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## RUSSIA

## FCSM Adopts New Rules for Disclosure of Information by Russian Issuers

The Federal Commission for the Securities Market of Russia (the "FCSM") continues to conform the subordinate rules applicable to issuers of Russian securities in accordance with the amendments to the Law "On the Securities Market" (as reported in the March 20, 2003 issue of the *CIS Legal Newswire*, this law came into force on January 4, 2003).

Among the measures taken by the FCSM to clarify the securities market rules, was the adoption of Resolution No. 03-32/11c "On Disclosure of Information By Issuers of Emissive Securities," dated July 2, 2003 (the "Disclosure Resolution"). The Disclosure Resolution establishes new rules on the disclosure of information by issuers of securities, which must be complied with effective October 13, 2003.

Prior to the adoption of the Disclosure Resolution, the FCSM used several legal acts to regulate the disclosure of information by Russian issuers. In practice, however, publicly available information on securities was incomplete and generally rather difficult to locate. Information that should have been disclosed by issuers was, for various reasons, not readily available or was not submitted to the FCSM. The Disclosure Resolution not only unifies the existing rules from previous legal acts on the disclosure of information, but also introduces new methods and deadlines for disclosure. Another significant change introduced by the Disclosure Resolution concerns the role of financial consultants licensed by the FCSM as professional stock market participants, who are now responsible for ensuring that their clients (issuers of securities) disclose all required information in a timely manner. The trend to increase the responsibility of financial consultants with respect to placement of securities was described in our *CIS Legal Newswire*, dated October 27, 2003. Additionally, the Disclosure Resolution envisages that if an issuer fails to disclose information as required by the Disclosure Resolution, sales of securities issued by such an issuer may be restricted.

### Applicability of New Rules

The Disclosure Resolution applies to all domestic issuers (except for issuers of government and municipal securities), professional stock market participants who consult issuers with respect to securities issuances, as well as foreign issuers, including international financial institutions, involving securities traded in Russia. The Disclosure Resolution covers all existing cases in which disclosure of information is mandatory: (i) disclosure during issuance of securities (for more detailed information regarding the disclosure of information during share issuance please see the October 27, 2003 issue of the *CIS Legal Newswire*); (ii) quarterly reports; and (iii) disclosure of material facts. The Disclosure Resolution

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sets forth standard documentation to be filed by issuers with the FCSM.

## Means of Disclosure

The Disclosure Resolution establishes that issuers must now disclose information as follows: (i) through the Internet by way of placement of information with news agencies authorized by the FCSM; (ii) through the Internet by means of placement of information on the issuer's own web-sites or web-sites specified by issuers; and (iii) through publication in the press. As a general rule, all three ways of disclosure of information are now mandatory for an issuer of securities.

*(i) Placement Through Authorized News Agencies.* Provisions regarding disclosure of information on-line are completely new for the Russian securities market. Currently, there are two news agencies accumulating and publishing information with respect to issuers – AK&M ([www.disclosure.ru](http://www.disclosure.ru)) and Interfax ([www.interfax.ru](http://www.interfax.ru)), which were selected by the FCSM as the result of a tender in 2001. It appears that under the Disclosure Resolution, issuers of securities must place information with either of the above two agencies. According to the Disclosure Resolution, an issuer must make information available via a news agency network by 10 a.m. on the day following an event requiring disclosure.

*(ii) Placement Through Internet Sources.* An issuer may choose any Internet source to place information subject to disclosure. As a general rule, the Disclosure Resolution provides that issuers must post information on the Internet within three days of an event requiring the disclosure. The Disclosure Resolution establishes definite periods during which an issuer must maintain information available for public review. For example, a prospectus on a share issuance post-registration must be made available on the Internet for five months from the date of its placement. Special rules are established on the disclosure of information in the form of quarterly reports. Thus, an issuer must post a quarterly report within 45 days after the respective quarter and maintain this report on the Internet for a minimum period of six months.

*(iii) Placement Through Official Publication.* Finally, information must be disclosed through official publication. If information concerns securities to be placed by way of an open subscription, such information must be published with a print run of at least 10,000 copies. In other cases, an issuer must

publish the information with a print run of 1,000 copies. Notwithstanding this obligation, information is still required for submission to the FCSM's Vestnik or Bulletin for official publication. The Disclosure Resolution requires that publication be made in print media sources within five days following an event triggering mandatory disclosure of such event.

## Role of Financial Consultants

In order for securities to be publicly placed, the prospectus of the issuance of such securities must be signed by a financial consultant. The Disclosure Resolution has significantly broadened the role of a financial consultant with respect to the disclosure of information related to the issuance of securities as described in the October 27, 2003 CIS Newswire. A financial consultant is now obliged to monitor whether an issuer duly performs its obligations to disclose information. An issuer must notify its financial consultant of facts subject to disclosure and submit copies of the documents disclosed by such issuer. If an issuer violates its disclosure obligations, a financial consultant of such issuer must notify the FCSM of any violations committed by an issuer not later than the next day after the financial consultant became aware of such violation. Importantly, a financial consultant of an issuer who has committed a violation is required to notify each news agency, as well as to post such notice on the Internet, concerning an issuer's violation of disclosure requirements.

