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RUSSIA

Recent Court Rulings Support Taxpayers in VAT Set-Off Dispute

In the latest in a series of disputes between taxpayers and the Russian tax authorities with respect to set-offs of value-added tax ("VAT"), taxpayers appear to have won another victory - this time in respect to setting off VAT paid to suppliers using borrowed funds.

As a general rule, under Article 168 of the Russian Federation ("RF") Tax Code (the "Tax Code"), VAT is included in the price of goods sold to a buyer. A taxpayer can reduce its total VAT obligation to the government by taking certain deductions as set forth in Article 171 of the Tax Code. One such deduction allows taxpayers to set off incoming and outgoing VAT payments, such that, for example, a taxpayer acquiring goods for subsequent resale may subtract the amount of VAT paid to the original supplier from the VAT amount received from the subsequent buyer. However, a court ruling last Spring suggested that the right to such deductions was not absolute.

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UKRAINE

Resolution No. 482: Should it Stay or Should it Go?

In the face of growing discontent and confusion, the National Bank of Ukraine (the "NBU") has issued a series of interpretative letters (the "Letters") attempting to clarify its position with regard to the application of Resolution No. 482, a controversial NBU enactment regulating foreign investment and the repatriation of profits, income and other funds obtained from investment activities in Ukraine ("Resolution No. 482"). The Letters have been issued in response to various appeals from foreign investors, Ukrainian banks, and the Ukrainian business community, including a dispute brought by a foreign investor in a Ukrainian court. The Letters seem to suggest that the NBU may be prepared to compromise on some provisions of Resolution No. 482, however, the extent of such compromise remains unclear.

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UZBEKISTAN

Annual Changes to Taxation Regime Enacted

As usual, Uzbek politicians enacted a host of new legislation immediately before the beginning of the new fiscal year, with both the Cabinet of Ministers and the Parliament enacting legislation affecting the taxation regime both for legal entities and individuals. The changes include, among others, establishing new tax rates, introducing a new royalty, allowing for VAT refunds, and eliminating certain tax benefits for companies with foreign shareholdings. These key changes are summarized below.

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UZBEKISTAN

Annual Changes to Taxation Regime Enacted1

On April 8, 2004, the RF Constitutional Court adopted Ruling 169-O ("Ruling 169-O"), which stated that only taxpayers who have paid suppliers with their own (non-borrowed) funds may set off VAT paid to other taxpayers against incoming VAT payments (see the October 11, 2004 issue of the *CIS & Central Europe Legal Newswire* for a discussion of Ruling 169-O). Shortly thereafter, the tax authorities began conducting numerous audits of taxpayers' indebtedness, and took the position that deductions for VAT amounts paid to suppliers with borrowed funds were unlawful.

On November 4, 2004 the RF Constitutional Court adopted Ruling 324-O ("Ruling 324-O"), aimed at clarifying Ruling 169-O. According to Ruling 324-O, the right of taxpayers to set off incoming and outgoing VAT payments can be denied if the taxpayer failed to bear real expenses to pay the outgoing VAT amount (e.g., if the taxpayer had no intention of paying the creditor back for the funds borrowed to pay its supplier). Ruling 324-O thus provided a mixed message, since, on the one hand, it generally denies the apparent position reflected in Ruling 169-O that taxpayers cannot set off VAT amounts paid on assets acquired with borrowed funds, yet, on the other hand, sets forth a basis upon which tax authorities may deny the deduction by arguing that the taxpayer had no intention of repaying the borrowed funds. The implications of Ruling in 324-O may therefore vary widely in court practice.

A recent court case, however, seems to suggest an interpretation of Ruling 324-O that is more favorable to taxpayers. On December 14, 2004, the RF Supreme Arbitration Court (the "SAC") issued a decision in connection with a dispute between the Chkalovsky Regional Tax Inspectorate of Yekaterinburg under the RF Ministry for Taxes and Duties (the "Inspectorate") and Limited Liability Company "Euromebel Factory" ("Euromebel"). In March of 2002, Euromebel apparently paid its supplier 4.6 million Rubles for the purchase of equipment, using funds from a payment received under certain bank promissory notes. Euromebel apparently had purchased the promissory notes from an individual under an agreement requiring the purchase price to be repaid in installments within one year from their purchase. As of the date of the equipment purchase, Euromebel reportedly had an outstanding balance due for the promissory notes. Thus, the Inspectorate considered that Euromebel did not have the right under Article 171 of the Tax Code to deduct the VAT amounts paid to the supplier until Euromebel had repaid this balance. On the basis of Ruling 169-O, arbitration courts of the first, appellate and cassation instances

supported the tax authorities. However, the SAC, guided by Ruling 324-O, decided to invalidate the tax inspectorate's decision and all court decisions taken in support thereof. The SAC concluded that the Inspectorate had failed to prove that Euromebel employed unfair practices (*i.e.*, to prove that Euromebel did not intend to pay for the promissory notes), and therefore Euromebel was entitled to set off the VAT amount paid to the supplier even if the payment was made with borrowed funds.

