

**Baker
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Doing Business with Russia: New Data, Tax and other Laws and Sanctions - What U.S. Companies Need to Know

ACC International Committee | April 2019



Agenda

1 Top opportunities/challenges

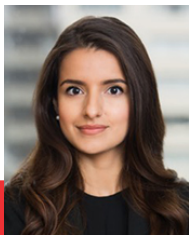
2 On-shore/off-shore options

3 Tax and registration requirements for B2B

4 Data residency and internet-related requirements

5 US and EU sanctions on Russia

Speakers



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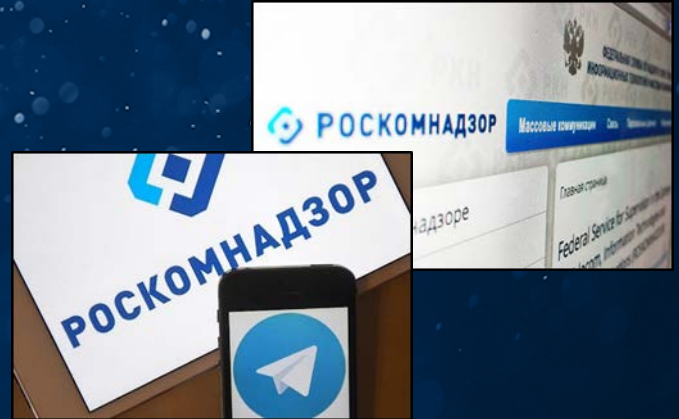
1



Top opportunities/ challenges in doing business with Russia

2

On-shore/off-shore options



3

Tax and registration requirements for B2B

Russian VAT Regime on E-Services

Snapshot

- Effective Jan 1, 2019, non-resident suppliers of electronic services to Russian customers are required to tax register in Russia, charge, collect, report and remit Russian VAT in connection with **both B2C and B2B supplies** (prior to 2019 only B2C services were covered)
- No exceptions and thresholds (even minor, one-time and intragroup transactions for recharge of global software costs formally covered, same as bundled services where electronic services have a secondary role) – huge impact for multiple industries
- Full-blown tax registration (no separate VAT registration). Tax audit and long-term virtual PE risks?
- Tax penalties and risks of non-compliance:
 - up to 10% of gross turnover for failure to tax register;
 - 20-40% of unpaid VAT for failure to pay VAT to the Russian budget;
 - up to 30% of unpaid VAT for failure to provide and no VAT credit available to Russian customers;
 - enforcement perspectives;
 - no VAT credit available to Russian customers
- Impact on tax gross-up clauses

Russian VAT Regime on E-Services

E-services definition and types

- E-services are services (i) performed through an information and telecommunications network, including the Internet, (ii) automatically, (iii) with the use of information technologies
- Exhaustive list of 14 e-service categories:
 - Provision of access / right to use software (including computer games) and databases via the Internet;
 - Provision of advertising services or advertising space on the Internet;
 - Displaying offers for sale / acquisition of goods (works, services) on the Internet;
 - Digital trading platform / marketplace services;
 - Provision and support of commercial or personal presence on the Internet, including support of customer's electronic resources

Russian VAT Regime on E-Services

E-services types – cont'd

- Storage and processing of information on the Internet;
- Provision of real-time computing capacity;
- Provision of domain names and hosting services;
- Information system and website administration services on the Internet;
- Automated data search and sorting services, including real-time stock exchange data and real-time automated translation services
- Provision of rights to use e-books and other electronic publications, informational and educational materials, images, musical works with or without lyrics, and audiovisual works via the Internet, including by way of remote access;
- Automated search for and/or provision of information on potential customers;
- Provision of access to data search systems on the Internet;
- Statistical services on websites

Russian VAT Regime on E-Services

Structuring opportunities:

