stock that do not grant voting rights to the holders). Holders of privileged stocks shall receive dividends and enjoy privileged treatment as compared to the holders of ordinary stocks in the distribution of company profits as well as in the event of the liquidation of the enterprise.[128]

The JSC shall distribute net profits of the enterprise to the participants as dividends or contribute them to the reserve fund of the JSC.[129] Participants shall receive dividends in direct proportion to their shares in the charter fund of the enterprise.[130]

The JSC shall create a reserve fund in an amount of not less than ten percent of the charter fund. The charter shall stipulate the procedure for contributing to this fund or for transferring money therefrom.[131]

The JSC may grant stock options to its employees as it desires. For example, a JSC may grant its employees the right to purchase stocks of the company under preferential terms.[132]

The financial year of the JSC shall run from January 1 to December 31.[133] An annual general meeting of the shareholders must be convened within three months from the closing of the financial year to approve the financial report of the enterprise for the preceding year.[134]

The highest organ of the JSC shall be the general meeting of the stockholders, which shall convene at least once per year.[135] The participants and the charter of the enterprise shall determine the power of this body. At intervals, between sessions of the general meeting of the stockholders, the highest organ of the JSC shall be the board of directors. The general meeting of the stockholders shall determine the size and composition of the board. The board must have an uneven number of members, but not less than three members in the case of a closed JSC or five members in the case of an open JSC.[136] The powers of the board of directors shall also be determined by the participants and stipulated in the charter of the enterprise.

At their general meeting, the shareholders shall appoint one of the

127. *Id.* art. 46.
128. *Id.* art. 49.
129. *Id.* art. 68.
130. *Id.* art. 70.
131. *Id.* art. 81.
132. *Id.* art. 83.
133. *Id.* art. 85.
134. *Id.* art. 86.
135. *Id.* arts. 91, 92.
136. *Id.* arts. 108, 109.

directors to serve as the general director or president of the enterprise. In addition to the board of directors, the JSC may appoint an executive committee (*pravlenie*) to manage the affairs of the company at intervals between sessions of the board of directors. When this option is exercised, the board of directors shall become the super board of directors and the executive committee shall function as the operational board that would run the day-to-day affairs of the enterprise. The general director shall preside over the executive committee.[137]

Russian law grants the participants virtually unrestricted freedom to determine the powers of the meeting of shareholders and those of the board of directors. If the parties wish to create a truly executive board of directors and a meeting of shareholders with limited policy-making powers, they may do so by allocating a wide range of executive powers to the board. One sticky point that typically arises in this regard is that in a joint stock company in which the Russian participant is a minority partner, the latter will resist any attempts by the majority foreign partner to take full control of the executive organs of the enterprise. For example, an arrangement by which a seventy-five percent foreign partner shall retain the power to nominate the chairperson of an executive board of directors as well as the executive general director of the enterprise will not be well received by the twenty-five percent Russian partner. Traditionally, the Russian party, even if it is the minority partner, will insist on the right to nominate the chairperson of the board of directors. One way for the seventy-five percent foreign partner to accommodate this politically charged Russian request is to do the following: create a two-tier board of directors—an executive super board and a nominal operational board, stack the deck against the operational board by allocating more executive powers to the super board, vest more powers in the executive general director, let the Russian party nominate the chairperson of the operational board, but insist on the foreign partner's right to nominate the executive general director and control the executive super board. This arrangement will save the enterprise from a potential political stalemate.

An audit commission consisting of stockholders in the company shall supervise the financial affairs of the enterprise. A member of the executive committee may not concurrently serve on the audit commission.[138]

A JSC may establish subsidiaries, branch offices, or representation offices in the territory of the Russian Federation or abroad. The JSC shall own at least "fifty percent of the stocks plus one" in any of its

137. *Id.* arts. 125, 126.
138. *Id.* art. 130.

subsidiaries.[139]

In addition to the internal audit carried out by the audit commission, a JSC may engage the services of an accounting firm to carry out an annual external audit of its books.[140]

VI. Russian Federation Legislation on the Taxation of Joint Ventures

A. *A Chronology of Russian Federation Legislation on the Taxation of Joint Ventures*

Tax planning is a critical element in the business strategy of any United States company contemplating investment abroad. When the prospective foreign market is the Russian Federation, good tax planning takes on an additional importance for any United States investor. A close look at the Russian tax culture reveals three disturbing features: the system lacks a clearly articulated tax policy; the tax burden is quite severe on the taxpayer;[141] and there is no tradition of tax compliance by businesses and individual citizens.[142] The combined effect of these three ele-

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139. *Id.* arts. 149, 150.

140. The law itself neither requires nor proscribes external audits—a practice engaged in by virtually all joint ventures in Russia.

141. In September 1992 the Russian Internal Revenue Service published its 1992 third quarter report on the state of taxation in Russia. *See Taxes Are Reduced, but the Number of Taxpayers Has Risen*, IZVESTIIA, September 11, 1992, at 1. The report contained the following revelations: about 40 different types of taxes are being collected in Russia today; by comparison with advanced tax systems in the world where, on the average, the number of taxes being collected is 100, the figure of 40 puts Russia in the bush league among tax systems; the foregoing notwithstanding, the tax burden on the taxpayer is commensurably higher in Russia than it is in the advanced tax systems of the world; during the first seven months of 1992, 1218 trillion rubles were collected in taxes—about a third less than the amount that was envisaged by the budget plan; about 94% of all taxes collected were attributable to only four sources—profits tax yielded 45%, VAT contributed 33%, tax on luxury items kicked in 5%, and income tax produced 10.6%; the government is able to collect only 57% of the VAT that is called for in the state budget—this is due perhaps to the fact that not all goods that are produced are sold or exchanged; the Russian Internal Revenue Service estimates that only about 45% of all goods that are produced in Russia are sold or exchanged. The report ended by asking a question that in the Russian context is rhetorical, i.e., how much money would the state receive in tax revenues if all payable taxes are actually collected by the state revenue service? Even the head of the Russian state tax service, Mr. I. Lazarev, did not have an answer for this question. The report did conclude, however, with this optimistic note: the state revenue service today employs about 80,000 persons and a newly formed department of tax investigations uncovered 40 million rubles in unpaid taxes during the first two months of its existence.

142. *Kommersant* recently reported that the Russian government is getting quite

ments is a very volatile and discretionary tax structure that has the potential for turning a conscientious and law-abiding taxpayer into an unsuspecting tax evader and an unknowing tax delinquent. The Russian government is painfully aware of these shortcomings[143] and is working

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concerned about the low level of tax compliance in the Russian Federation. This is evidenced by the fact that in the middle of October two high ranking Russian government officials—the Minister of Internal Affairs (Mr. Stepankov) and the Procurator General (Mr. Elin)—visited Cyprus in an attempt to uncover how many Russian citizens have secret accounts in that well-known tax haven. The Russian government believes that many Russian citizens are evading taxes in Russia by opening tax-free secret bank accounts in Cyprus. The purpose of these high profile visits to Cyprus is to track down these tax evaders. *See There Will Not Be an Increase in Taxes or in the Value of the Ruble*, KOMMERSANT, October 12-19, 1992, at 2. In the same article, the newspaper's political commentaor posed the following question: "Why do people refuse to pay taxes?" To his question he offered the following answer: "The answer is quite simple: because of the oppressive nature of the tax system. The higher the tax rate, the narrower the tax base, because it is cheaper not to pay ten million rubles in taxes, but rather to spend five million rubles in attorney's fees and bribes. That way, you save yourself five million rubles." *Id.*

A subsequent study confirms the worst fears of the Russian government, i.e., that Russian entrepreneurs are, in fact, setting up offshore companies in Cyprus to take advantage of the low Cyprus corporate income tax (4.25%) and the relief from Russian tax laws that is provided by the Russia-Cyprus convention on the elimination of double taxation. As of October 12, 1992, there were 300 Russian offshore corporations registered in Cyprus. *See Cyprus is Attractive as Usual for All*, KOMMERSANT, Oct. 12-19, 1992, at 14. In addition to Cyprus, other offshore tax havens that are popular with Russian entepreneurs are the Bahamas, Gibraltar, Isle of Man, Ireland, Hong Kong, and Panama. *See An Advertisement: Registration of Companies in Zones with Advantageous Tax Rates*, KOMMERSANT, Oct. 12-19, 1992, at 32.

143. Cognizant of the need to inject some order into the Russian system of taxation, the Supreme Soviet of the Russian Federation adopted a decree that in effect banned the practice of burying tax measures in legislation that have nothing to do with taxation. Under this old practice a statute dealing with, for example, environmental protection could include a provision granting tax exemptions to enterprises that adopt technology that was deemed by the statute to be environmentally friendly. Because these tax riders are typically oblivious to any other tax laws that are already on the books, they result in confusion and inconsistency in tax legislation. The July 10, 1992 decree puts an end to the practice of promulgating tax legislation in the form of tax riders. Here is the full text of the decree:

> For the purpose of the systemization of the tax legislation of the Russian Federation and with a view to injecting some order into its tax legislative activities, the Supreme Soviet of the Russian Federation decrees as follows—1) Federal taxes (including the rates of taxation and tax privileges) that are passed pursuant to the Law of the Russian Federation, *On the Fundamental Principles of the Tax System of the Russian Federation*, shall be instituted only by legislative acts of the Russian Federation which in turn must be enacted by the Supreme Soviet of the Russian Federation in the form of laws and decrees dealing exclusively with taxa-

hard to rectify them.