## Other Innovative Rules

As a general rule, an issuer is now obliged to provide access to disclosed information to any interested party at the location of the issuer's chief executive as registered with the State Unified Register of Legal Entities. Also, an issuer must provide copies of notices made in connection with the disclosure of information, as well as registered decisions on the issuance of securities, the prospectus of securities, the reports on the issuance of securities and quarterly reports, within seven days from the date of the request, to any holders of securities of an issuer and to any interested parties at their request for a fee not exceeding the costs for photocopying. Copies of the provided documents must be certified by the issuer.

## Liabilities of Issuers

According to the Disclosure Resolution, an issuer is responsi-

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ble for disclosure of information even if the issuer has entrusted third parties to disclose information regarding securities issued by such issuer. If an issuer has failed to disclose information, the issuer must provide the FCSM with the reasons for such failure. The absence of valid reasons generally constitutes a basis for imposition of fines on that issuer. Currently, the RF Administrative Code dated December 30, 2001, sets the maximum fines for violation of disclosure rules from 300 to 400 times the minimum monthly wage (currently, this sum would equal from approximately US \$1,000 to US \$1,333). In addition to fines, the Disclosure Resolution establishes that an issuer's failure to disclose information may trigger imposition of restrictions on sales of securities issued by such issuer in accordance with Russian law. However, Russian law currently does not specify what types of restrictions, would be possible or the mechanism for imposition of such restrictions. / *E.Korotkova and E.Abrossimova in Moscow*

## Amnesty for Unregistered Shares

On December 15, 2003, the RF President signed the anticipated draft law "On Regulation of Relations with Respect to Placement of Shares Without State Registration" (the "Share Amnesty Law"). The Share Amnesty Law applies to shares which were placed prior to the entry into force of the Law "On the Securities Market", dated April 22, 1996, which came into effect, April 22, 1996 as amended (the "Securities Market Law"), but were not properly registered, as required by the Securities Market Law ("Unregistered Shares"). The Share Amnesty Law is aimed at reducing the uncertainty with respect to transactions involving unregistered shares.

Pursuant to the Securities Market Law, any transaction with unregistered securities is prohibited. According to the Civil Code, any transaction concluded in violation of the law is null and void. Therefore, currently, any transaction with unregistered shares is considered null and void. According to the law, a void transaction is invalid *ab initio*, which means that (i) there is no need for the court to declare this transaction illegal, and (ii) any interested person may request a court to enforce the consequences of a void transaction (*i.e.*, to return the parties to the original position which existed prior to the purchase of the unregistered securities). In practice, many

companies failed to initially register shares prior to 1996. This failure to register has been used in many cases by interested parties as a means of extorting money from holders of unregistered shares due to the legal uncertainty even where the shares were subsequently registered with the Federal Commission on Securities Market ("FCSM").

The Share Amnesty Law establishes three rules enabling Unregistered Shares to be considered valid (*i.e.*, for shares placed without registration before April 1996).

First, in accordance with the Share Amnesty Law, one year is granted for the relevant joint stock companies to submit necessary documents with the FCSM for the registration of Unregistered Shares. The FCSM must either register the Unregistered Shares or refuse their registration, if there are grounds for doing so under the Securities Market Law, within 60 days after obtaining all necessary documents regarding the Unregistered Shares from a company.

Second, and most importantly, the Share Amnesty Law provides that upon registration of the Unregistered Shares, and in accordance with the Share Amnesty Law, the shareholders, as of the date of registration of the Unregistered Shares, shall become valid owners of such shares. In addition, any transactions on the basis of which the above shareholders have acquired the Unregistered Shares, may no longer be declared invalid on the basis of non-registration of such shares. It appears that the second rule will not affect those transactions which have already been invalidated by a court prior to the coming into force of the rules under of the Share Amnesty Law.

Third, the Share Amnesty Law establishes that joint stock companies that have failed to submit documents for registration of Unregistered Shares within one year following entry into force of the Share Amnesty Law are subject to liquidation if claims are brought by registration authorities.

The Share Amnesty Law will become effective 10 days after its official publication. / *E.Korotkova and E.Abrossimova in Moscow*

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## Supreme Court Supports Bank Account Holders' Rights

On August 26, 2003, the Cassation Chamber of the RF Supreme Court confirmed the invalidation of a part of Presidential Decree No. 1212 "On Measures to Increase the Collection of Taxes and Other Mandatory Charges and to Regulate Cash and Non-Cash Currency Circulation," dated August 18, 1996 (as amended) (the "Decree").

As a general rule, Paragraph 3, Section 7 of the Decree provided that a withdrawal (transfer) of funds from a bank account was permitted only upon receipt by the bank of a confirmation from the tax authorities that notification on opening/closing of an account was properly delivered to them. In addition, the RF Tax Code provides that a bank must notify the relevant tax authorities upon opening/closing of a company's or an individual entrepreneur's bank accounts within five days from the date of opening/closing of such account.

The requirement, established by the Decree, was challenged in the RF Supreme Court by the Joint Stock Commercial Bank "Nash Dom" as violating the rights of both clients and banks. In particular, based on relevant provisions of the RF Civil Code, from the moment of entering into a bank account agreement with a client, a bank must follow the client's instructions to withdraw or transfer the funds from the client's bank account. However, the banks could not fulfill their contractual obligations and provide clients with withdrawal or transfer services during the notification period. In practice, this time period could take over ten days and such delay could adversely affect the day-to-day activities of banking clients.