- Triggers for Russian tax registration:
 - provision of ESS to Russian customers, ***and***
 - direct participation in settlements with such customers
- Imposing an intermediary between the actual vendor and the Russian customer(s)
 - ✓ ***a foreign reseller***
 - non-Russian tax implications for the group
 - beneficial ownership confirmation on “passive” income (e.g., royalties)
 - ✓ ***a foreign agent / commissioner / treasury company***
 - VAT recovery by Russian customers
 - ✓ ***a Russian agent / commissioner / treasury company***
 - Russian PE considerations

Russian VAT Regime on E-Services

Non-electronic sales and expected developments

- “Force of attraction”: foreign ESS vendors registered in Russia required to report and pay VAT on all their sales subject to Russian VAT, including non-electronic sales?
 - Eriell GmbH case (2016), several official guidance letters of the Russian Ministry of Finance (2018-2019)
 - Russian customers should no longer act as tax agents
- Expected guidance letter of the Federal Tax Service
 - If the Russian customer has voluntarily withheld VAT from the amount of the purchase price, remitted this VAT to the Russian budget and further claimed this VAT for recovery, the Russian tax authorities are instructed not to raise claims either to the foreign ESS vendor or to such Russian customer
 - VAT recovery issues?
- Potential legislative developments to relieve certain categories of foreign vendors from Russian tax registration reporting requirements (criteria under discussion)

4

Data residency and internet-related requirements



Internet in Russia - Key Milestones

Ten years ago the Internet was
mostly unregulated in Russia



Then the Internet started
to draw more attention

Winter
2011



The first Russian law
on website blocking enacted
in 2012 (child protection)

**Child
pornography**

**Promotion of
suicide**

**Illegal
drugs**

**Court
decisions**

**Early
2012**



The diagram features a horizontal red timeline line at the bottom. A vertical brown pole is positioned at the left end of this line, with a red circular base. A red arrow-shaped sign is attached to the pole, pointing to the right and containing the text 'Early 2012'. To the right of the timeline, there are four circles arranged in a 2x2 grid. The top-left circle is dark blue and contains the text 'Child pornography'. The top-right circle is red and contains the text 'Promotion of suicide'. The bottom-left circle is red and contains the text 'Illegal drugs'. The bottom-right circle is dark blue and contains the text 'Court decisions'.

Mr. Zharov becomes the new
Head of Roskomnadzor

Early
2012



Anti-piracy law

Preliminary and permanent
website blocking injunctions



Summer
2013

Blocking of extremist content
and calls to mass disorder



Winter
2013

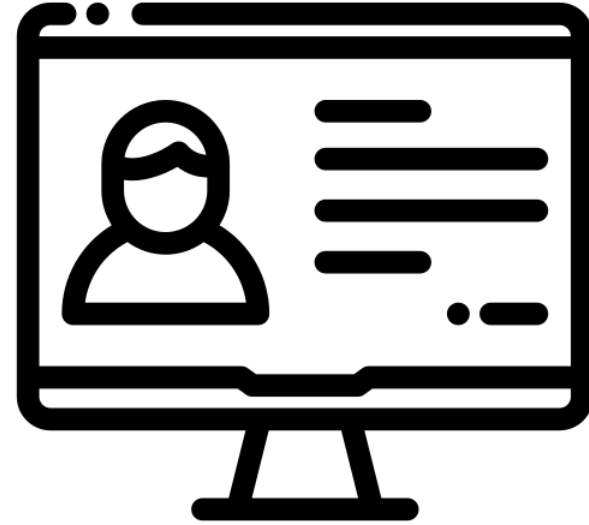
Blocking of illegal gambling websites



Summer
2014

Personal data localization rules

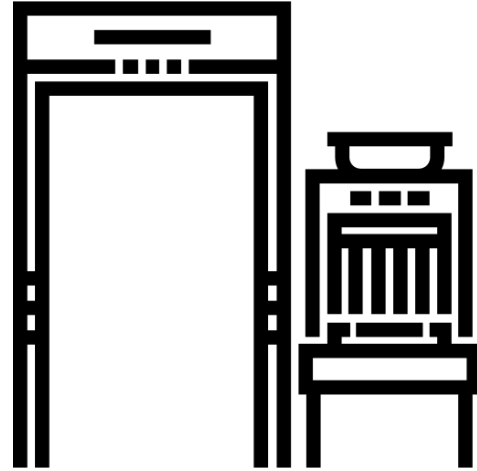
Blocking of websites violating
Russia personal data laws