Even before the demise of the USSR federal state on December 25, 1991, Soviet tax policy was ill-defined and its tax legislation lacked specificity and stability. The Russian government inherited all of the bad habits of the USSR's tax policy. The post-1991 tax laws continue to manifest the same lack of consistency[144] that characterized prior USSR tax legislation. With the elimination of Soviet federal taxing authorities, the government of the Russian Federation was determined to fill the void created by the collapse of the USSR's tax collection mechanism.[145] The

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tion. Those state agencies that are authorized to promulgate executive legislation that is intended to implement specific tax legislation must also devote such legislation exclusively to tax matters. Any changes in the existing tax regime shall be instituted by way of amendments or additions to specific tax legislation of the Russian Federation. 2) Drafts of legislation of the Russian Federation which regulate matters that are not directly connected with taxation may not include provisions dealing with the imposition of or the granting of an exemption from taxation. Any draft legislation that fails to conform with this law shall not be listed in the register of draft legislation and consequently may not be presented for discussion before a session of the Supreme Soviet of the Russian Federation. All proposals for the modernization of the tax legislation of the Russian Federation must be presented in the form stipulated in clause 1 of this decree.

See Decree [No. 3255.1 of July 10, 1992] of the Supreme Soviet of the Russian Federation, *On Certain Questions Relating to the Tax Legislation of the Russian Federation,* ROSSISKAYA GAZETA, August 14, 1992, at 6. This decree put in place three cardinal rules of modern Russian tax law: only the legislature may impose new taxation or grant exemptions thereto; all tax legislation must be promulgated in the form of legislative acts that deal specifically and exclusively with taxation, not in the form of tax riders to legislation that deal with matters not related to taxation; an executive agency may, through its tax regulations, provide guidelines for the interpretation or application of tax legislation but may not amend or vitiate the intent of the tax legislation in question.

144. During a private meeting with the United States Ambassador to Russia (Mr. Robert Strauss), the Chairman of the Soviet of the Russian Federation seized the opportunity to express publicly his feelings about the current tax policy of the Russian government. Mr. Ruslan Khazbulatov characterized the Russian government's tax policy as "absolutely incorrect, unprofessional, and detrimental to industry, as a result of which enterprises stagnate and in protest against which entire regions, Krai and autonomous republics, refuse to make payments to the central tax coffers." He opined during the same meeting that the Russian legislature deems it necessary to "exempt from taxation all new investment in industry and plans to convince the government to reduce taxes on imported goods." *See Spiker Parlamenta Rossii Prinial Posla SSHA,* ROSSISKAYA GAZETA, July 11, 1992, at 1 [*The Speaker of the Russian Parliament Received the U.S. Ambassador*].

145. On March 21, 1991, the Supreme Soviet of the Russian Federation established its own state revenue service, the Russian equivalent of the United States Internal Revenue Service, to replace the State Revenue Service of the USSR within the territory of Russia. *See* Law of the Russian Federation, VED. S'EZDA NAR. DEP. RF, Issue No. 15,

Russian government would like the outside world to believe that it desires its tax laws to be predictable. The unfortunate truth, however, is that when it comes to the promulgation of tax legislation, the word "stability" is just not in the mental software of the Supreme Soviet of the Russian Federation. For example, between October and December of 1991, the Russian Federation government promulgated an inordinate amount of overlapping tax legislation dealing with the various aspects of joint venture taxation. Many of these new tax laws acquired numerous and poorly coordinated amendments within a few months of their enactment.[146]

Item No. 492 (1991). On November 21, 1991, the President of the Russian Federation issued his own decree entitled *On the State Revenue Service of the Russian Federation*, VED. S'EZDA NAR. DEP. RF, Issue No. 47, Item No. 1641 (1991). A special tax police force of the Russian Federation was created on February 11, 1992. *See* KOMMERSANT, February 17, 1992, at 25.

146. On July 16, 1992, the Supreme Soviet of the Russian Federation handed down a new stack of amendments that directly modified the provisions of eight of the pieces of tax legislation listed in this study, as follows: Law of the Russian Federation, *On the Taxation of Added Value*; Law of the Russian Federation, *On the Taxation of Luxury Items*; Law of the Russian Federation, *On the Taxation of the Income of Individuals*; Law of the Russian Federation, *On the Taxation of the Income of Banks*; Law of the Russian Federation, *On the Taxation of Income Derived from Insurance Activities*; Law of the Russian Federation, *On Investment Tax Credits*; and Law of the Russian Federation, *On the Taxation of the Income of Enterprises and Organizations*. *See* Law of the Russian Federation, *On the Incorporation of Amendments and Additions to the Tax System of Russia*, Law of July 16, 1992 (Law No. 3317-1), VED. S'EZDA NAR. DEP. RF, Issue No. 34, Item No. 1976 (1992).

Among other things, the July 16, 1992 amendments to the VAT law exempted mineral lease payments from the value added tax. *See infra* note 185 and accompanying text. The July 16, 1992 tax relief to the mineral lessee was in part reversed by a subsequent law of August 14, 1992 that imposed an excise fee on oil and gas extracted from wells that are located in territories with "relatively good mineralogical-geological and economical-geographical conditions." *See* Decree of the President of the Russian Federation, *On the Imposition of an Excise Tax on Mineral Use in the Territory of the Russian Federation*, VED. S'EZDA NAR. DEP. RF, Issue No. 34, Item No. 1993 (1992) (amended July 16, 1992).

The following is a partial list of the tax regulations unveiled during the fourth quarter of 1991, with subsequent amendments through July of 1992:

1. Instructions of the Ministry of Finance of the Russian Federation, *On the Specific Features of the Taxation of the Profits of Joint Enterprises with the Participation of Foreign Investors and the Dividends of the Participants in Such Enterprises in the Territory of the Russian Federation*; Law of October 14, 1991, Instruction No. 16/315-B, VNESH. TORGOVLIIA 39 (1991).
2. Law of the Russian Federation, *On Value Added Tax* [amended on May 22, 1992, and July 16, 1992]. Law of December 6, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 52, Item No. 1871 (1991). Law of May 22, 1992, VED. S'EZDA

For the purpose of this new tax legislation, the term "enterprise" refers to all forms of business organizations that Russian law treats as legal entities, i.e., state enterprises, municipal enterprises, closely held family enterprises organized as limited partnerships, limited partner-

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NAR. DEP. RF, Issue No. 23, Item No. 1229 (1992); Law of July 16, 1992. *See* ROSSISKAYA GAZETA, July 17, 1992, at 1. A full text of the July 16, 1992 amendments is published in VED. S'EZDA NAR. DEP. RF, Issue No. 34, Item No. 1976 (1992).

3. Law of the Russian Federation, *On the Taxation of Luxury Items* [amended on July 16, 1992]. Law of December 6, 1992, VED. S'EZDA NAR. DEP. RF, Issue No. 52, Item No. 1872 (1991).

4. Law of the Russian Federation, *On Individual Income Tax* [amended on July 16, 1992]. Law of December 7, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 12, Item No. 591 (1992).

5. Law of the Russian Federation, *On the Taxation of Individual Property,* Law of December 9, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 8, Item No. 362 (1992).

6. Law of the Russian Federation, *On the Taxation of the Income of Banks* [amended on July 10 and 16, 1992]. Law of December 12, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 12, Item No. 595 (1992). The July 10, 1992 amendments were embodied in an amendment of the Decree of the Supreme Soviet of the Russian Federation, *On the Procedure for the Implementation of the Law of the Russian Federation 'On the Taxation of the Income of Banks.' See* Decree of the Supreme Soviet of the Russian Federation, *On Matters Relating to Taxation,* VED. S'EZDA NAR. DEP. RF, Issue No. 32, Item No. 1876 (1992).

7. Law of the Russian Federation, *On the Taxation of Securities Transactions,* Law of December 12, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 11, Item No. 523 (1992).

8. Law of the Russian Federation, *On the Taxation of the Income Derived from Insurance Activities* [amended on July 16, 1992]. Law of December 13, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 12, Item No. 597 (1992).

9. Law of the Russian Federation, *On the Taxation of Enterprise Property* [amended on July 10, 1992]. Law of December 13, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 12, Item No. 599 (1992).

10. Law of the Russian Federation, *On Investment Tax Credits* [amended on July 16, 1992]. Law of December 20, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 12, Item No. 603 (1992).

11. Law of the Russian Federation, *On the Taxation of the Income of Enterprises* [amended on July 16, 1992]. Law of December 20, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 12, Item No. 601 (1992) [hereinafter Law on Enterprise Income Taxation].

