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LEGAL BASIS FOR THE ACTIVITY OF FOREIGN ENTITIES IN THE RUSSIAN FEDERATION

According to the treaty signed in Brześć in December 1991 the Soviet Union broke up and the Commonwealth of Independent States (CIS) was established. The deterioration of the USSR upset and severed the production-space links of economy. Manifold economic enterprises which had been built for years became impaired organizations. Excessively developed and outdated factories were not able to keep up with new requirements of the market. All branches of economy required substantial investment.

The changes in question effected trade ties between Russia and the world. The maintaining economic recession together with the devaluation of national currencies and declining production caused a substantial drop in trade exchange.

Transformations currently observed in Russia and other countries belonging to the CIS are of much interest on the side of the whole world. They are also of much interest to Poland due to numerous economic ties which should be reactivated and developed in the common best interest. Correctly directed activities should be conducted on the basis of the existing legal-treaty regulations, which will be presented in this study.

1. INTRODUCTION

The main target of this article is the presentation of the present possibilities of the established entities and the activity of foreign entities in the Russian Federation.

It described the critical analysis of the legal aspects and basis which are based for the activity of foreign enterprises in Russia and other countries belonging to the CIS.

This article could be very useful to all readers which are interested in the problems connected with the legal conditions regulating economic co-operation between Poland and Russia. It is also very important since one can find only a little information in Polish literature about this subject.

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2. LEGAL CONDITIONS REGULATING THE ECONOMIC CO-OPERATION BETWEEN POLAND AND RUSSIA LEGAL-TREATY BASIS

The major documents that regulate economic relationship between the Republic of Poland (RP) and the Russian Federation (RF) are:

– the agreement on support and mutual protection of investment, (Dziennik Ustaw 1993, pos. 569, 570),

– the agreement on avoiding double taxation in the field of income and property tax,

– the treaty on trade and economic co-operation.

In addition to that, in the course of the last few years a number of other legal acts concerning individual areas of both parties have been signed. These are:

– the agreement on co-operation of north-east provinces of RP with Kaliningrad district,

– the agreement on trans-border co-operation,

– the agreement on co-operation between provinces of RP with Saint Petersburg district,

– the agreement on the conditions of co-operation between Bielgorod district and Opole province.

The agreement on support and mutual protection of investment (signed in Warsaw dated 2 October 1992) is aimed at creating favourable conditions for the investors operating in the territory of RP and RF. The term "investment" covers all kinds of property values located by the investors of one party in the territory of the other party in accordance with the second party's law. The values in question cover movables and properties, property rights, shares, contribution, other forms of equities, authorship rights. The right to search, extract and use of natural resources is excluded.

The agreement concerns all investment made by the investors of one country in the territory of another country after 15 October 1986. A separate protocol to the agreement takes into account all investment made before that date on the basis of international agreements signed within the former RWPG (CMEA – Council for Mutual Economic Aid) if it is transformed in accordance with the currently valid regulations of the country of their realization.

The contract guarantees full and unconditional legal protection of the mentioned investments as well as their equal and just status. In its relationship with Russia, Poland enjoys most-favoured-nation clause (MFNC), therefore this status should not be less favourable than the one given to local or foreign investors enjoying MFNC.

The status of most favoured does not cover prerogatives, which are given or will be given by one party in relation to the participation in the free trade zone, economic or duty union or on the basis of agreement on avoiding double taxation.

Art. 6 of the agreement guarantees the investors of both countries the possibility to transfer the financial assets abroad if taxes and allowances are paid. The transfers should be made in exchange currencies according to the exchange rate valid on the day of transfer and in accordance with the regulations of the party where the investment was made.

Litigations resulting from the made investments should be resolved, if at all possible, by way of negotiation. If the litigation is not resolved in this way, in the period of six months from the date it appeared, it can be passed on, depending on the investor's choice, to:

– the right court or arbitration of the country where the investment was made, or

– arbitrary court "ad hoc" according to the Arbitrary Regulation of International Trade Law UN Committee (UNCITRAL).

The agreement on support and mutual protection of investment will be in force for the period of 15 years from the moment of its ratification by the Russian *Duma* and it will be extended by a further 5 year period unless one of the parties informs in writing about the intention to terminate the agreement within a 15 month notice period before the expiry date.

Another important document regulating the economic relationship between Poland and Russia is the agreement on avoiding double taxation in the field of income and property tax, made on 22 May 1992. The above act became effective on 22 February 1993 and abolished the earlier agreements of 27 May 1977 and 19 May 1978 on avoiding double taxation in the field of income and property tax of legal entities.