Summer
2015

“Yarovaya” laws

Mandatory data retention for
online communication services



Russian court authorizes LinkedIn blocking



Autumn
2016

Telegram refuses to implement
decryption backdoors

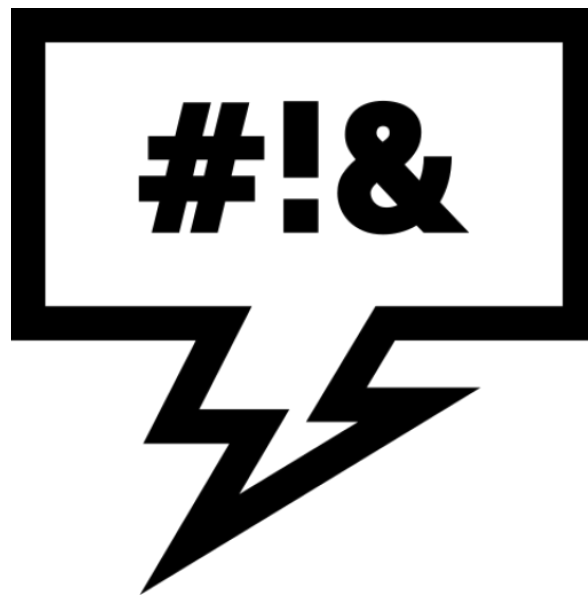
Roskomnadzor attempts blocking

Up to 18 mln IP addresses blocked

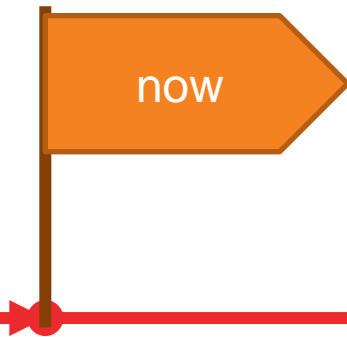


Summer
2018

Blocking of insults to state
authorities in obscene form



Draft law to facilitate website
blocking in Russia



But foreign services still go to Russia

2

Website blocking in more detail



takedown
request from
Roskomnadzor



voluntary
removal or
geo-blocking



blocking
by all ISPs
in Russia

[eais#xxxxx] the Roscomnadzor is informing

**Notice
of making an entry into the "Unified register of domain names, Internet web-site
page links and network addresses enabling to identify the Internet web-sites
containing the information prohibited for public distribution in the Russian
Federation".**

In accordance with No. 7 of Article 15.1. of the Federal Law dated 27.07.2006 No. 149-FZ "On Information, Information Technologies and Information Protection" we notify you that on the basis of a decision of The Ministry of Internal Affairs of the Russian Federation dated <date> No <number> Internet web-site page (s) link (s) <URL> was (were) included in the "Unified register of domain names, Internet web-site page links and network addresses enabling to identify the Internet web-sites containing the information prohibited for public distribution in the Russian Federation", the number of the register entry is <number>-PII due to the fact that this information contains methods and techniques of development, manufacture and consumption of drugs, psychotropic substances and their precursors, supply and sale areas of drugs, substances and their precursors, cultivation methods and areas of narcotic plants.

It is necessary to immediately inform the owner of the revealed Internet web-site about this fact, and to notify him of the need to remove the information prohibited for distribution in the Russian Federation immediately.