12. Law of the Russian Federation, *On the Taxation of Enterprise Profits,* Law of December 27, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 11, Item No. 525 (1992).

13. Law of the Russian Federation, *On the Fundamental Principles of the Tax System of the Russian Federation,* Law of December 27, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 11, Item No. 527 (1992).

ships, and joint stock companies of both the open and closed types. All of these enterprises are taxable entities under these new laws. A general partnership is not a taxable entity except for purposes of the value added tax (VAT), discussed in subpart VI(D) below.

A distinct feature of these new Russian tax laws is that they regulate enterprise income and profits taxes in two separate statutes. This bifurcated approach to taxation ensures that even nonprofitable enterprises will nevertheless pay taxes on their income. The intention of these laws is not to subject the same corporate taxpayer to both an income tax and a profits tax. A taxable enterprise, however, will have to pay one tax or the other. These laws eliminated the tax holiday[147] that some joint ventures enjoyed under the pre-1991 USSR federal law on corporate taxation. The Investment Tax Credits legislation should encourage investments by those enterprises that might feel overburdened because of the combined effect of the other tax laws put in place by the Russian government at different times between October and December of 1991.

The following discussion analyzes the key provisions of the law on the taxation of enterprise income, the law on individual income tax, the law on value added tax, the law on the taxation of individual property, and the law on the taxation of enterprise property. The enforcement of these and all the other tax laws of the Russian Federation is entrusted to two very powerful agencies of the Russian federal government.[148]

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147. On the question of a tax holiday for joint enterprises, the Russian Federation legislature did a somersault on July 10, 1992 by partially restoring this important tax incentive to some preferred enterprises. The Decree of the Supreme Soviet of the Russian Federation, *On the Amendment of the Decrees of the Supreme Soviet of the Russian Federation on Matters Relating to Taxation*, Decree No. 3257-1, VED. S'EZDA NAR. DEP. RF, Issue No. 32, Item No. 1876 (1992), contained an important amendment to the Law of the Russian Federation, *On the Taxation of the Income of Enterprises and Organizations*. The July 10, 1992 amendment deleted paragraphs 3 and 5 of Article 4 (which denied any tax holidays to all enterprises, including international joint ventures) of the Law of December 20, 1991 as well as added the following new fourth paragraph to Article 3 of that law:

> It is hereby decreed that these joint enterprises with the participation of foreign investors that are engaged in the production of goods and were properly registered prior to January 1, 1992 shall continue to enjoy the exemption from the taxation of their income during the first two years (in the case of joint enterprises that are established in the Far Eastern Economic Zone—three years) after the first profitable year of operations.

148. The administration of Russian tax laws is entrusted to a very powerful agency called the State Revenue Service (SRS) of the Russian Federation. The SRS was created in 1991 to replace its USSR predecessor, which was called the State Revenue Service of the USSR. *See* Law of the Russian Federation, *On the State Revenue Service of the Russian Federation*, Law of March 21, 1991, 15 VED. S'EZDA NAR. DEP. RF Item 492

B. *A Digest of the Law of the Russian Federation* On the Taxation of Enterprise Income

Just one week after passing the law on the taxation of enterprise income, the Russian legislature adopted a companion law on the taxation of enterprise profits. The latter law went into force on January 1, 1992. The enterprise income tax law of December 20, 1991 had not gone into force as of December 15, 1992, but the State Revenue Service of the Russian Federation has already issued instructions on how it should be applied to foreign companies operating in Russia if and when the law goes into force.[149] Enterprises other than banks will, however, pay either an income tax or a profits tax. Most certainly, the same entity will not be subject to both the income and profits tax. A principal difference be-

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(1991). The powers of the SRS were enhanced in a subsequent decree of the President of the Russian Federation, *On the State Revenue Service of the Russian Federation*, Law of November 21, 1991, 47 VED. S'EZDA NAR. DEP. RF Item 1641 (1991). The enforcement of the tax laws, on the other hand, is entrusted to another state agency called the Tax Inspectorate of the Russian Federation, popularly referred to as the tax police. Like the SRS of the Russian Federation, the Tax Inspectorate was intended as a successor to the USSR (federal) antecedent—the Tax Inspectorate of the USSR—whose powers and functions it inherited. The creation of the Tax Inspectorate in 1992 was heralded by numerous newspaper articles touting its virtually unlimited powers. Among other things, the "tax police" are authorized to carry firearms and to impose a fine of up to 500 rubles "on the spot" on all persons who are determined by the officers to be "tax evaders." *See Tax Police—Armed and Very Intelligent*, KOMMERSANT, February 10-17, 1992, at 25.

In an unusual case that was reported in late 1992, a taxpayer won an unprecedential fight against the all-powerful Tax Inspectorate. *See Bank Sues the Tax Inspectorate and Wins*, IZVESTIIA, August 26, 1992, at 2. In 1990 the Tax Inspectorate determined Vostok (a cooperative bank) to be delinquent in the payment of its taxes, accused it of hiding its taxable income, and assessed a fine on the bank in the amount of "millions of rubles." As the basis for its action the Tax Inspectorate (which at this time was still the Tax Inspectorate of the USSR) cited Instruction No. 34-B, issued by the USSR Ministry of Finance on June 15, 1990. In the opinion of the Tax Inspectorate, Vostok violated the provisions of this ministerial instruction. As its defense against the charge of tax evasion, Vostok argued that it did not have actual or constructive knowledge of Instruction 34-B because it was neither published nor otherwise brought to its attention. As such, Vostok contended, the fine assessed against it by the Tax Inspectorate was unlawful. Confident in its position, Vostok agreed to submit itself to a tax audit. Vostok filed suit against the Tax Inspectorate in the Supreme Court of Arbitration. The court agreed with Vostok's contention, and a tax audit revealed that Vostok did not owe any additional taxes. The court ordered the Tax Inspectorate to refund the full amount of the fine assessed against Vostok, plus court costs. In total Vostok received a refund in the amount of 4.23 billion rubles. *Id.*

149. *See* Instructions of the State Revenue Service of the Russian Federation, *On the Taxation of the Profits and Income of Foreign Enterprises*, Instructions of May 27, 1992, No. 13, 8 VNESH. TORG. 49-52 (1992).

tween these two tax regimes is that the profits tax allows businesses to deduct wages and other employee costs, and the tax rate is calculated at thirty-two percent. Under the income tax regime, wages and employee costs are not deductible and the rate is calculated at eighteen percent. Each taxpayer will apparently have a choice between these two tax regimes. Against this backdrop, this Article next examines the key provisions of the enterprise income tax legislation.

1. General Provisions

This legislation shall not apply to banks because banks shall continue to be taxed under the separate law *On the Taxation of the Income of Banks.*[150] Article 1 further stipulates that insurance companies shall continue to pay taxes on their insurance income under the separate law *On the Taxation of Income Derived from Insurance Activities.* [151] However, this legislation shall apply to any other income derived from noninsurance activities by insurance companies.[152]

All foreign enterprises organized under the laws of foreign countries that maintain a permanent presence and conduct business activities in the territory of the Russian Federation[153] shall pay an income tax according to the provisions of this legislation. Throughout this legislation, such enterprises shall be referred to as "foreign enterprises." The permanent presence of a foreign enterprise in the Russian Federation may take the form of a branch office, representation office,[154] wholly owned

150. Law on Enterprise Income Taxation, *supra* note 146, art. 1.

151. Law of December 13, 1991, *supra* note 146.

152. Law on Enterprise Income Taxation, *supra* note 146, art. 1.

153. This law does not define what is meant by "business activities in the territory of the Russian Federation," a concept that is critical to determining what constitutes Russian-based taxable income. For example, will a respresentation office be deemed to engage in the conduct of business activties in the Russian Federation if all it does is display goods, operate a warehouse for the storage of goods, accept or make delivery of goods, purchase goods based on orders by its parent company, gather business information for the exclusive use of its home office, initiate preliminary negotiations on behalf of its parent company, or engage in any other form of ancilliary services solely at the behest of its parent company? Russian law is unclear on this point.