The RF Supreme Court ruled that Paragraph 3, Section 7 of the Decree contradicts the RF Civil Code, including Section 2 of Article 849 which establishes the bank's obligation to withdraw or transfer funds from the client's account not later than on the day following the date when the relevant payment document was submitted to the bank unless other periods are provided by law, or pursuant to the bank account agreement. According to the RF Supreme Court, the restrictions imposed by the Decree, limit the client's right to manage or dispose of monetary funds located in the accounts which is

expressly prohibited by Article 858 of the RF Civil Code. Such limitations on the account may only be imposed by law and not through governmental decree. / *O.Titenko in Moscow*

## New Procedures for State Registration of Legal Entities in the Russian Federation

In accordance with the RF Law "On State Registration of Legal Entities" (the "Registration Law") which came into force in 2002, authority for State registration of legal entities was transferred to the regional departments of the RF Ministry for Taxes and Duties (the tax inspectorates). This major change in registration procedures was an important departure from the previous rules regulating registration of legal entities and was aimed at simplifying and shortening the registration process. One of the main objectives of the reform was the "one-window" principle, according to which legal entities would submit registration documents to one State authority (the tax inspectorate) only, which would in turn notify the other State authorities on registration of legal entities. However, not all of the aims of the reform have been fully accomplished, and thus reform of the registration procedure continues.

In particular, on June 23, 2003, the RF President signed RF Federal Law No. 76-FZ "On Introduction of Amendments and Additions to the RF Law 'On State Registration of Legal Entities,' which comes into force on January 1, 2004. The law also covers the registration of individual entrepreneurs, and will be called accordingly, the RF Law "On State Registration of Legal Entities and Individual Entrepreneurs" (the "New Registration Law"). The RF Ministry for Taxes and Duties will also be responsible for the state registration of individual entrepreneurs, and a separate State Register of individual entrepreneurs will be maintained.

In addition to detailed provisions on registration of individual entrepreneurs, the New Registration Law also introduces some changes with respect to registration of legal entities

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generally. Not all changes are progressive. For example, under the current law, all applications submitted to the tax inspectorate with respect to the initial registration, reorganization or liquidation of a legal entity, may be signed only by a person authorized by the Registration Law (which, among others, may be the chief executive officer, the founders of a legal entity, the chief executive officer of the parent company, etc.), and all such signatures must be notarized. Under the New Registration Law, representatives from the list of authorized signatories, acting on the basis of a power of attorney, are excluded. At the present time, it is unclear whether such representatives may submit to the tax inspectorate applications signed by an authorized signatory. If this is not allowed, the registration process may be significantly delayed, because the signatory would need to submit the application and required documents personally or send it to the tax inspectorate by mail (not the most reliable method).

As a separate development, on November 28, 2003, the RF State Duma adopted in the third reading a draft law "On Introduction of Amendments and Additions to the RF Legislative Acts With Respect to Improvement of Procedures of State Registration of Legal Entities and Individual Entrepreneurs" (the "Draft Law"), which is aimed at full realization of the "one-window" principle introduced by the Registration Law. The Draft Law provides that legal entities and individual entrepreneurs will no longer be required to submit documents for registration to the Social Insurance Fund, the Pension Fund or the Medical Insurance Fund (the "Social Funds") separately. Instead the burden will pass to the tax inspectorates, who will need to notify the relevant Social Funds on the State registration of a legal entity or an individual entrepreneur within five days from the actual registration.

The Draft Law also provides that the registration of a legal entity or an individual entrepreneur as a taxpayer must be carried out by the same tax inspectorate after State registration (currently, this is regulated only at the level of the Order of the RF Ministry for Taxes and Duties). The application for registration as a taxpayer must be submitted by a legal entity/ individual entrepreneur along with the application for State registration. Accordingly, the Draft Law provides that the State Register of Legal Entities and Individual Entrepreneurs will additionally contain the following information: information on branches and representative offices of the legal entity; the tax identification number and the date of the taxpayer's registra-

tion for; the State statistic codes; the registration numbers and dates of registration with the Social Funds; and information on bank accounts. Additionally, the Draft Law expressly prohibits provision of information on bank accounts to third persons, except for authorized State bodies. If signed by the RF President, the Draft Law will enter into force starting from January 1, 2004. *I. O. Titenko and E. Trubitsina in Moscow*

## Exclusion of a Participant from a Limited Liability Company

The exclusion of a participant from a limited liability company was examined by the Supreme Arbitration Court of the RF, which is the highest judicial body charged with commercial disputes, for the first time in Case No. 7325/03 on August 26, 2003. Under Article 10 of the RF Law "On Limited Liability Companies", participant(s) holding in the aggregate a minimum of 10 percent of the company's charter capital are entitled to demand, by filing a lawsuit, that another participant be expelled from the company, if such participant:

- (i) has grossly violated its duties;
- (ii) has made the company's activity impossible; or
- (iii) is materially obstructing the company's activity.

No further guidelines are provided by the law and thus it was unclear how these provisions would work in practice. Previously, in interpreting certain provisions of the law, the RF Supreme Arbitration Court recommended that while evaluating whether a participant grossly violated its duties, the lower courts must take into consideration the participant's fault, as well as the occurrence (or possibility thereof) of negative consequences for the company. However, in practice, it remained unclear how to evaluate such negative consequences.