Although this most recent court decision and Ruling 324-O certainly give taxpayers cause for optimism, the Federal Taxation Service will undoubtedly continue to aggressively challenge set-offs of VAT in this long-running dispute between taxpayers and the tax authorities. *IO. Titenko, E. Zamoshkina*

Land Re-Classification Law Finally Comes into Effect

The new RF Law No. 172-FZ "On the Re-classification of Land or Land Plots" (the "Land Re-classification Law") was signed by President Putin on December 21, 2004, and took effect on January 5, 2005. The Land Re-classification Law outlines the procedures, criteria, and special requirements applicable to the approval of an application for the re-classification of land.

In the past, local authorities often inconsistently applied their authority to allow re-classification of land since no specific criteria or specific procedures with respect to approval of such re-classification were set forth by law. Further, the RF Government, although vested with the authority to re-classify land at the federal level, was often reluctant to do so until federal law clarified the criteria and procedures for such re-classification. The adoption of the Land Re-classification Law should help to make the process much more transparent

Regulating Authority

According to the Land Re-classification Law, applications seeking the re-classification of agricultural and reserved lands (except for those lands which are the property of the RF) are to be submitted to local authorities at the RF subject level. Applications with respect to all other lands are to be submitted to the RF Government.

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Necessary Supporting Documents

The Land Re-classification Law lists the documents which must be supplied along with a land re-classification application, including the conclusion of an ecological review (in cases prescribed by law) and a calculation of agricultural or forestry losses (where applicable). The Land Re-classification Law clarifies that both of these documents must be included with the application upon filing.

Classification and Registration of Land Re-classification

According to Article 285 of the RF Civil Code, use of a land plot in violation of its permitted use, as determined by the land's classification, may serve as grounds for terminating the property rights to the land plot.

The Land Re-classification Law provides that the re-classification of a land plot enters into legal force from the moment of the reflection of the re-classification in the State Unified Register of the Rights to Immovable Property and Transactions Therewith.

Grounds for Refusing a Re-classification Application

Under the Land Re-classification Law, a re-classification application may be rejected on three grounds: (i) where a legislative restriction exists on re-classifying lands of a particular land category; (ii) in the event of a negative ecological review; and (iii) when the re-classification sought does not comply with governmental plans for the development of that territory.

Thus, although the grounds for rejecting an application for re-classification appear to be relatively narrow, they could in practice continue to give local and federal authorities broad authority to reject an application for re-classification of land for several reasons.

First, despite the new law, numerous legislative restrictions continue to exist with respect to each particular category of land. For example, agricultural land may be re-classified only in very limited circumstances, *e.g.*, agricultural land may be re-classified as industrial land only if the land is unsuitable for agricultural use.

Second, it would appear that the government may always use the grounds that such re-classification does not comply with governmental plans for a particular area, even if such plans are not formally adopted at the time an application is submitted, since no further detail is provided with respect to this issue under the law.

At the same time, it should be noted that the law expressly permits decisions on land re-classification to be challenged in court, and thus applicants will now have recourse to the courts if an application is rejected. / *J. Romanova*

Requirement to Notarize Mortgage Agreements Abolished

On December 30, 2004, President Putin signed RF Law No. 216-FZ "On the Introduction of Amendments to the Federal Law on Mortgages (Pledges of Immovable Property)" (the "Mortgage Law Amendments"), abolishing the requirement for notarizing mortgage agreements and introducing certain other changes to RF Law No. 102-FZ "On Mortgages (Pledges of Immovable Property)", dated July 16, 1998, as amended (the "Mortgage Law"). The Mortgage Law Amendments, which entered into force on January 10, 2005, generally simplify the process of concluding mortgage agreements and establishing mortgages over land plots or related property. The key changes introduced by the Mortgage Law Amendments are summarized below.