154. This law does not define what constitutes a "representation office" for purposes of Russian enterprise income taxation. Many foreign companies that plan to do business in Russia set up what could best be referred to as "listening outposts" somewhere in Russia, typically in a hotel room, staffed by one or two employees. Typically, these outposts are not registered with the local government authorities as such. The principal assignment of these outposts is to gather business intelligence for their home office. If a business lead developed by such a representation office develops into an actual project, preliminary negotiations with the Russian party may be commenced by the representa-

subsidiary, or agency arrangement.[155]

For purposes of this legislation, "taxable income" shall include all proceeds received from the sale of goods, services, or other things of value as well as from any other nonsale activities, after the deduction of the value added tax (VAT) and other deductions.[156] The taxpayer shall deduct all deductible expenses (with the exception of salaries and analogous expenses) enumerated in a list published by the Russian Federation government. Both the legislative and the executive branches of the Russian government will agree on the deductions included in this list.[157]

Interest paid on bank loans shall be treated as a deductible business expense to the extent that such interest does not exceed the rate stipulated by the Russian Federation Supreme Soviet. The taxpayer may also deduct some other taxes paid to the Russian government from gross income prior to the computation of taxable income. These taxes include a property tax, a land use tax, and a highway tax.[158]

Hard currency income shall be taxed at the same rate currently appli-

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tion office. But invariably these negotiations continue and are concluded outside Russia. Then there is the full-blown representation office that is fully staffed and registered with the Russian authorities as such. It not only gathers business intelligence but actually conducts legal business on behalf of the home office. For the purposes of this analysis I will refer to this as the "full-blown local presence" of a foreign company. A close reading of article 4 of this law suggests that the latter type of representation office is what the authors of this law had in mind. The problem, however, is that modern Russian law does not permit the establishment of the first type of representation office in the territory of the Russian Federation. There is no law on the books that requires all representation offices of foreign companies to register with the Russian authorities in order to function as such. There is a law (a Tax Inspectorate Instruction), however, which says that to open a bank account in any Russian bank, a representation office must be registered with the Russian authorities. The practical result of this law, which is ostensibly a banking regulation, is that all representation offices must be registered with the Russian government authorities. As long as a representation office is registered with the Russian tax authorities as a taxpayer and derives income from the territory of Russia, it qualifies as a taxable entity under the provision of article 4 of this law regardless of whether it functions merely as a "listening outpost" or as a "full-blown local presence" of a foreign company. It should be noted, however, that in Russian practice the key element in determining the taxability of a representation office is not whether it functions as a listening outpost or as a full-blown local presence, but rather whether it derives income from the territory of the Russian Federation. Thus, a registered taxpayer that does not have any taxable Russian income will avoid Russian-income taxation. This law does not provide for the Russian taxation of the worldwide income of a registered representation office of a foreign company.

155. Law on Enterprise Income Taxation, *supra* note 146, art. 1.

156. *Id.* art. 5, para. 1.

157. *Id.* art. 6.

158. *Id.* art. 6, para. 2.

cable to income derived in rubles.[159] All hard currency income shall be converted into rubles for the purpose of computing income tax by using the "official exchange rate" of the Russian Central Bank in effect on the date of the receipt of the income.[160] Once converted into rubles, the taxpayer shall add the hard currency with any ruble income to arrive at the taxpayer's total taxable income. Tax on all such income, including hard currency income, shall be paid in rubles.[161]

The Supreme Soviet of the Russian Federation, the Supreme Soviets of the subordinate republics within the Russian Federation, and the city councils of Moscow and St. Petersburg have the power to assess and collect income tax from enterprises. Each taxing authority shall establish its own tax rate for its territory. This rule grants some discretion to the respective taxing authorities to vary the tax rates in their respective jurisdictions. Thus, for example, the city council of St. Petersburg may decide to grant a tax benefit to its enterprises by assessing a lower income tax on them. Therefore, two similarly situated enterprises operating in different tax districts of the Russian Federation may pay different taxes on their similarly computed incomes. This discretionary authority, however, does not permit the taxing authority to grant preferential tax treatment to one particular industry over another. Article 8 of this legislation (discussed below) specifically prohibits industry-by-industry discriminatory tax treatment by local authorities. In the exercise of their discretionary taxing power, the taxing authorities may assess an income tax of up to, but not more than, eighteen percent of net income.[162] Article 8, paragraph 1 of this law allows the taxing authority to "progressively increase" the tax rate depending on the size of the taxpayer's tax base. The tax rate, however, shall not be dependent upon the character of the taxpayer's activities, except for the following special tax rates stipulated in article 8, paragraphs 2 and 3:

1. Accounting and consultant firms shall pay income tax at the rate of twenty-five percent;

2. Brokerage firms, as well as all other firms that provide services as intermediaries, shall pay an income tax at the rate of forty-five percent;

3. Income derived from auction sales, casinos, video rentals, audiocassette rentals, rental of pinball machines, or other gambling and entertainment activities shall be taxed at the rate of seventy percent;

4. Russian participants in any joint venture involving foreign investors

159. *Id.* art. 7.
160. *Id.* art. 7, para. 2.
161. *Id.* art. 7, para. 3.
162. *Id.* art. 8, para. 1.

shall pay income tax on their dividends at the rate of fifteen percent.[163]

Foreign entities participating in a joint venture shall pay a fifteen percent tax on their dividends from such joint ventures. Foreign entities that receive income from a source in the Russian Federation but do not maintain a permanent representation office or conduct business activities in the territory of the Russian Federation shall pay a tax on such income (e.g., author's royalties, fees for the use of one's patent license, fees paid to the lessor of equipment) according to the rate set forth in paragraph 1 of this provision. Basically, an income tax rate of up to eighteen percent shall apply, unless any applicable international convention stipulates otherwise.

Article 11 stipulates a five-year tax holiday on the following categories of income:

1. Income received by a patent holder from the use of its patent;

2. Income received from the use of an invention by an enterprise that purchased a license to the invention. In this case, the tax holiday is for two years starting from the date of the use of the invention;

3. Income received from a new patented process intended specifically to create a new technology on the basis of a patented invention. In this case, the tax holiday is for five years starting at the beginning of the new production process;

4. All proceeds, including hard currency income, received by an enterprise from the use of an industrial model shall be tax exempt for one year starting from the date the enterprise first used the model.

In the computation of the state budget for the next fiscal year, the Supreme Soviet of the Russian Federation may change the tax rates as well as the deductibility of expenses from taxable income and any tax privileges stipulated in this legislation.[164]

Income earned by enterprises owned by private individuals shall be taxed like any other enterpise at the rate stipulated in article 8 of this legislation.[165] Therefore, income earned by an entrepreneur operating as a sole proprietor shall be taxed under the provisions of the Law of the Russian Federation called *On the Taxation of the Income of Individuals.*[166] In a general partnership (*polnoe tovarishchestvo*), article 16, paragraph 1 stipulates that the agreement among the partners shall determine the income of the partners and that such income shall be taxed pursuant to the provision of the Law of the Russian Federation *On the*

163. *Id.* art. 8, para. 4.
164. *Id.* art. 13.
165. *Id.* art. 15, para. 1.
166. *Id.* art. 15, para. 1.

Taxation of the Income of Individuals.[167] Under Russian Federation law a general partnership is not a legal entity and, therefore, it does not pay tax. A general partnership, however, must file an informational tax return that the government uses to verify the taxable income of its partners. The income of a mixed partnership (*smeshannoe tovarishchectvo*) shall be taxed at the rate applicable to enterprises. The partners shall receive as dividends any income left over after all taxes have been paid by the mixed partnership. If a partner in a mixed partnership is a legal entity, that partner's dividend shall be taxed under article 8 of this legislation just like any other corporate income. By contrast, if a partner in a mixed partnership is an individual, that partner's dividend shall be taxed pursuant to the Law of the Russian Federation *On the Taxation of the Income of Individuals.*[168] Therefore, under Russian Federation law, a mixed partnership is a legal person for tax purposes.

According to the stipulations in article 18, income earned by a joint stock company, regardless of whether it is a closed or an open joint stock company, shall be taxed at the rate applicable to enterprises in article 8 of this legislation. Participants in a joint stock company shall pay tax on dividends under article 8 of this law (if the participant is a legal entity), or according to the law *On the Taxation of the Income of Individuals* (if the participant is a physical person). The provision in article 18 applies only to joint stock companies with no foreign participants. If any participant in a joint stock company is a foreign investor, article 8, paragraphs 4 and 5 of this legislation mandate that the dividends distributed to participants, whether Russian or foreign, shall be taxed at a lower rate of fifteen percent.

2. Some Concluding Remarks

Even though the Russian Federation Supreme Soviet passed this new enterprise income tax law on December 20, 1991, the law itself fails to stipulate when it will go into effect. The deliberate failure to set an effective date reflects the strong disagreement between the Russian Federation legislature and government regarding certain provisions in this law. The law of December 20, 1991 simply stated that "[the law] will go into effect as soon as agreement on that point is reached between the legislature and the executive branch." In the meantime, the statement issued by the executive branch simultaneously with the adoption of the legislation by the Supreme Soviet expressed the desire that "the law will go into

167. Law of December 7, 1991, *supra* note 146.
168. *Id.*

effect on January 1, 1993," but the legislative sponsors of the law expressed the wish that the law "go into effect as soon as possible."

The position of the executive branch is that because the new VAT law imposes a twenty-eight percent tax,[169] Russian industries deserve a break from heavy income taxation. The executive branch believes that one way to give Russian enterprises a financial break is to "put off as much as possible the tax on income and tax on profits." In any case, until the corporate income tax law of December 20, 1991 goes into effect, the existing Russian Federation law on corporate income tax will continue to operate. The law of December 20, 1991 will probably go into effect no later than January 1, 1993. Any tax planning for the period after January 1, 1993 should base its assumptions on the provisions of this law.

Under the provisions of the December 20, 1991 law, a general partnership is not a taxable entity. Instead, the law treats a general partnership as a conduit for the distribution of dividends to its partners, who in turn must pay an income tax on such dividends.[170] By contrast, the law taxes mixed partnerships as if they were corporations.

