# News on legislative developments in the field of the energy complex, environment protection, safety at hazardous facilities and energy efficiency

## Legal acts adopted

### Tightening of legal requirements relating to industrial safety: insurance of the civil liability of owners of hazardous facilities

Amendments to the Law concerning Industrial Safety of Hazardous Production Facilities and the Law concerning Safety of Hydraulic Structures (**"the Safety Laws"**) connected with new Law on Compulsory Insurance of the Civil Liability of an Owner of a Hazardous Facility will enter into force on 1 January.

The Insurance Law introduces the notion of a "hazardous facility", which, although defined with reference to high-risk facilities which are subject to registration under the Safety Laws, extends the range of such facilities whose owners are obliged to undertake compulsory insurance. Gas stations, facilities with permanently installed lifting equipment, cable railways, lifts and escalators (except for lifts in residential buildings) are now classified as hazardous.

The required level of the sum insured under a compulsory liability insurance agreement is significantly increased compared with the current minimum requirements for hazardous production facilities (no such requirements currently exist for hydraulic structures). The sum insured will range from 10 million to 6.5 billion roubles and will be dependent on the scale of the consequences of an accident. By way of comparison, under the current rules the minimum sum insured ranges from 100,000 to 7 million roubles depending on the quantity of hazardous substances present at a facility.

As from 1 January legal entities using a hazardous facility without proper insurance will be penalized by an administrative fine of from 300,000 to 500,000 roubles.

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This raising of sum insured levels means that the amounts of premiums payable to insurers will also increase.[1]

Despite the adoption of the tariffs by the Government, the Ministry of Economic Development, acting on the basis of an appeal by the professional and industrial associations addressed the Government with a letter concerning a need to revise the tariffs and published on its web site a draft Government Decree which sets substantially lower basic insurance tariff rates, which for certain hazardous facilities are as low as just a fraction of those adopted (http://www.economy.gov.ru/minec/about/structure/depregulatinginfluence/doc20111103_019).

## New licensing law

On 3 November a new Law concerning the Licensing of Certain Types of Activity entered into force to replace the identically named Law of 2001 (certain provisions of new Law came into force earlier).

One of the main changes is the provision that licences issued to legal entities and private entrepreneurs are not time-limited. Licences issued before the Law entered into force likewise became permanent.

The list of licensed activities is cut to 49 types. Licences for activities which are not on the new list ceased to have effect from 3 November. In the case of some activities licensing will cease upon the entry into force of relevant normative acts (for example, the licensing of activities involving the manufacture and servicing of medical equipment will be discontinued from the effective date of relevant technical regulations).

Under the new Law, Government-approved statutes concerning the licensing of particular activities must contain exhaustive lists of licensing requirements for particular activities (these may not include obligations to comply with Russian legislation as a whole or requirements as to the particular types and volume of products which are produced or planned for production. The Law also sets out detailed procedures for the conduct of licensing and for the adoption of decisions by a licensing body.

Licensing bodies can now suspend licences only where administrative proceedings have been brought against the licensee for failure to carry out an order to remedy a gross violation of licensing requirements, or where administrative suspension of activities for a gross violation of licensing requirements has been imposed.

The Law introduces a new ground for the termination of a licence: termination may now take place on the basis of an application from the licensee in connection with the discontinuation of licensed activities.

The conduct of scheduled and unscheduled inspections is dealt with in much greater detail: a scheduled inspection may be performed one year after a decision to grant or re-issue a licence and once every three years thereafter. "Simplified" licensing rules which provided exemption from scheduled inspections are abolished and a closed list of grounds on which unscheduled on-site inspections may be carried out is established. Inspections may be conducted without prior arrangement with a public prosecution body, except for unscheduled inspections undertaken on the basis of representations from citizens and organizations.