Form of a Mortgage Agreement

Until recently, excessively high state duties on the notarization of mortgage agreements complicated the process of concluding such agreements. This burden was significantly reduced by RF Law No. 104-FZ "On the Introduction of Amendments to Article 4 of the RF Law 'On State Duties'", which entered into force on September 25, 2004 (the "State Duties' Amendments"), dramatically lowering notaries' mortgage fees (see the October 11, 2004 issue of the *CIS and Central Europe Legal Newswire* for a discussion of the State Duties' Amendments). The Mortgage Law Amendments go one step further by changing the procedure for concluding mortgage agreements to eliminate the notarization requirement entirely.

The Mortgage Law Amendments leave intact other requirements for the form of mortgage agreements, namely that they must be made in writing and must be registered with the State.

Mortgage of Property, Inseparable Improvements on Mortgaged Land Plots

The Mortgage Law Amendments also introduce a rule that any buildings or objects under construction which are located on a

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mortgaged land plot are automatically subject to the mortgage as well, unless the mortgage agreement or a federal law states otherwise. Previously, the opposite principle applied: buildings or objects under construction were not considered to be subject to the mortgage of the underlying land plot unless specified as such in the mortgage agreement or a federal law.

Similarly, the Mortgage Law Amendments provide that inseparable improvements to mortgaged property are also deemed mortgaged automatically, unless the mortgage agreement or federal legislation provides otherwise. Mortgages of inseparable improvements to mortgaged property were previously not regulated by the Mortgage Law.

Creation of a Mortgage

The Mortgage Law Amendments also provide for new rules regarding the creation of a mortgage without a mortgage agreement. Under Articles 64.1 and 64.2 of the Mortgage Law, as amended, a land plot (or lease rights thereto) is deemed mortgaged in favor of a creditor of the owner (or lessee) of such land plot if: (i) the land plot (or lease rights thereto) was acquired using a loan from such creditor; or (ii) a building located on the land plot was constructed using such loan. Conclusion of a separate mortgage agreement is not required, and the mortgage is effective from the time of registration of the mortgagor's title to the land plot (or the land lease rights), or the mortgagor's title to the building, as appropriate. These rules apply unless the mortgage agreement or federal legislation provides otherwise.

Other Changes

The Mortgage Law Amendments also provide for certain other changes of a more technical nature. In particular, the Mortgage Law Amendments:

- simplify the rules for changing the terms of a mortgage deed (*zakladnaya*), by establishing, inter alia, a one day period for registering an agreement on the amendment of a mortgage deed;
- allow a borrower mortgaging a residential house or an apartment to insure against liability for non-performance of its obligations under the underlying loan agreement. The insurance coverage under such an insurance arrangement cannot exceed twenty percent of the cost of the mortgaged property; and
- establish certain rules for the state registration of a mortgage in connection with the issuance of "mortgage certificates", securities introduced by RF Law No. 152-FZ "On Mortgage Securities", dated November 11, 2003, as amended.

The Mortgage Law Amendments were introduced as part of the State's recent initiative to facilitate lending in Russia, and, in general, it is anticipated that their entry into force will increase mortgage lending in Russia. */D. Gubarev*

LEGISLATIVE ALERT: Amendments to Joint Stock Company Law Proposed

On November 22, 2004, a draft law "On the Introduction of Amendments to the RF Law "On Joint Stock Companies" (as amended) (the "JSC Law")" (the "Draft Amendments"), was introduced to the RF State Duma for initial consideration. The Draft Amendments address, among other things, provisions on the establishment and reorganization of joint stock companies ("JSC(s)") (Chapter 2 of the JSC Law), the competence of general shareholders' meetings (Chapter 7), the procedures for shareholders to exercise their rights to demand the repurchase of their shares (Article 76), and approval of interested party transactions (Chapter 11). The most substantive changes proposed by the Draft Amendments are summarized below.

Establishment of a JSC

The Draft Amendments would extend the list of issues to be approved by the founders of a JSC at the foundation meeting, stipulating that the founders elect the audit committee (or auditor) and the external auditor, if required. In cases where founders have not yet paid for shares or made in-kind contributions to the initial charter capital of a JSC, the Draft Amendments would allow the board of directors to change the procedure and form for paying for such shares or making such in-kind contributions within one year of the JSC's establishment. Such decisions would need to be approved by the board of directors unanimously.

Reorganization

The Draft Amendments attempt to simplify the process for reorganizing a JSC. In particular, according to the Draft Amendments, when a reorganization results in the establishment of a new company, issues related to (1) the approval of the charter of the newly established company,

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and (2) the formation of its governing bodies would be adopted by a general shareholders' meeting of the reorganized company. Under the current JSC Law, these issues fall under the competence of the general shareholders' meeting of the newly established company.