The law taxes the dividends distributed to participants in a joint stock company with a foreign participant at a lower rate of fifteen percent, as compared to an eighteen percent tax rate for dividends distributed to the participants in a wholly domestic joint stock company. Apparently, association with a foreign investor creates a tax advantage in the eyes of a Russian enterpreneur.

C. *A Digest of the Law of the Russian Federation* On the Taxation of Individual Income

1. Introduction

On December 7, 1991, the Supreme Soviet of the Russian Federation passed a new law on the taxation of individual income. The new law introduces a few changes into the existing law. For example, under the new law, the minimum tax rate for an individual shall be twelve percent for a monthly income of up to thirty-five hundred rubles. For any monthly income in excess of thirty-five hundred rubles, the new maximum tax rate shall be sixty percent. Under the old tax law, which remained in effect until December 31, 1991, the tax rate was calculated at a minimum of thirteen percent for a monthly income of up to one thou-

169. This VAT rate has now been reduced to 20% by a law of July 16, 1992. *See supra* note 146 and accompanying text.

170. Law of December 20, 1991, *supra* note 146, art. 16.

sand rubles and a maximum of fifty percent on a monthly income in excess of three thousand rubles. In other words, the new law reduces the minimum tax rate, but actually increases the tax level on individual income.

Of interest to Western companies with employees stationed in the Russian Federation is article 2 of the new law relating to the taxation of nonsalary income paid to such expatriate employees. The new law stipulates that the Russian Federation shall tax all income received by such employees maintaining a permanent Russian residence, regardless of whether the income is in rubles or hard currency, or in the form of payments or in-kind payments. For purposes of this law, payments in-kind would include: cost-free use of a company car in the Russian Federation, rent-free residence in a company apartment in the Russian Federation, subsidized airline tickets for periodic home-leave visits by such employees or members of their family, tuition fees for children of employees attending private schools or preschool institutions in the Russian Federation. The law does not stipuate how the Russian Federation tax authorities intend to monitor these "payments in kind," which virtually all Western companies provide for their employees in the Russian Federation.

2. General Provisions

All individuals shall be subject to the provisions of this law, regardless of whether they are citizens of the Russian Federation, the constituent republics of the Commonwealth of Independent States, foreign countries, or stateless persons.[171] All persons maintaining a permanent residence in the Russian Federation shall pay an income tax on all income received either in a monetary form or in-kind.[172] This rule applies to one's global income, which includes income earned outside the territory of the Russian Federation. This provision does not provide a working definition of what constitutes a taxable presence in the Russian Federation, a concept that instead should be inferred from the general principles of Russian Federation tax law.

Under article 3 of this law, certain types of income are exempt from taxation including, but not limited to, the following: social security benefits, pension benefits, workers' compensation benefits, income received from the sale of produce grown in one's private garden plot, and most

171. Law of the Russian Federation, *On the Taxation of Individual Income*, *supra* note 146, art. 1.

172. *Id.* art. 2.

types of insurance payments.

Pursuant to the amendments of July 16, 1992,[173] the rate of taxation shall be as follows on a monthly income of:

Income	*Tax Rate*
up to 200,000	12%
200,001 - 400,000	2,400 rubles plus 24% of the amount in excess of 200,000 rubles
400,001 - 600,000	6,400 rubles plus 30% of the amount in excess of 400,000 rubles
600,001 & above	124,000 rubles plus 40% of the amount in excess of 600,000 rubles

All individuals receiving income from private entrepreneurial activities, to the extent such activities are not prohibited by law, shall pay an income tax according to the provisions of this law.[174] Under article 12 of this law, the taxable income of private entrepreneurs shall be the difference between the business cost and receipts from their business activities. Business costs include expenses connected with the production and sale of one's goods and services, salaries paid to employees, costs of medical and social insurance, costs of property insurance, business license fees, and interest on loans.[175] Business costs do not include, however, penalty payments for late repayment of loans, costs of advertisements, and costs

173. Just one week earlier, on July 10, 1992, the Russian Federation Supreme Soviet enacted amendments to the law *On the Taxation of Individual Income*, which called for a different tax rate as follows: income of up to 200,000 rubles shall be taxed at a rate of 12%; income from 200,001-400,000 rubles shall pay a tax of 24,000 rubles plus 20% of the amount in excess of 200,000 rubles; income from 400,001-600,000 rubles shall pay 64,000 rubles plus 30% of the amount in excess of 400,000 rubles; income in excess of 600,000 rubles shall pay 124,000 rubles plus 40% of the amount by which it exceeds 600,000 rubles. In other words, the July 10, 1992 amendments retained the old minimum 12% tax rate but raised the income level to which such rate applies from 3,500 rubles to 200,000 rubles; taxed income between 200,001-400,000 rubles at 20%; reduced the maximum tax rate from 60% to 40% but raised the level of income to which such rate is applicable from 35,001 to 600,001. *See* Law of the Russian Federation, *On the Incorporation of Amendments and Additions to the Tax System of Russia,* Law of July 10, 1992, KOMMERSANT, July 6-13, 1992, at 24. The discernable difference between the amendments of July 10, 1992 and those of July 16, 1992 is that the latter taxed a monthly income of between 200,001-400,000 rubles at 24% whereas the July 10, 1992 amendments taxed the same income at 20%.

174. *Id.* art. 11.

175. *Id.* art. 12.

of repairing capital equipment.

Every year all taxpayers shall declare their income for the preceding year no later than April 1 of the following year. All taxes shall be paid in three installments during the year in which the tax is due: June 15, August 15, and November 15.

There are other miscellaneous provisions of this law. All persons not maintaining a permanent residence in the Russian Federation but receiving income from the Russian Federation shall pay a tax on this income according to the provisions of this law. Also, all income received in a currency other than Russian rubles shall be converted into rubles using the market exchange rate as established by the Central Bank of the Russian Federation. Income received in kind shall be valued at current market prices, and if such payment in kind is received in currency other than the Russian ruble it shall be converted into rubles using the market exchange rate established by the Central Bank of the Russian Federation.

D. *A Digest of the Law of the Russian Federation* On Value Added Tax

1. Introduction

In an effort to raise revenue, the government of the Russian Federation has adopted a value added tax (VAT), a common device among European nations. The VAT is a form of sales tax leveled on practically all goods and services.[176] In Europe, even within the European Community (EC), the amount of the VAT varies from one nation to another and from one good to another. In its decision to impose the VAT as a revenue-raising measure, the Russian Federation government chose, at first, to impose a massive twenty-eight percent VAT on all goods and services produced in the Russian Republic. This rate is clearly confiscatory in relation to worldwide standards. The Russian Federation VAT law, from which the legislature has now partially retrenched, contained no provision refunding the producers of goods and services the VAT on the purchase price of the capital equipment, thereby exacerbating the situation. World practice on this latter point varies, but most European nations refund the VAT levied on capital equipment purchases.

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176. The VAT

> is a tax based on the net value added to the taxable product by each person concerned with a distinct stage of manufacture, and chargeable also on services rendered. . . . Certain goods and services are zero-rated and certain others exempt but other goods and services are charged at rates varied from time to time.

David Walker, *Value Added Tax*, THE OXFORD COMPANION TO LAW 1271 (1980).

As soon as the Russian government realized that the twenty-eight percent rate was far above world standard, it was forced to bring the rate down. Until this law was changed, the VAT law undoubtedly added to the costs of doing business in the Russian Federation. The original December 6, 1991 text of the statute stipulated that the VAT rate would have been 28 percent and that with regard to those goods and services exchanged at a regulated price into which tax has already been built, the VAT rate would have been 21.88 percent.[177] The July 16, 1992 amendments substantially modified the tax rate as follows: 10 percent for nonluxury food items and some children's goods;[178] 20 percent for all other goods and services as well as for luxury food items.

2. General Provisions of the VAT Law

The law itself consists of ten articles designated respectively as general provisions, payers of VAT, items on which VAT shall be assessed, definition of taxable exchange of goods and services, exemptions from VAT, rates of taxation, procedure for collection of VAT, period of payment of VAT, responsibility of taxpayers, and enforcement by the tax authorities.

The VAT is defined as a budgetary assessment on the value added by the production of goods or the performance of any work or services. In the case of the production of goods, the value is added at the time of production, but the assessment is collected at the time of the exchange of the goods so produced.[179] Payers of the VAT include: all enterprises classified as legal persons under Russian Federation law regardless of their form of ownership, wholly owned subsidiaries of foreign companies, branch offices and representation offices of foreign companies engaging in commercial activities in the territory of the Russian Federation, foreign companies and international associations engaging in commercial activities in the Russian Federation but based outside Russia, and private individuals engaging in business activities in the Russian

177. Law of December 6, 1991, *supra* note 146, art. 1.

178. On November 20, 1992, the government of the Russian Federation published a list of children's goods on which the VAT rate will be 10% beginning on January 1, 1993. The list contains twenty items ranging from school supplies to children's beds, children's mattreses, toys, clothing for newborn babies to children's clothing (not including clothing made from natural fur or natural leather). *See* Decree of the Government of the Russian Federation, *On the Adoption of the List of Children's Goods on Which Starting from January 1, 1993, the VAT Rate Shall Be Ten Percent*, Decree of November 20, 1992, No. 888. ROSSISKAYA GAZETA, November 26, 1992 at 6.