## Amendments relating to the granting (and appropriation) of land plots for the purpose of subsurface use

On 19 January amendments to the Law Concerning Subsurface Resources enter into force: new version of Article 25.1 is introduced which replicates the provision of the Land Code whereby land plots under State or municipal ownership may be leased to subsurface users without the conduct of a bidding process (such as a competitive tender or an auction). The land plots will be granted after a licence has been received and a geological and/or mining allotment has been registered, and new land plots needed for subsurface development work can be formed.

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[1] The basic insurance tariff rates are stipulated in Decree No. 808 of the Government of the Russian Federation of 1 October 2011 and the rules of insurance are stipulated in Decree No. 916 of the Government of the Russian Federation of 3 November 2011.

According to new rules land plots will be appropriated for State or municipal requirements from landowners, land users, landholders and lessees of land plots on the basis of decisions on the appropriation in response to petitions from subsurface users. The procedure for the adoption of decisions on the appropriation of land plots needed for the conduct of work associated with subsurface use is to be established by the Government.

### Establishment of the minimal cost of investment projects in the sphere of energy conservation and energy efficiency making them entitled to bid for government guarantees

The Government amended the rules for provision of government guarantees for investment projects in the sphere of energy conservation and energy efficiency.[2]

The minimum cost of projects entitling them to bid for government guarantees (500 million roubles for utilities and one billion roubles for all other industrial enterprises), the maximum shares of the federal government, regional and municipal authorities in principal's authorized capital, requirements as regards the break-even point and potential energy savings have been set.

### Adoption of lease rates for land used for solid waste reclamation

An Order of the Ministry of Economic Development establishing lease rates for public land allocated to solid-waste reclamation facilities entered into force on 14 August.  The Order stipulates differentiated lease rates for land allocated for waste reclamation depending on the method, i.e. burial, incineration or grading and processing.

[2] Decree No. 688 of the Government of 18 August 2011.

## Legal acts adopted in the area of tax law

### Extension of the List of Energy-Efficient Facilities and Technologies Investment in which is a Basis for Granting Investment Tax Credit

The Government has significantly lengthened the list of energy-efficient facilities and technologies from four (light-emitting diode lamps, condensation boilers, heat pumps and cogeneration units up to 25 MW) to 56 items, investment in which is a basis for granting investment tax credit[3].

The new list includes facilities and technologies used in the extraction and processing of oil, gas, coal and other commercial minerals and in power engineering, metallurgy, the chemical industry and mechanical engineering, and specifies applicable energy-efficiency indicators (specific energy consumption, fuel consumption and energy losses) and the values of the respective indicators for particular facilities and technologies, which act as selection criteria.

Investment tax credit allows for tax payments to be reduced for a certain period of time and within set limits, with subsequent gradual payment of the tax amount itself and interest charges. Investment tax credit is granted in relation to profits tax and regional and local taxes.  Credit is granted for the full cost of equipment acquired for the purpose of creating the listed facilities and technologies.  The extended list is effective starting 26 July.

### Revision of the Rules for Determining the Place of Supply of Goods, Work and Services for VAT Purposes

The new rules for determining the place of supply of goods and certain types of work/services for

[3] Decree No. 562 "Concerning Approval of the List of Highly Energy-Efficient Facilities and Technologies for Which Investment in the Creation Thereof is a Basis for Granting Investment Tax Credit" of 12 July 2011

VAT purposes are effective starting 1 October[4]. In particular, amendments are made to Article 147 of the Tax Code whereby the definition of the territory of the Russian Federation for the purposes of VAT on sales of goods is extended to include territories under the jurisdiction of the Russian Federation, i.e. artificial islands, installations and structures over which the Russian Federation exercises jurisdiction. The new definition of the place of sale of goods is in keeping with the way in which the concept of the "territory of the Russian Federation and other territories under its jurisdiction" is defined in Article 11 of the Tax Code. The practical significance of the amendments is that, for example, the sale of oil from an oil rig on the continental shelf will be subject to VAT. At the same time, taxpayers selling oil from such a location would be able to claim back input VAT provided that the general tax deduction requirements established by Chapter 21 of the Tax Code are met.