Competence of the General Shareholders' Meeting

According to the Draft Amendments, the issue of a JSC's participation in holding companies, financial-industrial groups, associations and other units of commercial organizations would be within the competence of the board of directors of the JSC, rather than the general shareholders' meeting, as currently provided by the current JSC Law. The issue of a JSC's participation in any other organization would also be transferred from the competence of the general shareholders' meeting to the board of directors, if the company's charter does not provide otherwise.

Share Repurchases

The Draft Amendments would revise Article 76 of the JSC Law, regarding the right of shareholders to demand that a JSC repurchase their shares in the company, by requiring a shareholder's signature on its repurchase claim to be notarized. The Draft Amendments also provide that such claim would be the legal basis for making changes on the repurchase of shares in the shareholders' register.

Interested Party Transactions

The Draft Amendments would alter Chapter 11 of the JSC Law to introduce a new approval procedure for interested party transactions, allowing such transactions to be approved within 90 days of their conclusion. Currently, the board of directors or general shareholders' meeting (as the case may be) must approve an interested party transaction prior to its execution. As information on issues to be considered by the board of directors or general shareholders' meeting of a JSC is in many cases publicly available, this statutory requirement weakens a company's position in competitive tenders, because the company must reveal the proposed purchase price when seeking approval for the transaction.

At this time, it is not clear when deputies of the RF State Duma will consider the Draft Law. We will continue to monitor the status of the Draft Amendments and will report on any developments. */E. Korotkova, A. Globina*

UKRAINE

Resolution No. 482: Should it Stay or Should it Go?

(Continued from page 1)

Resolution No. 482 was adopted by the NBU on October 14, 2004, and took effect on November 12, 2004 (see the December 27, 2004 issue of the *CIS & Central Europe Legal Newswire* for a more detailed discussion of Resolution No. 482). In brief, under Resolution No. 482 all foreign investors must open investment accounts in both foreign currency and in Ukrainian Hryvnia with a Ukrainian bank. Any funds transferred into or out of Ukraine in connection with a foreign investment must be channeled through these investment accounts. For example, under Resolution No. 482, a settlement for a sale of Ukrainian shares between a resident and a non-resident (or between two non-residents) must be made in Hryvnia in Ukraine. Similarly, dividends paid by a Ukrainian company to a foreign shareholder must be paid in Hryvnia to the foreign shareholder's Hryvnia bank account before being converted into foreign currency and transferred abroad. Thus, the new rules expose foreign investors to economic risks associated with currency conversion (*e.g.*, when converting Hryvnia received as profit from a foreign investment into foreign currency for transfer abroad). Moreover, foreign investors must also now contend with the administrative issues involved in opening investment accounts with a Ukrainian bank.

The burdensome consequences of Resolution No. 482 have provoked heated discussion among foreign investors, Ukrainian banks and the Ukrainian business community. Some banks and businesses have argued that Resolution No. 482 contradicts Ukrainian laws on foreign investments and exchange controls, and have called upon the NBU either to cancel Resolution No. 482 or, at a minimum, to amend it to bring it into compliance with such laws. In addition, a foreign investor disputed Resolution No. 482 in a Ukrainian court, causing its temporary suspension in accordance with Ukrainian procedural rules. Following the judicial suspension, some Ukrainian banks announced that they would service transactions settled in violation of Resolution No. 482.

In response to the judicial proceedings as well as the general outcry and confusion, the NBU has issued a series of Letters over the past month. In a Letter dated February 16, the NBU outlined proposed amendments to Resolution No. 482 and also invited the banking community to submit relevant proposals. Generally, if adopted, the NBU's proposed amendments would slightly relax the rules regulating foreign cash investments and

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related settlements (for example, to allow capital contributions in hard currency). In a Letter dated February 17, the NBU informed banks that the claim filed by the foreign investor had been rejected by the court, and as a result, Resolution No. 482 was reinstated and continues to remain in force.

It remains to be seen how the NBU will respond to the discontent expressed by the Ukrainian business community over Resolution No. 482: either by canceling Resolution No. 482 altogether, or by amending it to slightly relax the current stringent requirements. Generally, the NBU seems to be quite supportive of the objectives behind Resolution No. 482, and has referred approvingly to similar investment regimes in other countries. / *Y. Deyneko*

Mandatory Third Party Motor Vehicle Liability Insurance Law in Effect

The long-awaited Law of Ukraine No. 1961-IV "On Mandatory Insurance of Third Party Civil Liability for Motor Vehicle Owners," adopted by the Ukrainian Parliament on July 1, 2004 (the "Mandatory Insurance Law"), took effect on January 1, 2005. The Mandatory Insurance Law requires all motor vehicle owners in Ukraine to obtain insurance against any damage caused to third parties as a result of automobile accidents ("Civil Liability Insurance"), and imposes fines for violations. The licensing of and average annual premiums for Civil Liability Insurance are regulated by the State Commission for Regulation of the Financial Services Markets in Ukraine (the "Financial Services Commission"), the state regulator for the insurance market.

