New Investment Regime: Special Investment Contract

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1 Russia's favor for businesses

Russia is an attractive and lucrative market with its promising economic potential, vast natural resources and highly educated workforce. In recent years, the Russian authorities have been working on making it even more attractive by introducing tax incentives.

In order to improve business climate a wide range of investment regimes and incentives was introduced. Among such, there are Special Economic Zones, Advanced Development Territories, Freeport Vladivostok, Special Investment Contracts (the "**SPIC**"), etc. Now these regimes, actively developed in line with the government's support, are pushing forward the import substitution, simultaneously encouraging the production of products fabricated in Russia.

2 Silver lining for industrialists

One of the most attractive regimes provided for the investment is SPIC. Concluding a SPIC is the most realistic way for South Korean investors to advance Russian business. Being a new instrument intended to localize high-tech and industrial production in terms of investors' funds SPIC was first concluded in 2016.

In fact, the Russian Government's drive to promote and upgrade national industries through the SPIC has borne some noticeable results.

Country	Investor	Business	Location	Term	Price
Germany	Daimler (Mercedes-Benz)	Automobile	Moscow Oblast	9 years	RUB 15 billion
Germany – Japan	DMG Mori	Machine tool	Ulyanovsk	10 years	RUB 5 billion
Germany	Claas	Harvesting equipment	Krasnoyarsk Krai	10 years	RUB 750 million
Russia – Japan	Mazda Sollers	Automobile	Primorsky Krai	approx. 7 years	RUB 2 billion
Germany	Wilo	Pumping equipment	Moscow Oblast	9 years	RUB 750 billion
The UK	AstraZeneca	Pharmaceutical	Kaluga Oblast	10 years	RUB 1 billion
France	Sanofi	Pharmaceutical	Oryol Oblast	10 years	N/A

3 Bespoke for mid-termed projects less than 10 years

The SPIC is an agreement between an investor and the Russian Government represented by the federal, regional or local authorities, under which the investor develops production industry during certain period and the Russian Government warrants to various state support measures. Notably, greater incentives are offered if contracted with the federal authorities.

As a rule, the SPIC is effective for a term necessary for the project to turn an operating profit (i.e. payback period) plus 5 years, but not exceeding 10 years. This means that, if the operating profit is projected after 7 years as of the conclusion of the SPIC, then the subsequent extension of the SPIC could be possible only for an additional term of 3 years.

Such provision is associated with today's turbulent business environment under which Russian companies have finally accustomed to implementing short-term projects reaching a break-even point much faster than before.

In addition, the SPIC is applicable to certain sectors and industries. And, these areas especially include shipbuilding, machinery, metal and etc. where South Korean businesses have gained renowned reputation.

4 Investment incentives

The SPIC is concluded by the investor's initiative. Therefore, there is no relevance to any investment programs implemented by the Government unlike other special regimes as SEZ, ASEZ or Free Port of Vladivostok. Generally, the investor under the SPIC does not need to acquire any residency, but is entitled to contracted bespoke preferences, which is guaranteed by the authorities as a party to the SPIC.

Most importantly, the successful conclusion of the SPIC depends on negotiations with public authorities. The list of specific incentives under the SPIC, their amounts and other specific details are discussed on the negotiation table, and specific incentives and other material conditions of the SPIC are shaped individually.

4.1 Financial support

The companies investing in the key industries can count on financial support in the form of subsidies and grants. If the investor can effectively liaison with the Industrial Development Fund under the Ministry of Industry and Trade, subsidies can be provided for R&D expenditure, loans under discounted interest rate, and as well as for financing the construction or modernization of industrial infrastructure.

The SPIC may contain various financial measures guaranteed for the whole period of the SPIC. And most importantly, if a public authority enters into the SPIC which explicitly envisages to provide subsidies, such subsidies are considered "expenditure commitments" subject to the fiscal legislation and respective budget must be allocated for further contracted period.

4.2 Safeguards against sudden tax changes

So-called a "grandfather clause" is applicable with regard to an exemption from unfavorable legislative or tax changes for the entire period of the SPIC. This stabilizing clause is explicitly dictated by the legislation.

Tax incentives: regular business vs SPIC

Type		Regular business	SPIC
Income tax	Federal	2% (3% in 2017-2020)	0%
	Regional	18% (17% in 2017-2020)	0% (till year 2025)
VAT	Federal	18%	Up to individual negotiations with the authorities
Social contribution	Federal	~30%	
Property tax	Regional	up to 2.2%	
Land tax	Municipal	0.3% - 1.5%	

4.3 Shortcut to state procurement

As another advantage for SPIC, an investor will be able to gain access to the Russian public procurement market, annual worth of RUB 4.4 billion, by acquiring a special status of sole supplier. However, there are some extra conditions to be satisfied:

(A) Concluded on a federal level;

(B) Investments over RUB 3 billion;

(C) Incorporation of a Russian legal entity;

(D) Made-in-Russia products.

But, it should be noted, sole supplier status is not granted to an SPIC investor on an exclusive basis. Meaning, several suppliers may be provided with the status of a sole supplier.

5 Application thresholds

On the federal level, investors can apply for SPIC only if they are:

(A) Developing the industrial production that has no analogues in Russia

(B) establishing or upgrading of the production facilities for industrial products with the purpose of Import Substitution;

(C) implementing of the best available technologies, mostly for mining and other producing or manufacturing businesses.

(D) Investing in a single project not less than RUB 750 million ($ 13 million).

The threshold of RUB 750 million can be lowered or ignored, if the SPIC is concluded with regional or municipal authorities, without participation of the federal authorities. For example, In Khabarovsk Krai – RUB 300 million. Whereas in the Republic of Ingushetia the minimal limit is only RUB 20 million. In

Rodinsky District of the Altai Krai, the minimal investment is not even stated as a criteria for SPIC conclusion. However, if the federal authorities are not party to SPIC the federal incentives cannot be awarded.

6 Chances for South Korean manufacturers

Russia indeed remains a core market of the Eurasian Economic Union with overall 180 million consumers, but its economy is based on crony capitalism where awareness of special rules of game is highly appreciated.

In recent years, Russia has been focusing on "sticks and carrots" strategy to attract more foreign investors. In this case, sticks are sensed in the motion of continuously implying sanctions and tariffs to overburden exports to Russia so that foreign companies are forced to move inside these barriers. On the other hand, carrots are preferential tax treatments and various incentives under certain conditions, such as concluding the SPIC.

The framework of SPIC is suited for greenfield investments in manner to localize foreign production and technologies that were usually imported prior to the sanctions regime. Yet, the SPIC has gained popularity mostly among the Western investors seeking to consolidate their advantageous position in the Russian domestic market in those regions close to Moscow and Saint Petersburg, where core infrastructure and targeted customers already exist.

Given that South Korea is also known for its world-class manufacturing capabilities and advanced industrial technologies especially in these "embraced" areas, the Russian market comes across as an attractive place of opportunities for South Korean businesses seeking their futures in foreign markets.

Without a second thought, for new entry into Russian market or expansion of current Russian business, it is vital for new foreign investors to be prepared thoroughly, from meticulous market research to in-depth analysis of possible legal issues. For sure, a key to success will depend on the investor's effort to figure out the best business structure, which will help you avoid preventable risks and minimize the impact of other external factors that may influence the course of business in Russia.