179. Law of December 6, 1991, *supra* note 146, art. 1.

Federation having gross earnings in excess of one hundred thousand rubles per year. Even though general partnerships are not legal persons under Russian Federation law, this law requires them to pay the VAT if they engage in the exchange of goods and services "in their own name."[180] The VAT is the only tax legislation of the Russian Federation that treats a general partnership as a taxable entity.

The VAT applies to all goods produced or sold in the Russian Federation regardless of whether the seller produced the goods or purchased them from another producer. Imported goods are specifically exempted from the VAT.[181] Whenever goods change hands, either between two parties or between two self-accounting units within the same enterprise, including barter transactions, the VAT shall be assessed on them. Similarly, the VAT shall be assessed on all works performed or services rendered inside the territory of the Russian Federation.[182] In the case of any gratuitous transfer of goods or gratuitous performance of work or services, the VAT shall be assessed based upon the current market value (price or tariff) of the goods, work, or services.[183] This provision seems to include something similar to the United States gift tax. If goods are exchanged only for their partial value or if services are performed for which only partial payment is made, the VAT shall be assessed at the full value of the goods exchanged or services performed.[184]

According to the text of the VAT law, as amended on July 16, 1992, the following exchanges of goods, work, or services, among others, shall be exempted from the VAT: goods exported outside the Commonwealth of Independent States as well as the costs of their transportation; the unloading, loading, and transportation of imported goods in transit through the territory of the Russian Federation; goods intended for use by diplomatic missions or their personnel; municipal transportation services (except taxis) and suburban transportation services; apartment rental payments; insurance premiums; interest on loans; interest on savings accounts and certificates of deposit; sale of postage stamps, lottery tickets, postcards and envelopes; fees paid to attorneys for professional services; fees paid to translation services for translations from Russian into a foreign language and vice versa; mineral lease payments; winnings at casinos, gaming machines, and race tracks; services rendered by educational institutions in connection with the educational process; payments

180. *Id.* art. 2.
181. *Id.* art. 3.
182. *Id.* art. 3.
183. *Id.* art. 3, para. 2-C.
184. *Id.* art. 4, § 1, para. 3.

to kindergartens and other preschool establishments; royalties paid to investors, authors, and other owners of intellectual property; research work and experiments paid for out of state budget allocations; and funeral and burial services.[185] The law makes the list of exemptions from the VAT uniform throughout the territory of the Russian Federation.[186]

The VAT proceeds turned over to the state budget shall be the difference between the tax collected from the buyer of the goods, works, or services and the tax paid by the producer of the goods, works, or services to the supplier of the raw materials and services used in the production of the exchanged goods, works, or services.[187] For purposes of this computation, the money expended on nonproduction activities, the costs of capital equipment, and the costs of acquiring know-how, licenses, or other nonmaterial intellectual rights may not be deducted.[188]

The taxapayer shall pay the VAT to the government on a monthly basis for the preceding month, but not later than by the fifteenth day of the next month.[189] The tax shall be deemed as owed on the date when the seller receives the proceeds for goods or services either directly from the buyer or as a bank account deposit.[190] Those enterprises authorized to collect payments at the time goods are delivered shall owe the applicable VAT on the date of the delivery of the goods or services and after deliving documents demanding payment to the buyer.[191]

The taxpayer and its officials are responsible for full compliance with the stipulations of this law.[192] The tax authorities of the Russian Federation shall enforce VAT payment. A separate Implementation Decree of the Russian Federation Supreme Soviet stipulates that the VAT law of December 6, 1991 shall go into effect on December 16, 1991.

On May 22, 1992, the legislature amended articles 5, 7, and 10 of the VAT law.[193] The drafters made the amendments effective retroactively from April 1, 1992. Sections of the amendments, however, were made effective retroactively from January 1, 1992.

After a heated debate, the Supreme Soviet of the Russian Federation voted new amendments to the VAT law on July 16, 1992.[194] During the

185. *Id.* art. 5.
186. *Id.* art. 5, para. 2.
187. *Id.* art. 7, § 2, para. 2.
188. *Id.* art. 7, § 2, para. 3 (per July 16, 1992 amendment).
189. *Id.* art. 8, para. 1.
190. *Id.* art. 8, para. 2.
191. *Id.* art. 8, para. 2.
192. *Id.* art. 9, para. 1.
193. Law of May 22, 1992, *supra* note 146.
194. Law of July 16, 1992, *supra* note 146.

parliamentary debate on this tax bill, the Chairman of the Supreme Soviet's Committee on Budget, Planning, and Taxation (Mr. Alexander Pochinok) proposed an amendment that would reduce the VAT rate to fourteen percent for all goods and services and reduce the rate to seven percent for food items and children's goods.[195] The President of the Russian Federation countered with a proposal to reduce the VAT rate to fifteen percent for certain food items and to retain the current twenty-eight percent rate for all other goods and services.[196] The Deputy Chairman of the Supreme Soviet of the Russian Federation (Mr. Yurii Voronin) proposed a compromise. The compromise would adopt the President's proposal to reduce the tax rate to fifteen percent for certain food items and adopt the President's proposal to retain the twenty-eight percent tax rate for all other goods and services. This latter proposal would be implemented, however, on December 31, 1992. The compromise would also reduce the VAT rate on all goods and services to twenty percent, except for those food items listed in Part 1 of the President's proposal, for which the rate would remain at fifteen percent. This portion of the compromise would become effective on January 1, 1992. Voronin's compromise passed and thus became the July 16, 1992 amendments to the VAT law of December 6, 1991.[197]

E. *A Digest of the Law of the Russian Federation* On the Taxation of Individual Property

Certain individual property items taxed under separate legislation of the Russian Federation are not subject to taxation under this law. The luxury tax law is one such provision governing the taxation of individual property.[198] The taxation of automobiles is another such law. The term "individual," as used in this legislation, includes foreign nationals as well as stateless persons who own personal property located in the Russian Federation. Against this backdrop, the key provisions of this law may be reduced to the propositions set forth below.

All individuals owning property subject to taxation under this law shall pay the tax envisaged under this legislation.[199] The following property, if it belongs to an individual, shall be subject to this tax: dwelling houses, apartments, summer cottages, and other similar structures, mo-

195. *See* Nalogi Snizheni, *No ne na vse,* ROSSISKAYA GAZETA, July 17, 1992, at 1 [*Taxes Are Reduced, but Not for Everything*].

196. *Id.*

197. *Id.*

198. Law of December 6, 1991, *supra* note 146.

199. Law of December 9, 1991, *supra* note 146, art. 1.

torized boats, helicopters, airplanes, and other means of transportation other than automobiles, motorcycles, and other locomotive machines.[200] Article 3 stipulates the rate of taxation as follows: dwelling houses, apartments, summer cottages, and other similar structures shall be taxed at the rate of 0.1 percent of their inventoried value; if the foregoing items are not inventoried, the tax rate shall be multiplied against the compulsory state insurance amount;[201] the tax rate for vehicles shall depend upon engine size measured in horsepower;[202] all proceeds from such a tax shall go to the budget of the local council possessing jurisdiction over the location of such property.

Many individuals, however, are exempt from all payments of personal property tax. This exemption applies to heroes of the Soviet Union, laureates of medals of honor in the third category, invalids of the first and second category, veterans of the civil war, World War II, and other wars for the defense of the Soviet Union, persons who volunteered to fight in the armed or security forces of the Soviet Union during World War II, those persons who resided in the front-line cities during World War II who, even though they did not take part in combat operations, were entitled to claim special preferential treatment for war veterans in their pension applications, and persons who qualify for special preferential treatment under the Law of the Russian Federation *On the Social Protection of Individuals Who Were Subjected to Radiation at Chernobyl.*[203] In addition, pensioners and persons in active military duty are exempt from the payment of property tax on their dwelling house, apartment, summer cottage, or other similar structures, and owners of motorized boats with less than ten horsepower or 7.4 kilowatts are exempted from property tax on such boats.[204]

Article 4, paragraph 4 of the Law of December 9, 1991 grants to regional councils the discretionary authority to reduce the tax rates set forth here and to extend exemptions from this tax to specific individuals or classes of persons. Local city councils have similar authority, but they may exercise it only with regard to specific individuals.