There were also made certain amendments to Article 148 of the Tax Code by introducing a new rule for determining the place of sale of particular services which are rendered for the purpose of the geological study, exploration and extraction of raw hydrocarbons at subsurface sites which are situated wholly or partially on the continental shelf. The Law provides a closed list of such work and services:

1. work (services) performed (rendered) in blocks of the continental shelf and (or) in the exclusive economic zone of the Russian Federation involving the creation, readying for use (operation), technical maintenance, repair, reconstruction, modernization and retooling (other work of a capital nature) of artificial islands, installations and structures and other assets situated in those territories;
2. work (services) involving the extraction of raw hydrocarbons;
3. work (services) involving the treatment (primary processing) of hydrocarbons;
4. work (services) involving the carriage and (or) transportation of hydrocarbons from departure points situated on the continental shelf and (or) in the exclusive economic zone of and work (services) directly connected with such carriage and (or) transportation which is performed (are rendered) by Russian and (or) foreign organizations.

The introduction of the new rules for determining the place of sale of these services makes it possible for each taxpayer in the supply chain to recover its input VAT. Surprisingly, no change has been made to the treatment of services listed in subsection 4 of clause 1 of Article 148 of the Tax Code (e.g. processing of seismic data, engineering and design work). A crucial element of services for the purpose of geological study is the processing of seismic data, while a substantial portion of initial costs of the creation, readying for use, and modernization of artificial islands, installations and structures and other assets situated on the continental shelf would be engineering and design. The place of supply of such services seems to remain the place of activity of the purchaser. If so, there will still be circumstances in which the supply of such services to a foreign organization is outside the scope of VAT even if the services relate to the geological study, exploration and extraction of hydrocarbons at subsurface sites which are situated wholly or partially on the continental shelf.

## Transfer of Emission Reduction Units to Foreign Buyers is Exempted from VAT

The aforementioned Law also introduces a new rule regarding the place of sale of the transfer of emission reduction units (**ERUs**) for VAT purposes. Specifically, the amended version of Article 148 of the Tax Code provides that, for operations involving the transfer of ERUs received in connection with the implementation of projects aimed at reducing anthropogenic emissions or enhancing removals by sinks of greenhouse gases in accordance with Article 6 of the Kyoto Protocol to the United Nations Framework Convention on Climate Change, the place of sale is deemed to be the Russian Federation only if the purchaser of

[4] Federal Law No. 245-FZ "Concerning the Introduction of Amendments to Parts One and Two of the Tax Code of the Russian Federation and Certain Legislative Acts of the Russian Federation Concerning Taxes and Levies" of 19 July 2011

the ERUs carries on activities in the territory of Russia.

The Law should thus eliminate the current uncertainty over the applicability of VAT in relation to ERU transfers, which exists even at the level of Ministry of Finance letters (for example, Letter No. 03-07-08/75 of the Ministry of Finance of 18 March 2011 asserted that the transfer of ERU rights by a Russian organization to a foreign organization was subject to VAT at 18%). The amendments came into force on 1 October.

## New Tax Regime for the Oil Industry

The Government has adopted Decree No. 716[5] which as of 1 October stipulates the equalization of export customs duties on light and dark oil products at 66 percent to the export customs duty rate on oil, except the export customs duty rate on gasoline including straight-run gasoline, which is maintained at 90 percent. Also from 1 October a reduced export customs duty rate on crude oil based on the maximal rate of 60 percent to the world market price on Urals instead of 65 percent as in the past.