Art. 2 of the valid agreement determines the taxes it is related to. These are :

a) in Poland:

– legal entity/person income tax,

– natural person income tax,

– agrarian tax,

b) in the Russian Federation:

– taxes on profits and income assumed in the acts of RF "Tax on profit of enterprises and organizations", "Taxation of bank income", "Income tax on insurance activities" and "Income tax on natural persons",

– taxes on property assumed in the acts of RF "Tax on corporate capital" and "Natural persons wealth tax".

Taxation and related responsibilities of the persons living or based in the agreeing country cannot be more onerous than taxation (in the same circumstances)

of the persons living or based in the other country. Moreover, the taxation of income and profit made by a company based in the territory of the second party cannot be less favourable than the same taxation of the persons living or based in the third country.

In the light of the act, profits made by a Polish citizens owning a company in the territory of RF are taxed in the country to the extent to which they can be attributed to the given company.

The term "company" covers especially:

a) board head office,

b) branch,

c) offices,

d) production site,

e) workshop,

f) natural resources extraction place,

g) construction site, drilling areas, a ship used for searching and exploration of natural resources,

h) operating via an agent who meets the following requirements: carries the power of attorney, is not an independent representative.

While settling the profit of the company, the possibility to charge the expenditure incurred in the operation of the enterprise is allowed. It is also possible to split the substantiated expenditure between the person living or based in Poland and the person's company located in Russia. The expenditure in question covers managing costs and administration overheads, expenditure on research and development, interests, remuneration for managing, consultations, technical support, regardless of the fact whether they were made in the country where the company is located or anywhere else. The agreement also regulates the taxation of dividends, income from operating as freelance as well as taxation of movables and property.

Income on shares or other rights paid by a company seated in RF to a person living in Poland may also be taxed in the country where the paying company is located, but the tax cannot exceed 10% of gross dividend amount.

If the recipient of a dividend works in the country where the company paying dividends is located and the activity performed by the person is related to the participation in the mentioned enterprise, then the dividend is treated as the profit from the enterprise and this makes it subject to taxation.

The term "freelance" covers self performed activities:

- scientific
- literary
- artistic

– tutorial and educational in character as well as the following professions: doctors, lawyers, engineers, architects, dentists and accountants.

The income of freelancers in the country they are not the residents of, is subject to taxation in this country. This means that if a citizen of RF, who is a permanent resident of Russia, undertakes activities in the territory of Poland, then he will be subject to tax reliability set in Polish law.

The agreement on avoiding double taxation was issued on 22 May 1993, however the decisions of the agreement were put into effect on 1 January 1994.

The agreement will be valid for the period of 5 years from the date of issue. After that period each of the parties has got the right to terminate the agreement.

Another important document that has not come into effect yet is the treaty on trade and economic co-operation issued in Warsaw on 25 August 1993. The treaty was ratified by the two parties but ratified documents were not exchanged. The treaty will become effective on the day of exchange of the documents, at the same time the following documents re Polish-Russian relationship will lose the power:

1. the agreement on trade of 7 July 1945,
2. the agreement on establishing Economic and Scientific-Technical Co-operation dated 15 April 1964.
3. the agreement on economic relationship dated 13 November 1990,
4. the agreement on co-operation in the field of trade and economy of 3 September 1991.

The treaty holds declarations of the two parties to create the most favourable conditions in order to facilitate and develop trade and other forms of economic co-operation, especially in such fields as:

– industry,
– agriculture,
– power engineering,
– building,
– transport and communication
– sea industry and fishery,
– environmental protection,
– trade of goods and services,
– certification of goods,
– finances, banking, insurance.

The co-operation is to be executed by :

– development of production and industry co-operation,
– designing and building activities performed by companies from one country in the territory of another,
– investment co-operation development, especially connected with power engineering and communication systems,

– establishing enterprises and organizations with mixed capital,
– organization and managing expositions and trade fairs.

Another vital issue for the development of co-operation in the field of trade is granting each other the status of most-favoured nation as to :

– duty and charges on import and export, together with the methods of collecting the duty and charges,
– regulations concerning duty clearances, transit, reloading and storage,
– taxes and other internal charges imposed directly or indirectly on imported goods,
– methods of payment
– rules governing sales, purchase, carriage, distribution, consumption of the goods in the internal market.