In this particular case, one of the company's participants proposed that the general participants' meeting of the company (the company's highest governing body) approve the sale of certain company property, although the very same participant knew that this property was pledged to a bank as security for the company's loan obligations. The participant failed to in-

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form the other members of this pledge at the meeting. The Supreme Arbitration Court held that an action to expel the participant should be granted since the participant breached the obligations imposed upon the participants of the company by the company's charter and, as a result of this breach, the company faced negative consequences. / *K. Konstantinov and E. Abrossimova in Moscow*

## Special VAT Bank Accounts May be Imposed

The RF Ministry of Finance and the RF Ministry of Taxes and Levies recently proposed introducing "special VAT bank accounts" to be opened by all companies in addition to their existing bank accounts. It is envisaged that in making payments for goods or services, a purchaser would transfer the net purchase price to a seller's account separately from the VAT amount, which must be remitted directly to the seller's "special VAT account". The funds kept in the company's "special VAT account" would only be used for payment of VAT to the state budget or for payment of VAT to appropriate sellers or contractors. The company would only be able to use the funds kept in the special VAT accounts for purposes other than as described above in the event of the company's liquidation.

Officials of both ministries view this initiative as an instrument for countering the "abuse of unjustified VAT refunds". In addition, these changes should also facilitate the procedure for VAT refunds to conscientious taxpayers.

As recompense for the expense of maintaining and servicing the new special VAT accounts, it is envisaged that in 2005, VAT would be refundable "automatically" without the current lengthy and complicated verification procedures. Additionally, tax officials have proposed that the timing for receiving refunds of VAT related to capital investments would be reduced to one month, which would be an amazing result considering that taxpayers currently endure a lengthy process lasting between several months to one year or more in order to obtain capital investment-related VAT refunds.

In order to better monitor VAT payments, the RF Ministry of Taxes and Levies also has proposed the introduction of special electronic databases (technical instruments) which would keep track of all invoices related to a company. It is antici-

pated that if these databases are adopted, all data from such databases would also be submitted to the tax authorities on a regular basis. The tax authorities indicate that they plan to use this system to monitor the taxable base of each taxpayer to reduce tax fraud.

Russian tax officials are very optimistic about the prospects of the new VAT procedures following reports from Bulgaria, where special VAT accounts have already been introduced. During the first year after the adoption of the new system in Bulgaria, according to the RF Ministry of Finance, VAT income to the state budget increased by over fifty percent.

Members of the Russian business community, and even certain government officials, are not as optimistic as Russian tax officials, about the advantages of such a system and fear that the costs of the new VAT procedures will outweigh the economic benefits. According to research conducted by the RF Ministry of Economic Development and Trade, potentially at least US \$3 billion could be diverted from companies' cash flow to these special VAT accounts.

On December 2, 2003, the RF Government officially accepted for consideration, and is currently discussing, introduction of the special VAT accounts beginning from September 1, 2004. We will monitor this issue as it develops. / *Sergei Volfson in Moscow*

## Corporate Property Taxes to Rise Slightly

The current RF Law N2030-1 "On tax on property of Enterprises" dated December 13, 1991, as amended, will soon be replaced by the new Chapter 30 of the Tax Code. The draft of the new Chapter 30 is currently awaiting the signature of the President following successful passage by the State Duma and approval by the upper chamber of the Russian parliament - the Federation Council.

The corporate property tax is one of the regional taxes for which federal legislation establishes only the maximum tax rate with actual tax rates (*i.e.*, potentially lower) adopted by each of the Russian regions individually on an annual basis. The current federal law provides for a maximum corporate property tax rate of 2 percent of the value of the company's assets.

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In the initial draft of the proposed new Chapter 30, the Government proposes to increase the maximum property tax rate to 2.6 percent in order to compensate the Russian regions for the abolishment of the sales tax (which is currently in effect until January 1, 2004). The Russian parliament did not support the RF Government initiative, however, and established the maximum property tax rate at 2.2 percent in the new Chapter 30.

The new corporate property tax rates may be introduced as early as January 1, 2004 assuming that regional authorities amend their budget laws before then. / *Sergei Volfson in Moscow*

## New Restrictions on Tobacco Advertising

The State Duma Committee On Health Protection and Sports recently introduced draft amendments to the Law "On Limitation of Tobacco Smoking". The draft contains substantial changes to the current regulation of tobacco advertising in Russia. Most importantly, the draft amendments prohibit any advertising of tobacco goods except for advertising in specialized print and profile magazines, in line with other jurisdictions. In addition, according to the new draft, the supplementary health warning notice must occupy not less than 50 percent of the face of the cigarette box (currently, this supplementary notice must occupy not less than 4 percent of the face of the cigarette box). Furthermore, according to this draft, every tenth cigarette box must contain a flyer with additional health warning information. The draft amendments also increase the minimum age for buyers of tobacco products from 18 to 21. / *O. Titenko in Moscow*

### UKRAINE

## New Personal Income Tax Law to Take Effect in Ukraine

The recently enacted Law on Taxation of Income of Individuals (the "Income Tax Law") will take effect on January 1, 2004,

although some provisions will be phased in gradually over the next few years. The main innovation in the Income Tax Law is the introduction of a flat 15 percent tax rate on personal income of residents, with an interim 13 percent rate effective from January 1, 2004 to January 1, 2007. Under the current law, individuals are taxed based upon a progressive scale ranging from 10 percent to 40 percent, with the 40 percent rate applying to all income in excess of the Ukrainian Hryvnia equivalent of US\$ 320 per month. In addition to the new flat tax rate, the Income Tax Law also introduces a new 5 percent tax on interest earned from bank deposits and deposit/savings certificates.