According to experts' views, generally a new tax regime should produce favourable impact on the development of Russia's oil industry, including increase of its investment friendliness. It is noteworthy that the calculation formula of the maximal export customs duty rate on crude oil stipulated in Law No. 5003-1[6] has remained unchanged and provides for the establishment of the export customs duty rate on oil based on the maximal rate of 65 percent from the first date of the following month, i.e. there is no legal safeguard of stability of the new regime with respect to the export customs duty rate on oil, which is a significant restriction during consideration of an investment decision.

[5] Decree No. 716 "Concerning Amendments to Regulation No. 1155 of the Government of the Russian Federation, dated 27 December 2010" of 26 August 2011

[6] Law No. 5003-1 Concerning the Customs Tariff of 21 May 1993

## The Transfer Pricing Law

The new transfer pricing (**TP**) Law[7] is effective starting 1 January 2012. Many provisions of the Law have been harmonized with international TP principles, in particular the OECD recommendations.

The new regime covers any transaction with a tax effect for the purposes of profits tax, personal income tax, mineral extraction tax (MET) and/or VAT. Therefore, the TP regulations cover now not only transactions with goods, work and services but also the transactions which were not controlled before.

The Transfer Pricing Law includes a list of criteria defining how companies might be declared related parties. The main criterion remains the same, being the ownership threshold, i.e. if one party directly or indirectly controls more than 25% of another party (the current threshold is 20%).

The controlled transactions, i.e. those subject to examination by the tax authorities, mainly include related-party transactions and certain types of third-party transactions. Under general rule for all domestic related-party transactions, three billion roubles (approx. USD 100 million) in 2012 (two billion roubles in 2013 and one billion roubles in 2014) threshold applies in order for them to become subject to transfer pricing control. In relation to cross-border transactions, all related-party transactions are declared controlled.

For companies of fuel and energy sector it should be noted that the related-party domestic transactions above 60 million roubles threshold are also covered by transfer pricing regulations if the subject of the transaction is an extracted mineral subject to an ad valorem MET rate.

Also the following third-party cross-border transactions above 60 million roubles threshold are subject to transfer pricing control:

[7] Federal Law No. 227-FZ "Concerning the Amendment of Certain Legal Acts of the Russian Federation Related to Improvement of the Principles for Assessing Prices for the Taxation Purposes" of 18 July 2011

- transactions involving goods traded on global commodity exchanges that fall within commodity groups such as oil and oil products, ferrous metals, non-ferrous metals;
- transactions where the counterparty is located in a blacklisted jurisdiction determined by the Ministry of Finance (for example, Cyprus).

The law stipulates five TP methods similar to those used in international TP practice. Also the Law sets out a procedure for preparing documentation supporting the level of market prices used in controlled transactions. This documentation may be requested from a taxpayer by the tax authorities after 1 June following the calendar year to which controlled transactions relate. Under the new regime taxpayers liable to additional tax following a transfer pricing audit will eventually be exposed to significant penalties of 20 percent in 2014-2016 and 40 percent from 2017.

As the new TP law becomes effective Russian tax authorities will strengthen their focus on related-party transactions. The TP law will have significant impact on Russian taxpayers and will require significant preparation as early as by 1 January 2012.

## The Law Concerning Consolidated Groups of Taxpayers

On 21 November 2011 the law concerning consolidated groups of taxpayers was officially published in Rossiiskaya Gazeta.[8] Taxpayers will be able to apply to establish a consolidated group of taxpayers from 1 January 2012.

Most provisions of the law have not changed significantly in comparison with the draft reviewed in the August Russian Tax Brief. However, some significant amendments have been introduced which are covered in this article.

A consolidated group of taxpayers (hereinafter - 'Group') is to be a voluntary association of profits tax payers for the purposes of calculation and payment of profits tax based on the aggregate financial results of all Group participants. The agreement establishing the Group must be registered and accepted by the tax authorities.

Only Russian companies can participate in Groups. The minimum period for which a Group may be established is two years. A Group may be established by companies if one company directly or indirectly holds at least a 90% share in the others.