Civil Liability Insurance, which is mandatory in many countries, was, at least formally, also mandatory in Ukraine under the previous law, Law of Ukraine No. 85/96-VR "On Insurance," dated March 7, 1996, as amended. However the previous law did not impose any penalties for car owners or drivers for failure to carry Civil Liability Insurance, and consequently only a fraction of Ukrainian car owners and drivers currently have such policies. To address this issue, the Mandatory Insurance Law amended the Code of Administrative Violations to allow traffic police to fine drivers and car owners who are not in possession of proper Civil Liability Insurance certificates beginning on April 1, 2005. Under the Mandatory Insurance Law, the obligation to carry Civil Liability Insurance applies to both owners of vehicles and to drivers, who must present a Civil Liability Insurance certificate to traffic police upon request. Under the amended

Code of Administrative Violations, effective April 1, 2005, failure to confirm the existence of Civil Liability Insurance may result in a fine of up to 17 Ukrainian Hryvnias (approximately US \$3).

Insurance companies seeking to sell Civil Liability Insurance are required to obtain a license for this type of activity from the Financial Services Commission. The procedure for issuing these licenses is set by the Licensing Conditions, which were approved by the Financial Services Commission at the end of December 2004. To receive a license, which is issued for a 3 year period, an insurance company must have at least two years' experience insuring vehicles and third party liability under the previously effective law, be a member of the Motor (Transport) Bureau of Ukraine (the "Motor Bureau"), have a network of offices in Ukraine able to handle customer claims, and comply with certain other conditions. To become a member of the Motor Bureau, an insurance company must pay the Hryvnia equivalent of €100,000 to a special guarantee fund and make regular contributions to the insurance reserves of the Motor Bureau, within the limits set by law. At present, the Financial Services Commission has issued licenses to 28 Ukrainian insurance companies allowing them to issue Civil Liability Insurance policies to car owners and drivers in Ukraine.

The average annual premium for Civil Liability Insurance, which is set by the Financial Services Commission, is 291.48 Hryvnias (approximately US \$55). The average insurance premium for a given driver is calculated on the basis of a table of coefficients set forth in the Mandatory Insurance Law, and insurance companies are not allowed to charge higher rates. Retired citizens, persons with disabilities, war veterans and certain others may buy Civil Liability Insurance at lower premiums, and higher premiums are set for drivers in large metropolitan areas, less experienced drivers, owners of cars with more powerful engines, and drivers of cars used as taxis. Civil Liability Insurance that is only valid within Ukraine is, as might be expected, less expensive than a policy covering other countries.

As might also be expected, insurance companies are enthusiastically supporting the Mandatory Insurance Law, especially those which have already obtained a license to issue Civil Liability Insurance policies. The majority of drivers and car owners in Ukraine seem to support the introduction of mandatory Civil Liability Insurance, no doubt hoping that it will result in more straightforward resolutions of car accidents and issues of victim compensation. However, some concerns have been raised regarding the relatively high average annual premium (which is equivalent to about 50% of an average official monthly salary in Ukraine), as well as whether the Mandatory Insurance Law can be implemented successfully.

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These concerns derive in large part from the still developing state of the insurance services market in Ukraine as well as the skeptical attitude towards insurance and insurance companies among the public in general. / A. Lymar

New Law on Grain Warehouse Receipts

On December 23, 2004, Ukraine's parliament adopted Law of Ukraine No. 2286 "On Certified Commodity Warehouses and Simple and Double Warehouse Receipts" (the "Warehouse Receipts Law"), which will take effect on April 29, 2005. The Warehouse Receipts Law is aimed at facilitating the development of a market in Ukraine for grain and similar types of commodities stored at warehouses by simplifying the legal procedure for transferring ownership rights to such commodities through the circulation of warehouse receipts, as well as by creating mechanisms for creditors financing grain dealings to obtain rights to the commodities in the event of default. The Warehouse Receipts Law defines the concept of a certified warehouse, and establishes the types and form of permissible warehouse receipts, as well as the procedure for their circulation.