After receiving from the hosting provider a notification of inclusion of the domain name and (or) the Internet web-site page link in the Register, the Internet website owner shall take immediate measures to remove and (or) to limit the access to the Internet web-site containing information prohibited for distribution in the Russian Federation.

0-3 days

For voluntary removal before
Roskomnadzor instructs ISPs to
implement blocking



**Accessible
=> issue**

If available to Russian users,
Roskomnadzor may block it

**Possible
to unblock**

**But this may take from several
hours to several business days**

Suggested Action

- Ask hosting provider to forward emails from “@rkn.gov.ru” on 24/7 basis
- Promptly review Russian takedown requests
- Warn users about the takedown request, if applicable
- In case of delays respond back by email to confirm the intended action
- Monitor availability of your service / app in Russia

3

**Data localization
in more detail**

Personal data

GDPR-like definition,
broadly construed

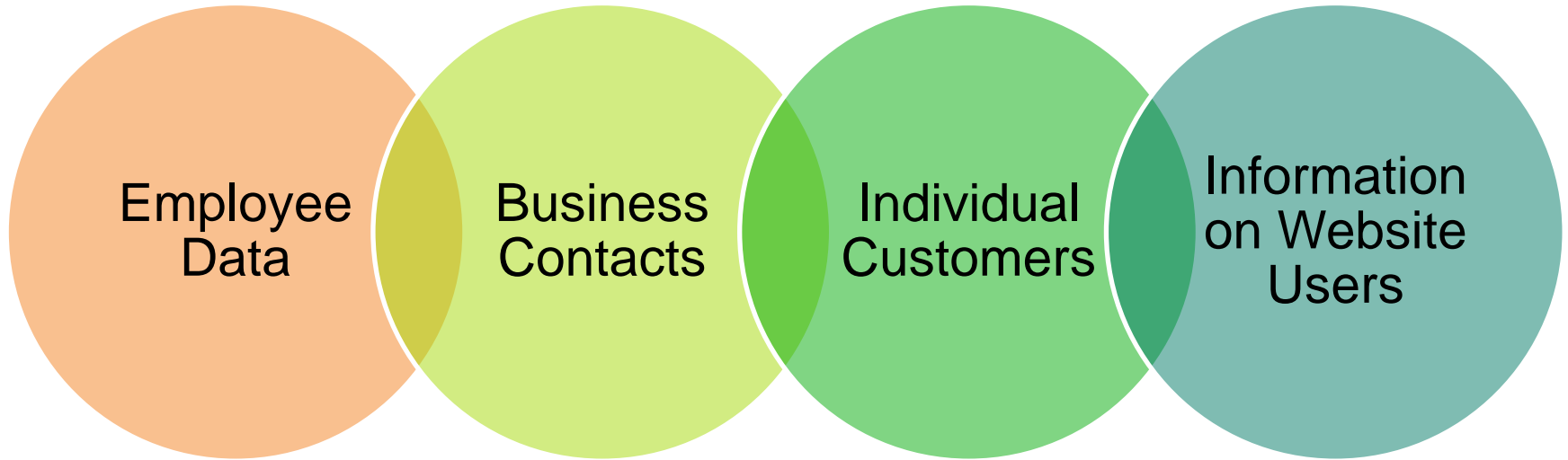
Data localization

use databases located in Russia
to initially record / update
personal data of Russian citizens