The group of companies should satisfy the following main criteria on applying to establish a Group:

- the aggregate amount of federal taxes which must have been paid in the preceding calendar year was at least 10 billion roubles;
- the total revenue of the group in the preceding calendar year was at least 100 billion roubles; and
- the aggregate value of assets of the group as at the preceding 31 December was at least 300 billion roubles.

These thresholds seem likely to be the main barrier to companies wishing to form a Group. The authorities have already changed them at least twice to expand the range of eligible companies, but they still seem to be rather high.

The law includes other criteria, for example, the companies should not be undergoing reorganisation, insolvency proceedings or liquidation and their net assets should exceed charter capital.

Tax accounting, tax calculation and tax payment responsibilities for the entire Group will be imposed on one participant, which is designated the "responsible participant". Should this company fail to discharge its liabilities, all members of the Group will be liable jointly and severally for any tax underpayment, the corresponding penalties and late payment interest.

Tax audits are to be performed with respect to all companies in a particular Group at the same time.

[8] Federal Law No. 321-FZ of 16 November 2011 Concerning the Introduction of Amendments to Parts One and Two of the Tax Code of the Russian Federation in Connection With the Creation of a Consolidated Group of Taxpayers.

The law states that a Group's profits tax base should be based on the Group's participants' income and expenses whereas early drafts provided for adding together profits and losses of each participant. The consolidated profit may not be reduced by any tax losses accumulated by the participants prior to the establishment of the Group.

Intragroup transactions are to be included in the consolidated tax base. Early drafts provided for the elimination of intra-group transactions from the calculation. The final text only provides that transactions amongst participants of the Group are not subject to transfer pricing control (except for taxpayers of mineral extraction tax at ad valorem rates, such as those which extract precious metals, ferrous metals, and various types of salt).

The law does not exclude companies which have subdivisions outside Russia from participation in a Group.

The concept of tax consolidation is without precedent in post-Soviet Russia, so implementation may not be straightforward. Thresholds may have been kept high deliberately so that the initial volunteers can act as a kind of pilot project before a final decision is made on how widely consolidation should be made available in future.

The establishment of a Group may be beneficial for some. The main advantages of the proposals are the possibility to strengthen control over the tax accounting function, decrease the amount of transactions subject to mandatory transfer pricing control and the respective administrative burden, and potentially optimize the tax burden of affiliates.

## Judicial acts passed

### For subsurface plots to be transferred for use, environmental examination is not required at the auction stage

The Supreme Arbitration Court upheld as compliant with the law the Government Regulation to hold an auction for the right to use a subsurface plot for geological study of subsurface resources, exploration and production of mortar sand, which was adopted without a state environmental examination.[9] The Court noted that current laws do not require a mandatory environmental examination to be held at the stage of auction preparation and conduct and that an obligation of a subsurface user to submit for a state environmental examination the documents that support the user's planned activities arises upon state registration of the licence issued to the user as a result of an auction.

### Provision of a right to use subsurface resources may be considered a void transaction

The Supreme Arbitration Court refused to transfer the case of Verkhnebakansky Cement Plant to the Presidium for supervisory review.[10] Previously, courts of lower instances had upheld the claim filed by the plant, which is a member of the INTEKO group, to recover from the Federal Agency for Subsurface Usage the amount of unjust enrichment in connection with a void licence agreement because contrary to the Law Concerning Subsurface Resources the right to use subsurface resources was transferred without consent of owners of the respective land plots. Thus the Supreme Arbitration Court upheld an argument that provision of a licence for the right to use subsurface resources in accordance with the Subsurface Use Licensing Statute is a transaction that may be considered void if contrary to law.

The assumption is that once the necessary subsidiary legislation has been passed, the amendments to the Law Concerning Subsurface Resources, which set out rules for land withdrawal for the purpose of subsurface use, will provide a mechanism for the resolution of conflicts associated with the access of subsurface users to privately owned land plots.