Over the years, it became apparent that the progressive tax regime was not yielding sufficient revenues as the rates were viewed by most citizens as extortionate, and as a result, individuals routinely sought to avoid payment by various schemes or simply ignored their obligations altogether. Ukrainian tax officials hope that the new flat rate, more in line with those in developing countries, will encourage the voluntary payment of taxes, thereby bringing a greater share of Ukraine's shadow economy into the mainstream and increasing tax revenues.

The Income Tax Law states that all income received by an individual, offset by the amount of "tax credits" (comprising deductible expenses and social tax exemptions), is subject to taxation.

These "Tax credits" (or deductions), a new concept under the Income Tax Law, consist of a variety of defined social tax exemptions and actual expenses incurred by a taxpayer that can be deducted from taxable income, such as mortgage interest payments, donations to registered charities and non-profit organizations of between 2 percent and 5 percent of the aggregate taxable income of such taxpayer for the reporting year, expenses for professional and/or higher education of such taxpayer or a close relative, medical expenses (including expenses for pharmaceuticals) and life insurance and non-state pension insurance payments. The Income Tax Law also provides that the amount of permitted deductions may not exceed the taxpayer's aggregate taxable income and excess deductions may not be carried forward to the next reporting year. The current personal income tax law does not allow for the deduction of any expenses from personal taxable income.

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The introduction of the concept of deductions in the Income Tax Law is yet a further indicator of Ukraine's desire to bring its taxation regime into line with international practice.

Most personal income will be taxed at the payment source. The payor of income, defined as a "tax agent", will be required to withhold the prescribed amounts from income due to the taxpayer. Ukrainian employers, as the principal payors of salaries, would be considered the principal tax agents within the meaning of the Income Tax Law. The Income Tax Law additionally recognizes other entities as tax agents, such as banks paying interest on deposits, notaries certifying real estate sale-purchase agreements, Ukrainian companies making payments to foreign individuals and casinos when paying out gambling winnings. A tax agent may incur liability for a failure to properly calculate, withhold and remit taxes to the state budget.

Although the tax on most income will be withheld at the source (primarily from salary payments), the taxpayer may also receive income from abroad and/or from other sources for which taxes are not required to be withheld at the source. To reconcile all permitted deductions, non-taxed income and the amounts withheld from the individual throughout the year, taxpayers will be required to file annual declarations to report all income received, expenses incurred and amounts already paid within the reporting year for the purpose of determining any under payment or over payment of tax. In case of any underpayment, the taxpayer must make up the difference. The amount of any overpayment is to be returned within 60 days after the filing of the tax declaration.

As noted above, the new tax rates apply to "residents", which is a concept broadly defined as "individuals residing in Ukraine". Under the Income Tax Law, if an individual, regardless of his or her citizenship, maintains a residence in Ukraine and in another country, such person would be considered a resident if he/she permanently resides in Ukraine. If a person maintains a permanent residence in both Ukraine and any other country, however, such person would only be considered a resident if he/she has more close, personal or economic ties with Ukraine and/or the individual's "center of life interests" is in Ukraine, a vague expression deemed generally to include a family residence or the fact of registration as an entrepreneur earning his/her living in Ukraine. Also, the Income Tax Law provides that if it is not possible to determine

whether Ukraine qualifies as the "center of life interests" of a taxpayer, or if a person has no permanent residence in any country, that person would be considered a Ukrainian resident, and thus subject to pay personal income tax, if he/she is present in Ukraine for at least 183 days during any calendar year.

Finally, the Income Tax Law states that if it is not possible to determine the residency status of a taxpayer who is a Ukrainian citizen on the basis of the rules set out above, such Ukrainian citizen would automatically be considered a resident for the purposes of the Income Tax Law. Also, if an individual unilaterally selects Ukraine as his/her primary residence or registers as a self-employed person in Ukraine, this individual will be deemed a resident of Ukraine for tax purposes.

Although the Income Tax Law specifies a flat tax rate of 13 percent (subject to increase to 15 percent in 2007 as noted above) for Ukrainian residents, the rate on personal income earned by non-residents from a source in Ukraine will be double that of residents, *i.e.* 26 percent starting from January 1, 2004 and 30 percent from January 1, 2007. This is a significant departure from current law, which taxed personal income of non-residents at a 20 percent rate.

In general, any income paid to a non-resident individual in connection with any type of activity in Ukraine is subject to taxation. In addition to taxing interest, dividends and other types of investment income, the Income Tax Law also provides for the taxation of income derived from a Ukrainian source by the following categories of non-residents: (a) employees of legal entities with offices or other sites of activity within Ukraine (e.g., construction sites), and also including representative offices of foreign legal entities in Ukraine, (b) notwithstanding the payment source, those who are members of the management bodies of Ukrainian business entities or their representative offices abroad and receive remuneration for such activity from Ukrainian residents, and (c) individuals engaged in entrepreneurial activity or who provide professional services in Ukraine, notwithstanding the location of the ultimate payment source.