However, in exceptional circumstances, e.g. when imported goods become a threat to domestic products, the two parties can undertake protective actions the conditions of which are determined in the treaty. In addition to that, the treaty allows each party to take actions the party believes are justified by the following considerations: public morality, public safety, protection of health and environment. Such prohibitions and limitations, however, should not be the means of wilful discrimination towards trade between the two countries.

The treaty assumes establishing a Common Polish–Russian Committee on trade and economic co-operation. The basic tasks of the committee are:

1. To prepare proposals and solutions aimed at the realization of agreements made between the two countries in the area of trade and economic co-operation.
2. To prepare proposals and recommendations aimed at the further development of trade and economic co-operation.
3. To determine areas of the highest priority for the two countries, the development of which seems to be most advisable.
4. To make decisions concerning ligitations related to the execution or intepretation of the resolutions of the treaty.

The committee can resolve the litigation by making a decision as to which of the parties is obliged to take actions necessary to settle the decision. It is not possible to resolve the dispute in the way assumed in the treaty than other solutions can be applied including arbitration and other methods assumed in international law.

The treaty on trade and economic co-operation, when put into effect, will be in force for an unspecified period of time. Each party has got the right to terminate the treaty. If such is the case the treaty becomes ineffective six months after the notification of the other party on the termination of the treaty. Although the treaty has not yet become effective, the Polish-Russian Chamber of Commerce and

Industry was established in 1993 to gather a number of companies of different lines. The possibility to establish such a chamber is assumed in Art 10 of the treaty.

The Polish-Russian Chamber of Commerce and Industry co-operates closely with the Chamber of Commerce and Industry of RF and the National Chamber of Economy it is a member of. It also co-operates with trade advisors' offices of RF in Warsaw and RP in Moscow. It plans to establish common institutions including stock exchanges, department stores, financial organizations and in the long term a common bank.

The Polish-Russian Chamber of Commerce and Industry has got its offices in Moscow, Samara and Kaliningrad. In Poland it is based in Warsaw with a division in Bydgoszcz.

As has already been mentioned there are agreements concerning regional co-operation of Poland and Russia.

The first such document is the agreement on co-operation of the north-east provinces of RP with Kaliningrad region of RF which was signed on 22 May 1992 and became effective on 22 October 1992. The agreement regulates manifold aspects of co-operation as well as organizational forms of practical realization. This agreement was the basis for a further five agreements made between the executive of the Kaliningrad region administration and the voivodes of Olsztyn, Szczecin, Elbląg, Suwałki and Gdańsk. The agreements assumed that the parties will aim at establishing conditions facilitating border co-operation between the regions, taking into account common interest in trade-economic links.

At the same time the agreement on border checkpoints with the supplementing protocol was signed, which discussed the border checkpoints between Kaliningrad region and the neighbouring border towns of Poland.

Further documents:

– the agreement on trans-border co-operation signed on 2 October 1992 and effective from December 1992,

– the agreement on co-operation of regions of the RP with Saint Petersburg region issued on 2 October 1992 and effective from 15 March 1993.

The documents determine the development directions of co-operation of the agreeing parties. The contents of the agreement assumed establishing a common Chamber of Commerce of the co-operating regions with the location in Gdańsk and Saint Petersburg.

The agreement on trans-border co-operation covers several areas of operation. These are (among others):

– development of regions, towns and rural areas,

– transport and infrastructure,

– communication,

– industrial co-operation,
– trade and services,
– finances and banking,

The agreement assumes establishing a special Polish-Russian Committee of Intrerregional Co-operation.

The two documents will be valid for 10 years and will be automatically extended by a period of 5 years. The parties have got the right to terminate the agreement six months before the end of a given period.

A factor restraining the development of co-operation between the Polish companies and their eastern neighbours is the mutual settling of the turnover in trade. Since July 1992 the settling of accounts has been conducted in exchangeable currencies on the basis of world rates.

Eastern partners obtain financial assets with great difficulty. Transfers of money via foreign banks can take up to a few weeks, which in the conditions of Russian inflation is an important issue for the companies.

It is a common belief that the "safest" form of exchange with the eastern market is barter. The condition which must be met by a Polish partner in order to execute such a transaction is to present the value of the goods in the exchangeable currency and register the copy of the contract in Bank Handlowy S.A. in Warsaw within 14 days after signing it.

Another way of trade is the exchange of goods for cash, and the whole transaction must be held in the territory of Poland. Note that the due amount collected by the Polish partner cannot exceed 20,000 ecu (due amount re a single item).