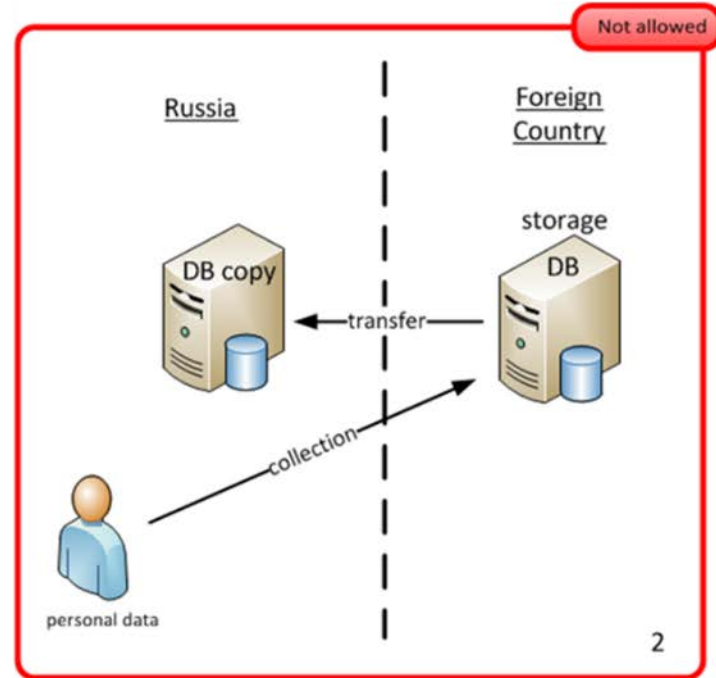
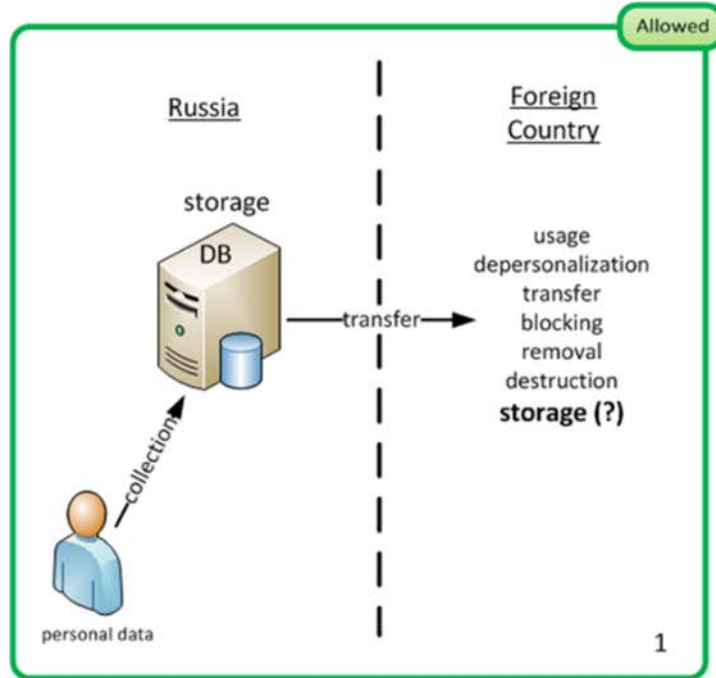
Key penalties

Website blocking, ~ US\$850 fines,
bad publicity

All Categories of Personal Data



Permissible Solutions



Audits of Local Companies



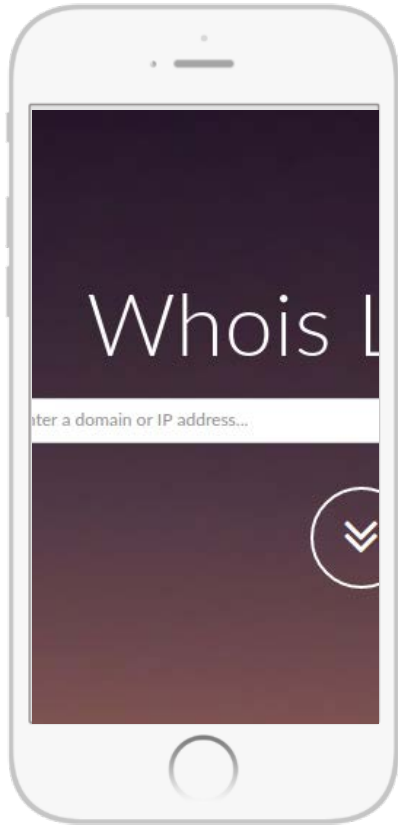
>1000 personal data audits each year:

- Documentary reviews
- Interviews with key employees
- Inspection of IT systems
- Test cases

Most

local subsidiaries of foreign
companies successfully passed
such personal data audits

Audits of Offshore Companies



- WHOIS checks
- Requests to provide copies to confirm title to servers / local hosting services
- Requests to describe data flows
- Letters to asserted hosting providers

Minimum enforcement

Roskomnadzor continues “soft” attempts to make certain US companies localize personal data



5

US and EU sanctions on Russia



US Sanctions and Export Controls

Who must comply with US sanctions?

US Persons

- Companies organized under US laws and their non-US branches
- Employees (regardless of nationality) of above entities
- US citizens and permanent resident aliens ("Green Card" holders) **wherever** located or employed
- Any individual or company physically in the United States, even temporarily

Secondary sanctions introduced under CAATSA apply to activities of non-US persons that occur outside of US jurisdiction

What types of restrictions are applicable?

Comprehensively Sanctioned Territories

- **Crimea:** Complete US embargo of Crimea since December 2014

Sectoral Sanctions

- Sanctions targeting Russia's financial, energy, and defence sectors

Specially Designated Nationals ("SDNs")

- Designated parties and entities 50% or more owned by SDNs
- Targets prominent oligarchs, banks, and military companies, among others
- Activity-based – e.g., human rights violators (e.g. Magnitsky), transactional criminal organizations, etc.

Secondary Sanctions

- Secondary sanctions target various business activities related to Russia
- Also target non-US persons' dealings with SDNs and other sanctioned parties

Russia: Export Controls

- Export restrictions on items subject to US jurisdiction
 - Certain items for exploration or production related to **deepwater, Arctic offshore, or shale formation projects in Russia** ("Russian Oil Industry End-Uses") that have the potential to produce OIL or GAS
 - Prohibited end-users (Entity List)
 - Parties subject to restrictions related to Russian Oil Industry End-Uses
 - Military end-user/end-use restrictions
 - US Policy of Denying Export Licenses for High Technology Items to Russia