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[9] Decision of Supreme Arbitration Court No.VAS-6779/11 of 17 October 2011.

[10] Determination of Supreme Arbitration Court No. VAS-10515/11 of 19 August 2011.

## Draft legal acts

### Draft law No. 562736-5 on state information system for the fuel and energy sector

The State Duma adopted in the second reading a draft law stipulating the establishment of a state information system for the fuel and energy sector that will include the following data:

1. organizations operating in the fuel and energy sector (name, structure and governing agencies, contact information);
2. incidents, accidents and emergencies in the fuel and energy sector and their direct and indirect impacts on the said sector;
3. energy reserves;
4. production capacity of organizations in the fuel and energy sector;
5. environment protection measures;
6. use of renewable energy sources;
7. state balance of mineral resources;
8. use of ports, sea and river transport related to the fuel and energy sector.

### Draft law No. 572971-5 on the prevention of oil spillages and liquidation of their consequences, obligations and liabilities of production companies

The Duma adopted in the first reading a draft law proposing to establish obligations for the organizations exploiting and utilizing artificial islands, constructions and rigs, underwater pipelines, conducting drilling operations as well as transiting and storing oil and oil products in the territorial waters, territorial sea and on the continental shelf of the Russian Federation to:

- adopt action plans for the prevention and liquidation of emergencies resulting from the spillages of oil and oil products;
- establish a search system for the spillages of oil and oil products at sea as well as a communication and warning system in the event of such spillages;
- set up provisions (in the form of a bank guarantee, insurance agreement or reserve fund) for fulfilment of the foregoing action plans, compensation for the damage caused to environment and performance of actions for the liquidation of oil and oil product spillages at sea.

### Draft law No. 454850-5 on utilization of associated oil gas (AOG) and amendments to certain legal acts of the Russian Federation

The Duma is considering on a preliminary basis a draft law which establishes accounting procedures and obliges users of mineral resources to design, build and commission an accounting system for AOG which is defined as a mixture of hydrocarbon and other gases and vapours both in a free as well as diluted state that are released from the crude oil during its extraction, transportation and treatment.

Subsurface users are obliged to utilize 95 percent of the hydrocarbon component of AOG (associated gas as defined in the Tax Code). Different utilization rates may be established during the adoption of a detail design for respective oil field. A benchmark of AOG flaring is set a maximum of a five percent.[11]

The draft law establishes requirements for the oil gas flaring equipment in terms of its environmental safety and a government agency to be charged with the maintenance of a flaring equipment register.

A special fee payable by subsurface users for failure to use AOG in excess of the flaring benchmark is set at 25 to 75 percent of the value of AOG hydrocarbon component – yet it does not release subsurface users from paying the emissions fee required by the environmental legislation.

The Government has expressed a negative opinion on the draft law. It is worth noting that a draft Government Decree has been available at the official web site of Ministry for Natural Resources and Environment Protection since April 2011 (http://www.mnr.gov.ru/regulatory/detail.php?ID

[11] This reiterates the same requirement in para 1 of Government Decree No. 7 dated 8 January 2009 to come into force as of 1 January 2012.

=118408). The new Decree sets higher emission fee coefficients for flaring AOG: 100 instead of 4.5 for oil fields equipped with metering devices, and 1000 instead of 6 if metering equipment is not used, but introduces an 'integral' AOG flaring measure to be calculated for both a parent and subsidiaries.

### Draft law No. 612001-5 on the use of natural gas engine fuel

A draft law was introduced to the Duma which stipulates measures focused on development of the market of natural gas engine fuel with a view to increase the energy efficiency of transport, environment protection and budgetary savings. In particular, the draft law proposes incentives for the use of natural gas engine fuel and transport vehicles running on natural gas in agriculture. It also entitles the Government to interdict the use of liquid engine fuel on territories placed under the sanitary protection regime.