Such a transaction however does not comply with Russian law according to which all the transactions have to be conducted via banks.

In addition to that prepayments are used quite often, confirmed letters of credit are less frequent. A new regulation introduced in Russia on 1 January 1996 concerning customs-banking control of foreign currencies is to counteract the practice of leaving the Russian currency abroad by companies. Polish and Russian companies are concerned that payments made by the bank of the Russian partner (including prepayments) will be transferred no sooner than after checking conducted by the bank representative that the goods crossed the border and that amounts and prices are identical to the ones stated in the "bank transaction passport" placed in advance.

3. INTERNATIONAL TRADE ARBITRATION

In the contemporary international economic traffic the litigations are settled mainly by arbitration, i.e. by arbitration court. Judicature is one of the forms of public, non -state judiciary.

Arbitration in the international economic traffic is called the international commercial arbitration and it gains its role from the factors/principles determined by the International Chamber of Commerce in Paris in the twenties – "cheaply, quickly, ultimately".

The arbitration court was developed in the hope that experts on economy and experts on international trade would join in settling disputes.

The makeup of the arbitration court is settled in the following way: Each party selects its arbitrator. The arbitrators choose the head arbitrator who enjoys the same rights as the other arbitrators. Another scheme is also possible. Namely, the third arbitrator, called a superarbitrator, joins whenever the arbitrators, chosen by the parties, are not able to issue and agreed arbitrators' ruling.

In the arbitration, the parties can not only influence the makeup of the court but the procedure as well. In the majority of legal systems the parties can determine the course of action before the arbitration court by choosing a specific model code.

Due to the fact that the lawsuit cycle is shorter than in the case of state courts, the costs of arbitration proceedings are lower than in the state court. The arbitration lawsuit is confidential which is valued by the companies involved in the international economic traffic.

The arbitrators are the people with the knowledge of law and trade customs, independent and free from national prejudice.

The characteristic of the arbitration court stems from the will of the parties expressed in the agreement on arbitration. The agreement in question can take up two forms: a compromise or arbitration clause.

A compromise takes place when the parties make an entry for the arbitration court in relation to an already existing litigation. The arbitration clause, usually a part of a contract, holds the agreement of the parties stating that possible disputes resulting from the contract will be settled by arbitration court madeup in the course assumed in the arbitration clause.

3. 1. Economic Arbitration in the Russian Federation

Not long ago, an institutional arbitration at the Chambers of Commerce of the countries members of the former RWPG (the Council for Mutual Economic Aid), was dominant in relations between the companies of the countries. The competence of the arbitrations derived from Moscow Convention signed by the countries members of the Council in Moscow in 1972.

Currently, in relation to the fact that on 15 December 1994 Poland gave notice to the convention, it is not binding to the Polish entities. Therefore it is necessary to put appropriate arbitration clauses in the contracts. It should be noted that the convention is still effective towards the entities from other

convention countries, as well as towards the contracts signed at the time when the convention was still in force.

Another factor which significantly effected the changes in the scope of legal status of the discussed issues was the dissolution of the Soviet Union. The Chamber of Commerce and Industry that existed in the USSR was changed into the Chamber of Commerce and Industry of the Russian Federation and as agreed, the arbitration court that had been operating at the USSR Chamber for more than 60 years would continue its operations at the new Chamber. A new base of norms was given to the court at the moment of introduction of a new act in July 1993 according to which the Chamber of Commerce and Industry of the Russian Federation is to assist settling the ligitations resulting from international economic traffic, giving a regulation to the International Trade Arbitration Court.

The legal basis for the operation of the court is the act introduced in 1993 based on the model law of UNICITRAL. The mentioned act is used for every international trade arbitration, if the arbitration is based in the territory of RF.

It is worth mentioning that the court operated according to the old regulation established before the dissolution of the USSR. With the resolution of 8 December 1994 the Presidium of the Chamber gave the court a new regulation which came into force on 1 May 1995.

The basic changes introduced by the new regulation are: simplified procedure, the possibility given to the parties to choose the arbitrators outside the recommended list.

Russian legislation concerning the arbitration judicatures is not limited to the act mentioned above. General knowledge of this issue is necessary due to the fact that a number of new arbitration courts offering their services in the area of international relations have recently appeared in Russia. In the light of expiration of the Moscow Convention it is particularly important for Polish entities.

The first formal base of existence of the arbitration courts (still in the time of the USSR) was art. 6 of "The rudiments of civil legislation of the USSR and united republics" and "The principles of operation of arbitration court established to settle economic litigations between unifications, enterprises and organizations".