The concept of circulating warehouse receipts (receipts that may be alienated by transfer or pledge) was introduced in Ukraine relatively recently by several normative acts, including the Civil Code (Articles 956 through 966), the Law of Ukraine "On Grain and the Grain Market in Ukraine," dated July 4, 2002, Resolution No. 510 of the Cabinet of Ministers "On Securing the Certification of Grain Elevators for Servicing Grain Storage and Processed Products Therefrom, and the Introduction of Warehouse Documents for Grain," dated April 11, 2003 ("Resolution No. 510"), and Decree No. 198 of the Ministry of Agrarian Policy "On the Confirmation of Provisions for the Circulation of Warehouse Documents for Grain," dated June 27, 2003. The Warehouse Receipts Law is intended to be the definitive legislative act on this issue, however refinement of a number of applicable regulations will be required to clarify the legal framework outlined in the law.

Certified Warehouses

Warehouse receipts may only be issued by a certified warehouse; a warehouse that has not obtained certification cannot issue warehouse receipts. Each certified warehouse must establish its own by-laws, which must be approved by the regulator and set forth, *inter alia*, the list and range of services provided by the warehouse, the main provisions of its

standard storage agreements, and rules for the acceptance, storage and release of goods and the issuance, registration and discharge of warehouse receipts. The by-laws of each certified warehouse must be publicly available.

Types of Warehouse Receipts

Article 2 of the Warehouse Receipts Law provides for two types of warehouse receipts: simple warehouse receipts ("SWR") and double warehouse receipts ("DWR"). An SWR is issued in bearer form, while a DWR must be issued as a registered document and allows for a pledge of the underlying commodities.

Simple Warehouse Receipts

As mentioned above, an SWR may only be issued in bearer form. An SWR must include a description of the warehouse and its location, the title to and quantity of the commodities, the term of storage, the amount of payment for storage, the date of issuance and the serial number of the certificate.

The holder of an SWR has the right to transfer the commodities accepted for storage by transferring the corresponding receipt to the acquirer of the commodity. As envisaged by Article 25 of the Warehouse Receipts Law, rights arising from an SWR are transferred by an unconditional endorsement; partial transfer of rights is not allowed. An SWR must specify the full name of the legal entity/individual to whom the rights are transferred and its location/place of residence, as well as certain other data. The endorsement becomes invalid if amended, corrected or defaced. If an SWR is endorsed by an individual, the signature must be notarized; if the endorsement is made by a legal entity, its corporate seal and the corporate seal of the new holder must be affixed.

An SWR may also be pledged, in which case the pledgor must give the SWR to the pledgee. The pledge of an SWR differs from a pledge of the underlying commodities under the Warehouse Receipts Law, as in the former case the SWR itself is the collateral, while in the latter case the commodities are the pledged collateral (as discussed in more detail below).

Double Warehouse Receipts

DWRs have similar requirements to SWRs. However, a DWR must be issued as a registered document, and unlike an SWR, consists of two separable parts: i) a warehouse certificate; and ii) a pledge certificate. This two-part form allows the owner to pledge the commodities stored at the warehouse directly, by concluding a pledge agreement, separating the pledge certificate from the DWR, and transferring it to the pledgee. The holder of the warehouse certificate section of the DWR has no right to

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dispose of it (or the commodities) without the pledgee's consent. When the pledgor has fulfilled its obligations under the pledge agreement, the pledgee returns the pledge certificate to the pledgor. Only the holder of both parts of a DWR has the full right to receive the underlying commodities stored at a warehouse.

General Formal Requirements

The form of the warehouse receipt is established by law. A warehouse receipt may be issued only after delivery of the commodities to the warehouse, and involves completing the formalities of the certificate, including entering the certificate into the warehouse's register, and issuing a registration number. After completion of these steps, the document is given to the owner of the commodities as evidence of receipt of the stored commodities. The holder of the warehouse receipt may receive the commodities upon presenting the receipt, whereupon the warehouse discharges the receipt by marking it "DISCHARGED" and excluding it from the register of warehouse certificates. Discharged warehouse receipts may not be circulated.

Enforcement of a Pledge

The Warehouse Receipts Law is not entirely clear regarding the enforcement of a pledge under either DWRs or SWRs.

The Warehouse Receipts Law provides that in the event of a default on the pledge of a DWR, the pledgee (the holder of the pledge certificate) may only enforce the pledge by obtaining a court order or by following the state enforcement procedure. Clearly, most creditors would prefer to satisfy claims for commodities without recourse to a court (or arbitration). However, the applicable state enforcement procedures themselves do not seem to make enforcement possible without a judicial resolution.