### Draft law № 584399-5 on economic incentives for waste treatment

The Duma adopted in the first reading a draft law which entitles regions to adopt procedures for the acceptance by manufacturer/producer of reusable tare and payment of collateral costs.

Manufacturers and importers of goods will be obliged to dispose of, decontaminate and/or bury goods which have lost their consumer characteristics. The draft law exempts business entities from the fee for environment contamination in the event they place waste in specially designated facilities preventing any harmful effect on the environment.

### Draft law No. 584587-5 on economic incentivizing of business entities for implementation of the best technologies

The Duma adopted in the first reading a draft law which established the main notions, principles for implementation and regulation of the best technologies available in the Russian Federation and introduced methods for economic incentivizing of business entities employing the best available technologies.

The business entities will be classified into three categories: (i) environmentally hazardous entities, (ii) entities with limited impact on the environment and (iii) entities with minor impact. Each of them receive the permitted emission limits and applicable government regulation measures.

The effective system of gradual fulfilment of emission and discharge standards is maintained by establishing the provisionally authorized emissions and discharges for the realization periods of actions plans on reduction of harmful impact on the environment (the realization period of an action plan may not exceed seven years).

Exemptions from the fee for harmful impact on the environment as incentives reducing contamination of the environment are proposed:

- adjustment of the fee for harmful impact on the environment whereby the incurred expenses on measures to reduce such harmful impact will be deductible from the assessed amount of the fee for harmful impact on the environment;
- exemption from the fee for harmful impact on the environment in the event of application of the best available technology.

Concurrently, the draft law increases economic sanctions versus business entities exceeding the established limits of permitted impact during their business activities by introducing, upon the expiration of three years after the effective date of the law, of coefficients of 25 percent and 100 percent to the fee rates for harmful impact in place of the currently applied rates of five percent and 25 percent.

For additional information regarding this Newsletter, please contact one of the following advisors from Ernst & Young's Tax & Legal Services Group.

# Tax Group for ECU

**Moscow**

Victor Borodin | Partner | +7 (495) 755 9760 | Victor.Borodin@ru.ey.com

Alexander Smirnov | Partner | +7 (495) 755 9848 | Alexander.Smirnov@ru.ey.com

Vladimir Zheltonogov | Partner | +7 (495) 705 9737 | Vladimir.Zheltonogov@ru.ey.com

Richard Lewis | Partner | +7 (495) 705 9704 | Richard.Lewis@ru.ey.com

# Legal Group for ECU

**Moscow**

| | Name | Position | Contact |
|---|---|---|---|
| | Dmitry Tetiouchev | Partner | +7 (495) 755 9691<br>Dmitry.Tetiouchev@ru.ey.com |
| | Sergey Stefanishin | Partner | +7 (495) 755 9872<br>Sergey.Stefanishin@ru.ey.com |
| | Vasily Makovkin | Senior Manager | +7 (495) 755 9972<br>Vasily.Makovkin@ru.ey.com |
| | Natalia Aristova | Senior | +7 (495) 755 9700<br>Natalia.Aristova@ru.ey.com |

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**Contacts**


Almaty
+7 (727) 258 5960

Astana
+7 (7172) 58 0400

Atyrau
+7 (7122) 99 6099

Baku
+994 (12) 490 7020

Donetsk
+380 (62) 340 4770

Ekaterinburg
+7 (343) 378 4900

Kazan
+7 (843) 567 3333

Kyiv
+380 (44) 490 3000

Krasnodar
+7 (861) 210 1212

Minsk
+375 (17) 209 4535

Moscow
+7 (495) 755 9700

Novosibirsk
+7 (383) 211 9007

St. Petersburg
+7 (812) 703 7800

Tashkent
+998 (71) 140 6482

Tbilisi
+995 (32) 43 9375

Togliatti
+7 (8482) 99 9777

Yerevan
+374 (10) 500 790

Yuzhno-Sakhalinsk
+7 (4242) 49 9090


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