Pursuant to art. 7 of the act dated 4 July 1991 on the arbitration court, parties can settle trade litigations by arbitration court. The term used in the act "arbitration court" does not denote the arbitration court that settles disputes related to international traffic, but it denotes a court of commerce established to replace former state committees that settled litigations between units of planned economy. Moreover, on 24 June 1992 the Cabinet of RF approved "Temporary rules of operation of arbitration courts". The rules do not apply to International Trade Court of Arbitration either.

Currently, standing courts of arbitration as well as those established *ad hoc* can operate in Russia. The most important issue is the course of gaining the enforcement clause in relation to the rulings of courts of arbitration. In the case of international litigations, regardless of the fact what court of arbitration settled the case, it is the common court that is authorized to issue the enforcement clause.

Summarizing , the convention courts will not have the legal power to settle the litigations of Polish enterprises and the will to submit a case to the courts may only result from the wish of the parties expressed in arbitration clause or in a so a called compromise. If such a will is not unanimously stated by the two parties in writing, than possible litigation is settled by the common court of the country of defendant, which in the case of Russia (and CIS countries) should be avoided due to a number of reasons.

While negotiating the arbitration clause, it is advisable to choose the court with experience in settling the litigations concerning international traffic and with the list of arbitrators coming from different countries or the court that allows to choose arbitrators outside their list.

While entering the clause with the arbitration court based in a third country, it is advisable to check whether the country and the country of our contractor are the parties of the New York Convention of 1958, which is a condition necessary to finally settle the arbitration ruling favourable for us. In the countries that have not signed the convention, sentences are enforced unless they violate local legislation.

4. PRINCIPLES OF ESTABLISHING AND LEGAL BASIS OF FUNCTIONING OF AGENCIES OF POLISH COMPANIES IN THE RUSSIAN FEDERATION

The principles of opening and functioning of agencies in the Russian Federation conform to the Act on foreign investment of 1991, Civil Code (part 1) and the Act on joint-stock companies of 1995. During the time of their functioning the agencies are completely subordinate to Russian law.

The preferred legal form of agency is a joint-stock company. The agencies can be owned by the foreign partner or they can be a joint Russian-foreign enterprise, with free proportion of share. Currently the initial capital of joint-stock companies cannot be lower than the amount equal to a thousand minimal salaries in the Russian Federation, for non-open joint-stock companies the amount cannot be lower than a hundred minimal salaries.

In order to accredit the agency the following documents are required (the trade information from Trade Mission of the Russian Federation in Poland):

– registration certificate or an excerpt from the register of companies,
– regulations and statute of the company's operation.

– a letter concerning the financial status of the company from the bank in the mother country servicing the company's corporate account.

– decision of the company on establishing an agency in the territory of the RF.

– letters of reference from three Russian companies that have co-operated with the foreign company,

– power of attorney for the company's representative authorized to register the company and than to manage the company's operations.

All the documents mentioned above have to be translated by a sworn translator into Russian and confirmed by a public notary. In addition to these documents, it is advisable to have a letter of reference from the Trade Agency of the Russian Federation in Poland.

Registration of an agency takes less than 30 days.

5. CONCLUSIONS

Changes to the legislation of the Russian Federation effect the whole organizational-legal system. The government and business circles ensure that they agree with the standards of European Community. Unification of law will enable the Russian Federation easier access to foreign capital which is particularly important in the light of the currently observed substantial deficit of investment assets. The quality of banking system has a major impact on the decisions of foreign investors as far as capital investment in Russia is concerned. Lack of confidence towards this system is observed on the side of both foreign investors and Russian citizens, especially as the possibilities of operation of foreign banks in this territory will probably remain highly limited till the end of 1999.

Not only the banking system but also the whole capital market, which is still far from stable, is a source of concern. An increase in the level of economic crime is also threatening. The share of "grey zone" in Gross Domestic Product amounts to 20% to 40%. Such a high level of economic crime is the result of contradictions in the existing legislation, which is not adjusted to the new conditions and continuous changes. In order to improve the image of Russia among foreign partners, the Russian government issued a project of changes to the tax system, the aim of which is to limit the number of legal acts that regulate foreign investors' operations from 200 to 30.

The membership of Russia in the World Trade Organization will enforce adjusting the internal regulations to international standards. This will bring a change to the conditions of foreign exchange and the use of clear rules and principles of operating in the Russian market.

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