The Warehouse Receipts Law is even less clear regarding the procedure for enforcing a pledge of an SWR, other than through judicial proceedings. The Warehouse Receipts Law provides that in the event of enforcement of a pledged SWR, the foreclosure does not apply to the commodities but rather to the SWR itself. The law further provides that the legal entity or individual in whose favor the SWR was enforced must be recognized as its new owner, provided that the pledgee provides appropriate documents to the warehouse evidencing the foreclosure proceedings. However, the law fails to identify which documents may serve as such evidence.

It is possible that the pledge of an SWR to a pledgee that is documented by an endorsement would be sufficient to make the pledgee the owner of the commodity and entitle him/her (or it) to claim the commodity directly from the warehouse without going to a court or providing evidence to the warehouse. The

law, however, does not actually specify that a transfer should be documented by an endorsement, and it remains to be seen whether such an approach would work in practice. Currently, neither existing practice, nor regulations such as Resolution No. 510 seem to allow for this arrangement. / *O. Soshenko*

Ukrainian Companies Required to Confirm Registration Details

2004 witnessed several significant changes to Ukrainian company law that will continue to affect businesses in 2005. One such change imposes a duty on every Ukrainian company to confirm its registration information with the company registration authority (the "Registrar").

Law of Ukraine No. 755-IV "On the State Registration of Legal Entities and Individuals Acting as Private Entrepreneurs," which took effect on July 1, 2004 (the "Registration Law"), requires all companies to confirm or update their registration information annually. Based on the date of their initial registration, many companies will be required to comply with the Registration Law for the first time in 2005.

Under the Registration Law, within one month of each annual anniversary of its registration, a company must provide a standard form confirming or, as the case may be, updating the information about the company filed with the State Register of Legal Entities (the "Register") to the Registrar. If the company fails to submit this form in a timely manner, the Registrar will send a reminder to the company. If the company fails to respond to the reminder within one month or the reminder is returned undelivered, the Registrar will then make an entry in the Register indicating either the company's failure to confirm its registration information or its absence at its registered address, as the case may be.

The information to be confirmed includes, in particular, the company's name, organizational form and shareholders, branches and representative offices, primary activities and location, as well as the individuals authorized to conclude legal transactions (*i.e.*, to sign contracts) on behalf of the company without a power of attorney, and any restrictions on the powers of authorized persons to act for the company.

Ukrainian companies should review their records to ensure compliance, as many will be affected by this requirement for the first time in 2005. / *V. Fedichin*

UZBEKISTAN

Annual Changes to Taxation Regime Enacted*(Continued from page 1)***New Tax Rates Established**

Decree No. 610 of the Cabinet of Ministers, dated December 28, 2004 ("Decree No. 610"), focuses on the introduction of new rates for those taxes that are subject to the jurisdiction of the Uzbek Government. Specifically, Decree No. 610 reduces the corporate income tax rate from 18% to 15% of income, which is defined as total revenue less permitted deductions (both as defined in the Tax Code, enacted on January 1, 1998). Decree No. 610 also increases the rates of some taxes, such as the land tax (by approximately 30% over 2004 rates), the water use tax (from US\$0.46 to US\$0.60 for 1,000 cubic meters of surface water, and from US\$0.59 to US\$0.77 for 1,000 cubic meters of underground water), and the subsurface use tax (for natural gas, from 18.5% to 58% of the total volume of production; for unstable gas condensate, from 6.7% to 32%; for crude oil, from 12.3% to 35%; rates for refined copper (8.1%), gold (5%), and silver (8%) are maintained at 2004 rates). The average rates for excise taxes on excisable goods produced in Uzbekistan remain unchanged, with two exceptions: the excise tax rate on natural gas is reduced from 40% to 19% of its sales price, and sales of crude oil and gas condensate are not subject to the excise tax in 2005. The new tax rates suggest that the Government is prepared to share the income of upstream oil companies and to encourage investors to participate in the natural gas production sector.

VAT Refunds Possible

By issuing Decree No. 610, the Government also seems to be trying to resolve a long-standing issue related to the zero value-added tax ("VAT") rate. Previously, legal entities which sold goods and services at the zero VAT rate could only carry forward negative balances to the next period to make a set-off. However, as they never charged VAT, in reality they could never set off those amounts. Pursuant to Section 19 of Decree No. 610, these legal entities may now be able to receive a refund for negative balances of VAT amounts under two conditions: (i) if the legal entity does not have any outstanding debts for taxes or other mandatory state payments; and (ii) if the refund is made from specially allocated funds in the State Budget. Decree No. 610 calls for the Ministry of Finance to issue a regulation outlining the procedure for receiving refunds. Currently, it is unclear whether negative balance amounts would carry over and be eligible for refunds in subsequent years if funds allocated to the State Budget in a given

year are not sufficient to cover all VAT refund amounts.