Article 5 sets forth the procedure for the assessment and payment of this tax. The tax authorities shall prepare a tax assessment, and all persons entitled to exemptions or rebates from such a tax must document

200. *Id.* art. 2.
201. *Id.* art. 3, para. 1.
202. *Id.* art. 3, para. 2.
203. *Id.* art. 4, para. 1.
204. *Id.* art. 4, para. 3.

their claim before the tax authorities.[205] Any tax assessments on residential property shall be based on the inventory value reported to the housing authorities on January 1 of the year for which the tax is due.[206] If the property was not inventoried, the assessment of taxes shall be based on its compulsory state insurance value.[207] For residential property owned jointly by several persons, each co-owner shall pay a prorated portion of the tax based on his share in the ownership of the property.[208] Finally, the tax on all vehicles shall be based on the value reported to the vehicle registration authorities on January 1 of the tax year.[209]

Article 5 goes on to provide that taxpayers must furnish all information needed by the tax authorities in order to assess the proper value of personal property free of charge to such authorities.[210] Also, a tax on any newly acquired residential property or means of transportation shall be assessed from January 1 of the year following the date of acquisition. If several persons jointly own a vehicle, the owner in whose name it is registered shall pay the tax. The inheritor of residential property shall pay the property tax at the time of the inheritance, and the collection of taxes shall cease at the time a residential property or vehicle is totally destroyed.

If the ownership of personal property passes from one person to another in the course of the same calendar year, the owner-assignor shall pay the taxes from January 1 up to the month of transfer. Thereafter, the owner-assignee shall pay the tax for the remainder of that year.[211] If an owner's right to exemption from or reduction in property taxes arises in the course of a calendar year, the tax on such property shall be computed beginning from the month in which such a right arose.[212] All taxpayers shall receive an annual tax notice no later than August 1 of the year for which the tax is due.[213] Taxpayers shall pay all taxes in two equal installments, to be made no later than September 15th and November 15th of each year.[214] Subject to a three-year statute of limitation, all persons shall pay any delinquent personal property taxes.[215] This

205. *Id.* art. 5.
206. *Id.*
207. *Id.*
208. *Id.*
209. *Id.*
210. *Id.*
211. *Id.* art. 6.
212. *Id.* art. 7.
213. *Id.* art. 8.
214. *Id.* art. 9.
215. *Id.* art. 10.

rule requires the tax authorities to send out notices of delinquent taxes within three years of the year for which the tax is delinquent.

Similarly, article 11 imposes a three-year statute of limitations on all tax audits by the tax authorities.[216] Thus, if the tax authorities wish to verify the accuracy of a property tax assessment or payment of a tax by a taxpayer, they must do so within three years from the audit year.

This statute went into effect on January 1, 1992. In the interim, the implementation decree states that "up until such time when the laws of the Russian Federation shall be revised to conform to this Law of the Russian Federation on the Taxation of Individual Property, the laws of the USSR governing local taxes shall remain in force to the extent that they do not contradict the provisions of this Law."[217]

F. *A Digest of the Law of the Russian Federation* On the Taxation of Enterprise Property

The key provisions of the Law of December 13, 1991 may be reduced to the propositions set forth below. The property tax envisaged by this law shall apply to enterprises, institutions (including banks and other financial institutions), organizations (including joint ventures with the participation of foreign investors that are treated as legal persons under the laws of the Russian Federation), international associations and organizations engaged in entrepreneurial activities in the territory of the Russian Federation, branch offices and analogous offices of the aforementioned taxpayers if such offices are established as self-accounting units with their own balance sheet, and Russian-based permanent representation offices and other isolated units of foreign firms, banks, and organizations. Hereinafter, all of the foregoing entities shall be referred to generically as taxpayers.[218]

This law assesses a tax on any property reflected as an asset on the balance sheet of the taxpayer.[219] For the purpose of taxation, such property shall be assessed at its median annual value. A taxpayer may compute the applicable tax base for such property by depreciating the sum total of the value of the property by the amount of use for the tax year using the following accounting yardsticks: depreciation of the main prop-

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216. *Id.* art. 11.

217. Decree of the Supreme Soviet of the Russian Federation, *On the Procedure for the Implementation of the Law of the Russian Federation 'On the Taxation of Individual Property,'* Law of December 9, 1991, VED. S'EZDA NAR. DEP. RF, Issue No. 8, Item No. 363 (1992).

218. Law of December 13, 1991, *supra* note 146, art. 1.

219. *Id.* art. 2.

erty, depreciation of the less valuable and fast deteriorating objects, use of profits, and use of leased objects.[220]

Article 4 lists those properties exempt from property tax. Those exempt include properties belonging to: enterprises and organizations supported with budget allocations; state administrative agencies; the college of advocates; agricultural enterprises engaged in the production, re-production, and storage of agricultural produce; agricultural enterprises engaged in fish farming, fishing, and production of fish products; educational cultural institutions; regional associations of nonprofit organizations; enterprises owned by nonprofit organizations for the promotion of the welfare of handicapped persons; and enterprises that operate with property leased from other enterprises or organizations. The property used as an insurance reserve for enterprises operating on seasonal cycles is also exempt. During the first year of their operation, all newly established enterprises shall be exempted from the payment of this tax if they were not organized as a spinoff from a liquidated enterprise.

The assessed value of a taxable property shall be reduced if the enterprise's balance sheet reflects the property as being used for: housing for communal or cultural purposes; environmental protection or fire prevention; production, re-production, and storage of agricultural produce; fish farming, fishing, and manufacture of fish products; road construction, construction of communications lines or as land set aside to service any of these projects; and communication satellites.[221]

The tax rate may not exceed one percent of the assessed value using the formula stipulated in articles 3 and 5.[222] The regional councils of the *krai* and *oblast* shall determine the exact tax rate.[223] In making such determinations, the regional councils shall take into consideration the activities of the enterprise.[224] All the councils shall make such determinations uniformly applicable to all enterprises engaged in the same spheres of activities.[225]

A taxpayer shall estimate and pay all property taxes quarterly. At the end of the tax year the taxpayer shall make a final determination of the

220. *Id.* art. 3.

221. *Id.* art. 5.

222. The original (December 13, 1991) version of this law had capped enterprise property tax at 0.5% of its assessed value. The amendments of July 10, 1992 raised that cap to 1.0%. *See* Law of the Russian Federation, *On the Incorporation of Amendments and Additions to the Tax System of Russia,* Law of July 10, 1992, KOMMERSANT, July 6-23, 1992, at 24.

223. *Id.* art. 6.

224. *Id.*

225. *Id.*

amount owed and pay any balance due at that time.[226] The authorities shall pay all proceeds from such a tax into the budget of the regional and local governments having jurisdiction over the location of the property.[227] All enterprise quarterly tax payments are due and payable within five days from the date when the enterprise must submit its quarterly financial report. Alternatively, all annual tax payments shall be due and payable within ten days from the date on which the enterprise must submit its annual financial report.[228] The authorities will credit the account of the taxpayer against future taxes. The taxpayer also has the option to have the excess refunded to him within five days of the receipt of his written request for a refund thereof.

This law went into effect on January 1, 1992. On March 16, 1992, the Russian Federation State Revenue Service issued a set of Instructions *On the Procedure for the Assessment and Payment into the State Budget of Enterprise Property Tax.*[229] These Instructions went into effect retroactively on January 1, 1992.

VII. AN ANALYSIS OF THE DECREE OF THE PRESIDENT OF THE RUSSIAN FEDERATION *ON THE FORMATION OF A REPUBLICAN HARD CURRENCY RESERVE FUND OF THE RUSSIAN REPUBLIC IN 1992*[230]

A. *Introduction*

Hard pressed for foreign currency, the Russian government has resorted to the same method used by the defunct Soviet federal government to raise cash, i.e., forcing enterprises to sell a portion of their hard currency export earnings to the government at a confiscatory exchange rate established by the government itself. The Russian Federation government employed this technique during the closing moments of 1991 when

226. *Id.* art. 7, para. 1.

227. *Id.* art. 7, para. 2.

228. *Id.* art. 8.

229. Instruction No. 7, Law of March 16, 1992, EKONOMICHESKAYA GAZETA, April 17, 1992, at 19.

230. Law of December 30, 1991 (as amended on June 14, 1992), ROSSISKAYA GAZETA, June 18, 1992, at 4. On January 22, 1992, the Central Bank of Russia promulgated its interpretations of this Presidential decree in the form of Instructions, *On the Procedure for the Mandatory Sale by Enterprises, Associations, Organizations, and Citizens of Hard Currency to the Hard Currency Reserve Fund of the Russian Federation, the Hard Currency Fund of the Constituent Republics of the Russian Federation and the Hard Currency Reserve Fund of the Central Bank of the Russian Federation,* Instructions of January 22, 1992, KOMMERSANT, January 20-27, 1992, at 24.

the President of the Russian Federation issued the decree of December 30, 1991. Unlike the similarly worded USSR decree, this Russian Federation Presidential decree contains few exemptions from the draconian effects of the Law of December 30, 1992. Thus, for example, the Russian Federation decree does not exempt joint enterprises from this obligation to sell a portion of their hard currency earnings to the government. Under this law, an enterprise forced to sell its hard currency to the state shall use two exchange rates: a special exchange rate for sale to the Republic Hard Currency Reserve Fund and the current market exchange rate for sale to the Central Bank of the Russian Federation.[231] Coupled with the loss of a tax holiday for joint enterprises and the harsh VAT law adopted by the Russian Federation, 1992 was a tough fiscal year for joint enterprises operating in the Russian Federation.