Further, the Income Tax Law specially provides that in case a non-resident receives taxable income from another non-resident in Ukraine, these amounts should be remitted to a

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bank account opened by the non-resident income recipient in a Ukrainian bank. This bank would be considered the tax agent responsible for calculation and remittance of tax to the state budget. The Income Tax Law also states that where such income is paid by one non-resident to another in cash or in any other form, the non-resident recipient would be under an obligation to calculate and remit the tax to the state budget on the next banking day after receipt of such compensation.

Also, where a non-resident receives taxable income from a Ukrainian resident, such resident becomes the tax agent responsible for calculation and remittance of tax to the state budget. When entering into a contract with a non-resident pursuant to which the non-resident would receive income taxable in Ukraine, the Ukrainian resident should specify in the agreement the tax rate that will apply to payments made to the non-resident.

Another new aspect of the law concerns the tax treatment of real estate transactions. For sales of real estate owned by a taxpayer as of January 1, 2004, all income received from the sale of such real estate, including the underlying land, is taxed at the rate of 1 percent of the overall sale amount if the total area does not exceed 100 square meters. If the area exceeds 100 square meters, in addition to the 1 percent tax on the first 100 meters, the income derived from the remainder of the property in excess of 100 meters is subject to taxation at the rate of 5 percent of the amount of sale. The same 5 percent rate applies to multiple sales of real estate made by the same taxpayer in a reporting year and to sales of unfinished construction. The tax is paid on the purchase price which cannot be less than the fair market value of the real estate sold.

With regard to real estate acquired after January 1, 2004, income received from the sale of such real estate will be taxed at the regular rates (i.e., the 13 percent rate until January 1, 2007 and at 15 percent afterwards), if the same taxpayer has only one real estate sale in a year. The taxable income will be determined as the difference between the expenses incurred for the acquisition of such real estate and the sales price, with the deduction of depreciation charges at the rate of 10 percent per year. However, the Income Tax Law does not contain any provisions that would allow an individual to deduct amounts spent on renovation of real estate from the amount subject to taxation.

The recent adoption of the Income Tax Law should be viewed

as a significant step towards liberalization of the Ukrainian taxation system. It is also expected that the Ukrainian Parliament and government will take subsequent measures to decrease the employment tax burden on employers, which are currently required to pay nearly 40 percent in social insurance and pension fund taxes on amounts of paid salaries. Without a decrease in those rates, the much anticipated effect of increased state revenues from personal income tax will not likely come soon. State revenues will increase only when private sector employers become willing to make salary payments to employees officially, and remit full payment of personal income, social insurance and pension fund taxes.

The prevailing view among government officials is that Ukrainian citizens and foreigners-taxpayers of Ukrainian personal income tax would be willing to pay personal income tax at the decreased rate, thus legalizing their income. Hopefully, these positive expectations of the Ukrainian government will be realized. The Russian experience of introducing a flat tax rate demonstrates that citizens are willing to pay a "reasonable" tax. / *Anton V. Lyman, Jaroslawa Z. Johnson and Adam M. Mycyk in Kiev*

## UZBEKISTAN

# Restructuring of the Oil And Gas Sector in Uzbekistan

On October 21, 2003, the Cabinet of Ministers of the Republic of Uzbekistan issued a decree "On Improving the Management Structure of the National Holding Company Uzbekneftegas" (the "Uzbekneftegas Decree").

The Uzbekneftegas Decree provides for the restructuring of subsidiary joint stock companies in Uzbekneftegas. As a result of such restructuring, the joint stock company "O'zneftgazishchita'minot" has been entirely liquidated, and the joint stock company "Uzneftepererabotka" has been liquidated with its enterprises transferred to another joint stock company "Uznefteproduct". In addition, the Uzbekneftegas Decree also provides for the merger of two joint stock companies "Uzgeoneftegasdobycha" and "Uzburneftegas" and the

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establishment of the new joint stock company "Uzgeoburneftegasdobycha". The Shurtan Gas and Chemical Complex has been transferred to, and the joint stock company "Uzneftegasstroy" has been included in, Uzbekneftegas. The Uzbekneftegas Decree establishes that the State-owned property and shares of stock which were contributed to the charter fund of Uzbekneftegas and the charter funds of its subsidiary joint stock companies may be alienated only by a decision of the Cabinet of Ministers.

The Uzbekneftegas Decree is the logical continuation in the implementation of the Government's plans related to the improvement of the management structure in the oil and gas sector and the privatization thereof, contemplated by Decree No. 386 of the Cabinet of Ministers "On Measures for Increasing the Efficiency of Operations of the General Economic Complex of the Cabinet of Ministers" dated September 5, 2003, and Decree No. 119 of the Cabinet of Ministers "On Further Measures for Denationalization and Privatization of Enterprises by Attracting Foreign Investors in 2001-2002" dated March 9, 2001, which provides for sale of 39 to 51 percent of the shares of stock in the charter fund of Uzbekneftegas and of its subsidiary joint stock companies. / *Alexander Voronin in Tashkent*

## Change in Currency Operations in Uzbekistan

The Government of Uzbekistan and the Central Bank of Uzbekistan proclaimed, on October 8, 2003, that their efforts to eliminate the multiple exchange rates existing in the country and to lift many currency restrictions had been successful, and that, as of October 15, 2003, Uzbekistan officially would adhere to the obligations set forth in Article VIII, Sections 2(a), 3 and 4 of the Articles of Agreement of the International Monetary Fund (IMF) (*i.e.*, the obligation to provide for convertibility of the national currency for current transactions). The Government and the Central Bank of the Republic of Uzbekistan have delivered its official notice to the Director-Manager of the IMF with respect to these changes in the Government's policy.