Steps for Navigating US Sanctions

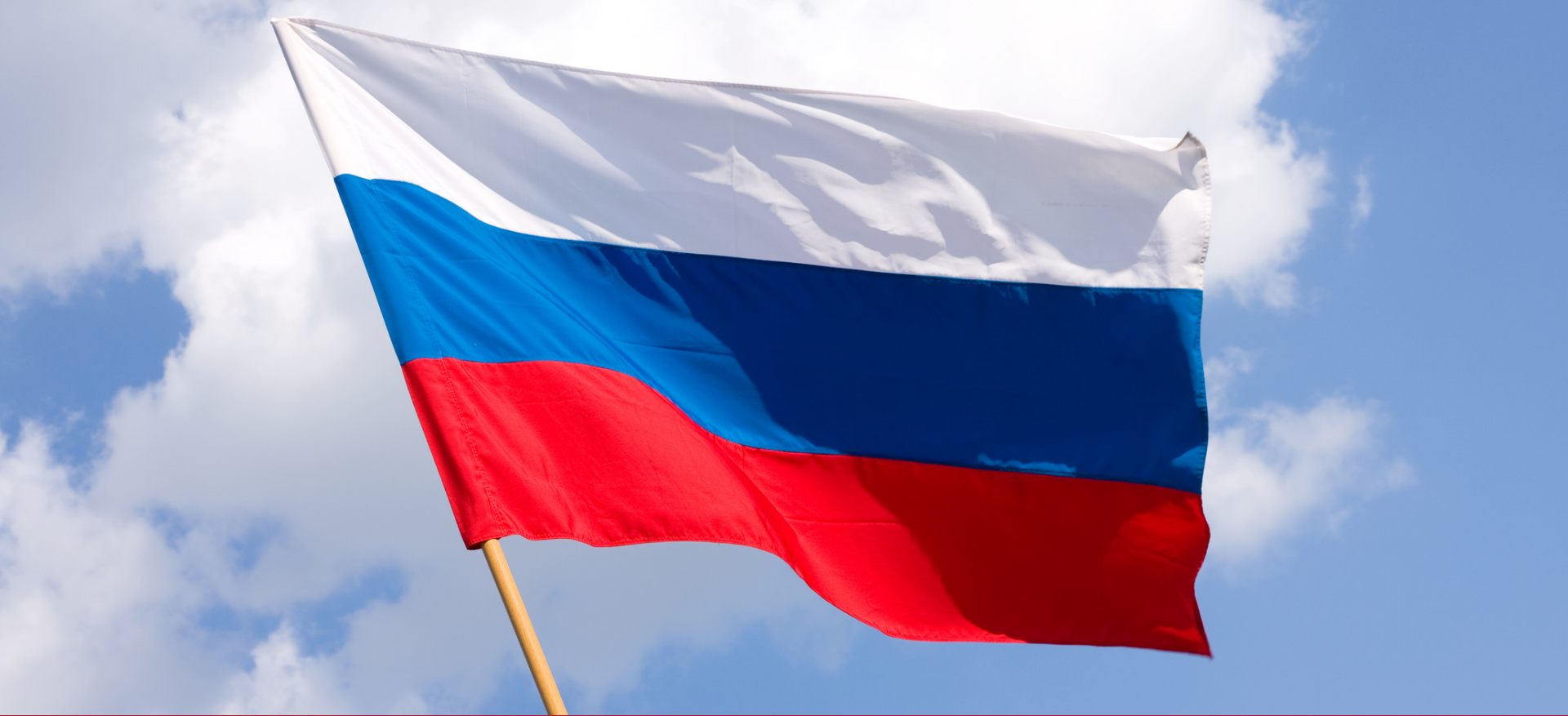
- Comprehensive analysis of the supply model, including all third parties and intermediaries
- Re-evaluate exports compliance: particular attention to the origin, classification, designation and end-users of supplied goods, technology and/or services, payment terms and currency of payment.
- Screening of ownership structure of the counterparties, including any financial institutions (banks) involved – last year's round of sanctions were against prominent politically-connected Russian business executives who have substantial holdings in major Russian companies
 - OFAC has expressed clear expectations around screening: daily; comprehensive (e.g. includes vendors, partners, other counterparties)(Zoltek); and screening system should identify and alert on potential matches with close name variations (Cobham).
- Adoption and implementation of corporate sanctions compliance policies
- Special sanctions/export control compliance clauses
- Consider whether deemed export licenses are necessary to hire Russian nationals



EU Sanctions and Export Controls

EU Sanctions Targeting Russia

- Extensive restrictions against Crimea (since June 2014)
- Sanctioned parties (DPs)
 - Targets individuals and entities deemed responsible for undermining or threatening the territorial integrity, sovereignty and independence of Ukraine
 - May include non-listed entities owned or controlled by one or more DP
- Sectoral sanctions targeting Russian financial, energy, and defense sectors
 - Aimed at restricting access to EU capital markets and funding
- Heightened EU export controls also apply
 - Restrictions on items for oil exploration and production in Russia (“Annex II” items)
 - Restrictions on dual use items for military end use or a military end user
 - Arms embargo



RUSSIA'S RESPONSE TO SANCTIONS

Russia's Response to the Sanctions

- Variety of measures to stimulate import substitution and support for local industrial production, so foreign investors may gain preferential treatment by localizing their production in Russia.
- Restrictions on public procurement of certain foreign products (software, cloud services, etc.). Private procurement was not affected.



Questions

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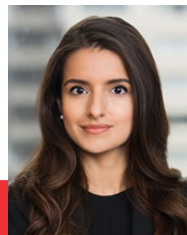
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