New Education Royalty

Section 7 of Decree No. 610 also establishes a new tax, requiring all legal entities to pay a royalty equal to one percent of their net sales (minus VAT and excise tax amounts, if any) to the Non-budgetary Fund for School Education, for the development of the school system in Uzbekistan. However, although the royalty reflects the Government's good intentions to fund children's education, its constitutionality is doubtful. It appears that in introducing this new tax, the Government has exceeded its power under the Constitution, which states in Article 78 that only the Parliament is authorized to establish taxes and other mandatory payments. Uzbek law, including the Law on the Cabinet of Ministers, dated May 6, 1993, does not grant the Cabinet of Ministers any rights to establish mandatory payments, including royalties (regardless of their nomenclature), except the right to establish the rates for certain taxes. Nonetheless, the Government has tried to legalize the royalty by stating that its status "shall be equivalent to State taxes and levies".

Companies with Foreign Shareholdings Lose Benefits

In its last session on December 2, 2004, the Parliament revoked the right of companies with foreign investment to a 2-year exemption from the land tax, thus continuing its efforts to equalize the tax regime for companies with foreign shareholdings and those without such shareholdings. Over the last three years, the Parliament has abolished many tax benefits and incentives which had been granted between 1998-2000 to companies with foreign investment. It appears that as of today only two specific major benefits remain under the Tax Code for companies with foreign investment: the 7-year corporate tax holiday (if the company is included in the Investment Program of the Republic of Uzbekistan), and the exemption from import VAT on certain imports of technological equipment, as well as on imports of raw materials and production components for their own manufacturing needs. It seems that the Government has begun to understand that, given the lack of interest of foreign investors in the Uzbekistan economy, it should pay attention to local investors who were previously disadvantaged. However, this attention will require the Government to create a solid policy establishing transparent rules by which businesses can access resources controlled by the Government (fuel, cotton, gold, grain) and "equalizing" the powers of government agencies and commercial companies in the economy by making it impossible for government agencies to adopt arbitrary decisions against businesses and to interfere in business activities. /J. Askarov

BELARUS

Priority for Debt Repayment Changed

On October 20, 2004, Belarusian President Alexander Lukashenko issued Decree No. 10 ("Decree No. 10"), which alters the priority for applying payments to various components of outstanding debt. Under the previous system, established in the Civil Code and following custom, if a payment was not sufficient to cover the entire amount due, the amount received was applied first to the creditor's expenses arising from the receipt of payment, and then for penalty interest amounts and default fees, and lastly to the principal and regular interest amounts. Decree No. 10 switches the order of the last two categories, so that now a payment against debt is first applied to the creditor's expenses to receive the payment, and then secondly to the main debt and interest owed, and lastly to default fees and penalty interest amounts.

The new order of priority is aimed at protecting the interests of the debtor and improving the mechanism for paying back delinquent loans. It is intended to benefit both debtors and creditors, by allowing debtors to save on expenses arising from credit agreements and creditors to get their money returned faster. However, in fact it is likely to lead to decreased debtor discipline. When a payment is late, additional interest and default fees are frequently imposed (if stipulated by the agreement or legislation). A debtor may decide to repay only the amount of the principal, at which point the penalty interest ceases to accrue, and then choose not to make any further debt payments without any risk that the amount of the debt will increase.

In fact, Decree No. 10 legalizes recent court practice. Although the Civil Code nominally regulated the priority in which debt payments were applied, in reality courts followed their own internal regulations which recommended that the amounts applied to interest payments before repayment of the loan principal be interpreted to apply to the basic interest accrued on the loan. Moreover, previously this order could be modified by an agreement between the parties to the loan agreement. Now, the priority established in Decree No. 10 is mandatory, *i.e.*, not able to be modified by an agreement between the parties, and

is applied regardless of the law governing the loan agreement.

Formally, the present situation represents a conflict of norms. Belarusian legislation allows the comparative weighting of legal force (precedence) attributed to judicial acts and legislation to be understood in various ways. The Civil Code is a codified law and therefore should be considered to have greater legal force. However, the wording in the Belarusian Constitution is not very clear, and can also be interpreted to give Presidential acts more authority. Law enforcement authorities almost always follows the latter variant in determining the precedence of judicial acts and legislation. Thus, in practice, Decree No. 10 will likely prevail. / A. *Vashkevich, Borovtsov & Salei*

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