The following is a summation of the key provisions of the Russian Federation Presidential decree of December 30, 1991.

B. *Decree of the Russian Federation* On the Forced Sale of Hard Currency Export Earnings by Enterprises to the Government: *General Provisions*

Effective from January 1, 1992, all enterprises and individuals earning hard currency from the export of any of the goods and services enumerated in the list appended to this decree, shall sell, at a special commercial exchange rate to be determined at a later date, forty percent of their total export earnings to the hard currency reserve fund of the Russian Federation. The government of the Russian Fedration shall separately stipulate the percentage of hard currency earnings from the export of precious metals and precious stones.[232]

All monies placed in the Republic's hard currency reserve fund shall be used to service the foreign debts of the Russian Federation, to stabilize the market exchange rate of the ruble, and to import essential items from abroad.[233] Alternatively, the Federation shall use all monies sold to the Central Bank of the Russian Federation under a separate provision of this decree exclusively for the stabilization of the market exchange rate of the ruble.

An enterprise or individual, in computing the amount of total earnings for purposes of this decree, shall deduct from gross earnings any amounts expended on insurance and transportation of exported goods. In an effort

231. *See* 1992 amendments as discussed in subpart VII(C) below.
232. *Id.* art. 2.
233. *Id.* art. 3.

to create a domestic hard currency reserve for the Russian Federation, all enterprises and individuals earning hard currency from their export activities shall additionally sell ten percent of their total export earnings to the Central Bank of the Russian Federation at the then-current market exchange rate.

For purposes of this decree, the term "enterprises" includes all forms of enterprises registered in the Russian Federation regardless of form of ownership, including but not limited to state enterprises and joint enterprises. This decree, however, does not apply to branch offices, representation offices, or other forms of business representations of foreign companies in the Russian Federation. For purposes of this decree, wholly owned subsidiaries of foreign corporations would qualify as Russian enterprises. As such, wholly owned subsidiaries come under the umbrella of this decree.

A newly created Inspectorate for Hard Currency Control will enforce this decree. which went into effect on December 30, 1991, the date of its signing.[234] The Central Bank of the Russian Federation shall sell the mandatory forty percent of all export earnings received by it between December 30, 1991 and January 1, 1992 to the Republic Hard Currency Reserve Fund at the commercial exchange rate in effect on December 29, 1991.

C. *Conclusion*

The most controversial aspect of this decree is a proposal to require all banks in the Russian Federation in which enterprises and individuals maintain their hard currency accounts to transfer automatically the requisite funds from the accounts of their clients into the respective hard currency reserve funds of the Republic and the Central Bank of the Russian Federation.

Because the thrust of this decree is "export earnings," which the decree defines as "earnings from the export of goods and services," hard currency earnings from nonexport activities apparently are not subject to the provisions of this law. Therefore, for example, an enterprise providing services within the territory of the Russian Federation but yet not involving any trans-border transfer of goods or services will not be covered by this law.

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234. On June 12, 1992, the Central Bank of Russia issued a set of intepretative instructions, *On the Procedure for the Compulsory Sale by Enterprise Associations, and Organizations of a Portion of their Hard Currency Earnings Through Authorized Banks and for the Conduct of Operations Within the Domestic Market of the Russian Federation*, 8 VNESH. TORA. 52-54 (1992).

On June 14, 1992, the President of the Russian Republic issued amendments to some provisions of the December 30, 1991 decree. These amendments did not repeal the law in question, but merely modified some of its clauses. Thus, for example, article 2 of the 1992 amendments provides that all enterprises, including joint enterprises, shall sell fifty percent of their hard currency export earnings to the state through a bank authorized to handle such transactions. This sale shall occur at a market rate established for the domestic hard currency market by the Central Bank of the Russian Federation. The enterprise must carry out the sale within fourteen days of receipt of the funding by the Central Bank. This fifty percent requirement replaces the two-tier (forty percent plus ten percent) arrangement stipulated in the original decree of December 30, 1991. These amendments also replace the two-tier exchange rates (special exchange rate plus current market coverage rate) used in the original December 30, 1991 decree. With these cosmetic amendments, the original decree remains in force and continues to hinder any Russian enterprises to which it applies.

VIII. Reflections on the Past, Present, and Future of Russian Joint Venture Law and Tax Regulations

On January 13, 1993, the modern Soviet international joint venture culture celebrated its sixth anniversary. By comparison with the mature business laws of the United States and continental European countries, Soviet joint venture law is still in its infancy. Like any infant, this law is experiencing toothing problems and is plagued with various infantile maladies. These are customary milestones in the natural development of any living organism. During its short period of existence, however, many positive changes have taken place in Soviet joint venture law and practice. Remarkable improvement in the draftsmanship of the joint venture laws has occurred, and many of the constitutional clouds that once hung over Soviet joint venture legislation no longer exist. In addition, Russian law has decentralized the system for registration of joint ventures and improved coordination between individual joint venture statutes and other elements of Soviet law. New laws now regulate many of the aspects of Soviet joint venture practice hitherto unregulated and, overall, new Soviet joint venture laws have taken giant steps towards conforming with world practice. Even more remarkably, the form and substance of Soviet joint venture foundation documents are beginning to resemble their Western counterparts. Gorbachev installed many of these changes during the last months of his administration. Other changes were in the pipeline when the USSR federal government suddenly folded on December 25, 1991. The Yeltsin administration has moved quickly to enact all

of Gorbachev's reform blueprints into law and has added a few charges of its own. The result is a modern Russian joint venture law reflecting an improved craftsmanship.

Notwithstanding the efforts of the Russian legislature to preempt all USSR joint venture laws in the territory of the Russian Federation, many elements of that law continue to govern aspects of joint venture practice in Russia. For example, the Russian Federation Law of December 25, 1990 on joint stock (discussed in Part V above) does not require the founders of a joint stock company to enter into a separate contract for the foundation of the enterprise. The only foundation document this law requires is a charter of the joint stock company, which in turn must be registered with the government authorities. In practice, however, all founding participants in a joint stock company sign a contract of foundation of the joint stock company in addition to adopting a charter for the new enterprise. This practice is a remnant of USSR law on joint stock companies that specifically required such a contract and considered it as one of the foundation documents of a joint stock company. The contents and format of all Russian preformation JSC contracts continue to follow the stipulations of USSR law on joint stock companies.

Similarly, the Russian Federation law of December 25, 1990 on joint stock companies does not require prospective founders of a joint stock company to conduct an economic feasibility study of their project before making a final decision. The old USSR joint venture law required such a feasibility study. Notwithstanding the loud silence of modern Russian joint venture law on this requirement, virtually all new JSC founding members take the precautionary step of conducting a preformation study as to the economic feasibility of their joint enterprise. This practice is also a holdover from old USSR joint venture law.

A similar situation involves the practice of the signing of a letter of intent between the prospective JSC founding members as a first step in the formation of a joint stock company. Modern Russian joint venture law does not require prospective joint venture partners to sign a letter of intent, but many prospective joint venture partners do so anyway. I have available a model letter of intent, a model contract of foundation of a joint stock company, and a model charter of a joint stock company.

Remarkably, these entrenched elements of modern Russian joint venture practice are governed not by Russian law but by USSR joint venture law. Because of the many influences of USSR law on modern Russian joint venture practice, any Western attorney who counsels United States investors in Russia will want to look to USSR law books for assistance during many joint venture transactions in the new Russian marketplace.

The establishment and operation of joint ventures in Russia has become routine. However, Russian joint venture law still has a few wrinkles to iron out. The next generation of Russian legislative reforms should introduce many general policy changes into its joint venture law. These changes should include: merging all statutes dealing with the establishment, operation, and governance of business enterprises into one commercial code or consolidated statute on business organizations; consolidating all joint venture tax legislation, along with all other tax laws of the Russian Federation, into one tax code for easy access; collecting and publishing all tax regulations issued by the various ministries, departments, and banks in one code of tax regulations; further simplication of the process of registration of a newly formed joint venture company; lifting many of the current restrictions on the activities that joint ventures may engage in; equalization of the tax treatment of investors in both wholly domestic and international joint ventures; leveling of the playing fields for all joint ventures that wish to invest in real estate; and providing a grace period whenever a new joint venture law is passed that radically departs from the existing one to give the marketplace time to make adjustments before the new law goes into force.

Modern Russian joint venture law has matured quite considerably since 1987. The changes proposed by this Article will enable it to further develop and transform Russia into a traditional marketplace for the Western investor who, up to this point, still views Russian joint venture law with suspicion. Even though modern Russian joint venture law is slowly but steadily embracing many of the core principles traditionally associated with United States and Continental European commerical law, it continues to manifest a few disturbing traits that are typically associated with the foreign investment laws of third-world nations. A true sign of maturity of Russian joint venture law will be when Western investors begin to view Russian foreign investment law as not beloning to this suspect class.