However, the Uzbek Government has introduced a "monitoring system", so that transactions that previously

were restricted now require careful monitoring by Uzbek-authorized banks (banks that have the authority to conduct foreign currency transactions) and certain Governmental agencies. Pursuant to the "Regulation on the Order of Monitoring the Validity of Currency Operations Performed by Legal Entities and Individuals", which became effective as of October 14, 2003 (the "Uzbek Currency Regulation"), all Uzbek-authorized banks must provide Uzbek tax authorities, on a monthly basis, with information on ten specific types of cross-border transactions in which their clients engage. For example, such information must be provided for transactions (i) in which dividends are repatriated, (ii) in which advance payments for imports are more than thirty percent of the contract value, (iii) in which the recipient of payments is not a party to the relevant cross-border contract, (iv) in which payments are made to companies registered in tax-free offshore areas (the list of offshore areas is specified), and (v) pursuant to an import contract that provides for a penalty of less than fifteen percent for the failure to timely deliver imported goods. The information provided by Uzbek-authorized banks should include details of the cross-border contract, names of the parties to the contract, and other issues of concern.

The Uzbek Currency Regulation also requires the Customs Committee of Uzbekistan to provide the Tax Committee of Uzbekistan with certain supporting information related to such cross-border transactions. In particular, Uzbek customs officials must inform the Uzbek tax authorities of any cross-border transactions that are undergoing customs clearance in which (i) an importer misstated the real value of the imported goods, (ii) a supplier of the relevant goods is not a party to the relevant contract, (iii) the relevant goods are not delivered within 180 days from the date that the purchase price was paid, or (iv) the relevant goods are being exported without a prepayment, a letter of credit, a guarantee from the purchaser's bank, or an insurance policy against political and commercial risks for export contracts.

If the tax authorities suspect a violation of Uzbekistan's currency laws based the information provided by the bank or customs authorities, the tax authorities may, with permission from the Republican Council for Coordination of Operations of Controlling Bodies the Uzbekistan, undertake a tax audit of the persons that carried out the "suspicious" transaction. / *Alexander Voronin in Tashkent*

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USA

## How the Patriot Act Affects Financing Transactions

Lawyers in the Chadbourne offices outside the United States have been asking when and how the USA Patriot Act might come into play in project finance transactions.

The Patriot Act is a law enacted in the wake of the terrorist attacks in the United States on September 11, 2001 to give US law enforcement agencies more tools for tracking down terrorists. The statute has been criticized by civil libertarians in the United States. It has broad reach. There are three separate requirements that might come into play in project finance transactions. They relate to establishment of a private banking or correspondent account, banking with foreign shell banks, and "primary" money laundering.

One goal of the Patriot Act is to cut off the supply of funds to terrorist groups. It does this through comprehensive rules on money laundering and bank secrecy. Participants in project finance transactions should be aware in particular of three rules.

### Opening Accounts

Any "financial institution" that establishes or maintains a "private banking account" or a "correspondent account" in the United States for a non-US person (including a foreign visitor or a representative of a non-US person) must establish internal due diligence procedures designed to detect and report instances of money laundering through these types of accounts.

Financial institutions subject to this requirement include all US banks whose deposits are insured by the Federal Deposit Insurance Corporation. The requirement also applies to trust companies, brokers and dealers registered with the US Securities and Exchange Commission, investment bankers, investment companies within the meaning of the US securities law, currency exchanges, insurance companies and loan or finance companies. This requirement also applies both to US

branches of foreign banks and to foreign branches of US banks.

Any financial institution establishing or maintaining a private banking account or correspondent account must put in place procedures designed to collect two types of information: the identity of the nominal and beneficial owners of the account and the sources of funds deposited into the account "as needed to guard against money laundering."

If the account is maintained by or on behalf of a senior foreign political figure (or any immediate family member, including the spouse's parents) or by a close associate of such a figure whose association is publicly known, then the financial institution must take additional steps to detect and report any transactions that may involve the proceeds of foreign corruption. A senior political figure includes a current or former senior government official -- a person with substantial authority over policy, operations or the use of government-owned resources -- in the executive, legislative, judicial, administrative, or military branches of a government outside the United States, whether elected or not. It also includes a senior executive of a foreign political party or a foreign government-owned commercial enterprise.

A "private banking account" is an account (or a combination of accounts) requiring minimum aggregate deposits of \$1 million or more in cash or other assets, and established on behalf of one or more individuals with direct or beneficial ownership interest in the account. A beneficial owner of an account is a person with a contractual or judicial authority to direct funds in and out of the account. It also includes a person entitled to all or any part of the assets in (or the income from) the account so long as the entitlement represents more than \$1 million or 5% of the assets in (or the income from) the account, whichever is less.

A "correspondent account" is an account established to receive deposits from or make payments on behalf of a non-US bank. It also includes accounts designed to handle other financial transactions related to such a bank.

Additional requirements are imposed if the correspondent account is requested or maintained on behalf of a foreign bank that operates under an "offshore banking license" or under a banking license issued by a foreign country that the US

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does not believe has embraced international anti-money-laundering principles. An offshore banking license refers to a banking license that prohibits the bank from conducting banking activities with the citizens of the licensing country or in the currency of that country. As of November 2003, nine countries and territories have been designated as uncooperative with international efforts to curb money laundering. They are the Cook Islands, Egypt, Guatemala, Indonesia, Burma (Myanmar), Nauru, Nigeria, The Philippines and the Ukraine. Any financial institution that maintains a correspondent account for a foreign bank from one of these nine countries or territories must identify the nature and extent of the ownership of the account owners -- not just the identity of the account owners and the sources of funds. If the foreign bank in one of these nine countries on whose behalf a financial institution is maintaining a correspondent account in turn provides correspondent accounts to other foreign banks, then the identity of those other foreign banks, as well as the identity, nature and extent of ownership of the correspondent accounts in those other foreign banks, must be learned.

Banks do not have to go through all this trouble for a one-off transaction with another bank. However, an account that is used to provide *regular* service requires a full inquiry. The Treasury Department said an account providing regular service means "an arrangement to provide ongoing services, and would generally exclude infrequent or occasional transactions." While this relieves those financial institutions engaged in a "one-off" transaction with another bank, the Treasury Department has not made clear how frequent a dealing is "infrequent" for purposes of avoiding this rule.

### Shell Banks

A narrower class of financial institutions is barred from establishing any correspondent account in the US for or on behalf of a foreign "shell bank."

This rule applies to banks insured by the Federal Deposit Insurance Corporation, other commercial banks or trust companies, US branches of foreign banks, thrift institutions and brokers and dealers registered with the Securities and Exchange Commission. It does not apply to investment companies, investment bankers, currency exchanges, insurance companies or loan or finance companies.

Financial institutions subject to this rule must also take steps

to ensure that any correspondent account it has with a foreign bank that is not itself a shell bank is not used "to indirectly provide banking services" to a shell bank.

A shell bank is a bank that does not have a physical presence in any country. A physical presence requires a fixed place of business with at least one fulltime employee. There must be operating records at that office, and the bank must be subject to the oversight of a government agency whose mission is to supervise banks.

### "Primary" Money Laundering

The Patriot Act requires that special measures be taken by any financial institution -- broadly defined -- or any US "financial agency" that does business with a "primary money laundering concern." The special measures are whatever the US Treasury Department decides to require. A "financial agency" is anyone acting as a "bailee, depository trustee, or agent" in connection with the handling of "money, credit, securities or gold." Multilateral agencies like the World Bank, International Finance Corporation, Asian Development Bank and Inter-American Development Bank are not subject to this requirement.

The Treasury Department has not issued guidance on how broadly one ought to interpret the term "financial agency." For instance, it is possible that a law firm acting in as an escrow agent for the participants in a project finance transaction may be a "financial agency" since it is an entity acting on behalf of another entity as an agent for money. An attorney at the Treasury Department dealing with the anti-money laundering provisions of the Patriot Act said such a broad reading is possible. However, the attorney also said a law firm may not be a type of institution this rule is meant to govern -- banks and other entities typically viewed as financial institutions.

The US Treasury Department has the power to designate "primary money laundering concerns." A primary money laundering concern can be a jurisdiction outside of the US, a financial institution operating outside the US, a transaction within or involving a jurisdiction outside the US, or any type of account.

To date, two jurisdictions have been designated as "primary

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money laundering concerns." They are Nauru and Burma. The Ukraine was designated as one in December 2002, but the designation was rescinded five months later after the Ukraine took steps to fix its anti-money laundering rules. In addition, two financial institutions have so far been identified as primary money laundering concerns. They are Myanmar Mayflower Bank and Asia Wealth Bank, both from Burma.

Once the Treasury Secretary identifies a primary money laundering concern, he can impose additional reporting requirements on financial institutions or agencies doing business with such a concern. The requirements can include maintaining records and filing reports when transactions involving the concern occur, and obtaining and retaining information concerning the beneficial owner of any account opened or maintained in the US by a foreign person (or a representative of a foreign person) involving the concern.

If a US financial institution or agency opens or maintains a "payable-through account" in the US for a foreign financial institution involving the money laundering concern, it has additional reporting requirements. It must take steps to report the identity of each customer (and representative of the customer) of the foreign financial institution who is permitted to use (or whose transactions are routed through) the payable-through account, and any other information that is "substantially comparable to that which the depository institution obtains in the ordinary course of business with respect to its customers residing in the US" with respect to that customer.

A "payable-through account" is an account opened at a depository institution by a foreign financial institution by means of which the foreign financial institution permits its customers to engage in normal banking activities in the US.

The US Treasury can also flatly prohibit opening any correspondent or payable-through account that involves a primary money laundering concern.

The US banks (including the US branches of foreign banks) should continually monitor the announcements from the Treasury Department for any additions to the list of primary money laundering concerns -- a list likely to keep growing -- as well as for the specific rules imposed on doing business with such concerns.

## Compliance Resources

When first enacted, the Patriot Act's anti-money laundering provisions created some panic and an overflow of different forms among US and foreign banks as they attempted to comply with the various due diligence and reporting requirements. Fortunately, as the Treasury Department began issuing detailed regulations implementing these provisions, it also made available various forms that financial institutions can use to satisfy the requirements. It has also published model internal procedures that it suggests financial institutions should adopt to detect money laundering. They are available on a website at [www.fincen.gov](http://www.fincen.gov). / *Samuel R. Kwon, in Washington*

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