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Counter-sanction restrictions on transactions with shares, stocks and real estate



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(9 23 Sep, 2024 - 16:37 👁 1402

Updated: 23 Sep, 2024 -

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Since February 2022, Russian government agencies have taken a number of measures aimed at countering sanctions and other restrictive measures of foreign states. In legal practice, such measures are traditionally called "counter-sanctions".

They are aimed at preventing the transfer of assets abroad in order to limit the departure of foreigners from the Russian economy or make it as unprofitable as possible. Counter-sanctions measures should be taken into account whenever there is a foreign element, and in some cases when it is absent.

In this article, we draw attention to aspects that businesses should consider when structuring transactions with shares, stakes in Russian business entities and real estate.

"Counter-sanctions" regulation

In 2022, the President of Russia issued a package of measures in response to the introduction of large-scale sanctions by foreign countries "counter-sanctions" decrees: first of all, this is Decree No. 81 of 03/01/2022 (Decree No. 81); Decree No. 126 of March 18, 2022 (Decree No. 126); Decree

No. 520 of 05.08.2022 (Decree No. 520); Decree No. 618 of 08.09.2022 (Ordinance No. 618); Decree No. 737 of October 15, 2022 (Decree No. 737). The issuance of the decrees was based on the framework provisions of federal laws that were issued back in 2006, 2010 and 2018. 1

Despite the extensiveness of the regulation, the texts of the decrees contained many ambiguous formulations and required additional specification. The issuance of new decrees or, even more so, the adoption of laws would require significant time for their development, therefore Russian government agencies were empowered to clarify issues of the application of counter-sanction acts. The main bodies for clarifying the decrees were the Ministry of Finance of the Russian Federation and the Bank of Russia.

Official clarifications are not limited to responses to individual requests. The Ministry of Finance of the Russian Federation and the Bank of Russia are actively creating new standards in the field of counter-sanction regulation: for example, Official Clarification of the Bank of Russia No. 2-OR dated March 18, 2022 contains answers to a significant number of questions on all counter-sanction decrees, and Official Clarification of the Ministry of Finance No. 1 on the application of Decree of the President of the Russian Federation No. 618 dated September 8, 2022 sets out a list of transactions that require the consent of the Government Commission for the Control of Foreign Investments (Government Commission).

Extracts from the minutes of the Government Commission have a special status. Despite their technical purpose, these documents became fundamental acts in interpreting the norms of counter-sanction decrees, since without them the practice of application was not clear. In particular, such an extract initially established the criteria for the admissibility of foreigners leaving Russian business 2, which subsequently entailed corresponding changes in the rules for issuing consents by the Government Commission, which are a by-law.

Who are the restrictions applicable to?

First of all, the restrictions apply to "persons from an unfriendly state". These are understood to mean foreign persons connected with unfriendly states 4 (for example, through citizenship, registration, doing business or deriving profits from there) or persons under the control of such foreign persons, regardless of their registration or main place of business. At the same time, the criteria of control that are used for the purpose of applying restrictions 5 are quite extensive 6.

The ambiguity in the interpretation of the criteria means that in practice it is sometimes impossible to determine unambiguously whether a person falls into the category "persons from an unfriendly state" - in particular, whether international financial institutions such as the International Finance Corporation or the International Bank for Reconstruction and Development are unfriendly. If unfriendly states have a large block of shares in international organizations, appoint directors, or are registered in, for example, one of the capitals of unfriendly states, due to the ambiguity of interpretation, their exit from business in Russia will most likely require the approval of the Government Commission 7. Under "friendly" non-residents are understood to mean any persons who are not "residents" while not being connected in any way with unfriendly states.

The following are exempt from the restrictions as a general rule: "residents". It is important to take into account that this concept is not applied in the sense of the Tax Code, but in the meaning used by currency legislation 8. The currency legislation classifies as residents: citizens of the Russian Federation, foreigners with a residence permit in the Russian Federation, Russian legal entities, foreign divisions of Russian legal entities, diplomatic missions and consulates of the Russian Federation, the Russian Federation, subjects of the Russian Federation, municipalities. If a citizen of the Russian Federation has foreign citizenship or a residence permit in a foreign state, for the purposes of counter-sanction regulation he will be considered as "residents" 9.

However, it should be noted that this rule will not apply if the transaction is carried out in relation to "enterprises, of strategic importance" 10. Unlike counter-sanctions, Federal Law No. 57-FZ of 29.04.2008 "ABOUT the procedure for implementing foreign investments in business entities of strategic importance for ensuring the country's defense and state security" considers a foreign investor to include a citizen of the Russian Federation who has a second citizenship, a residence permit or other document confirming the right to permanent residence in a foreign state 11. **Transactions that result in a foreign investor acquiring control over a strategic enterprise are subject to approval by the Government Commission, but within the framework of strategic activities, and not the counter-sanctions regime.**

From the concept "persons, associated with unfriendly states", also excludes persons controlled by Russian residents, and they must be disclosed to Russian tax authorities as a controlled foreign company (CFC) 12. It should be taken into account that, according to the requirements of tax legislation, a person who is not a tax resident of the Russian Federation (i.e. lives abroad for more than 183 days) is not required to submit a notification of a CFC 13. Thus, a situation may arise in which a foreign company is controlled by a Russian citizen, but there is no confirmation of such control that meets the requirements of counter-sanction regulation.

Restrictions on transactions with shares and stocks

As a general rule, counter-sanction restrictions apply to transactions:

- between residents, if at least one of them is under the control of unfriendly non-residents 14
- between a resident and any person of an unfriendly state 15;
- between persons of unfriendly states 16 ;
- between residents and "friendly" non-residents with shares acquired by friendly non-residents from persons of unfriendly states after February 22, 2022, not at organized auctions 17;
- between persons unfriendly state with a friendly non-resident 18.

Concepts "resident", "person" unfriendly state", "friendly non-resident" are discussed in more detail in the section "Who are subject to the restrictions?"

If the transaction falls under restrictions, it requires approval by the Government Commission. Such a transaction can only be approved if the following conditions are met 19

- 1) carrying out independent ratings market cost assets appraiser from list Government commissions
(https://minfin.gov.ru/ru/document?id_4=301496-

list of assessments of assessment organs recommended for implementation of market assessments and asset values);

- 2) obtaining an expert opinion from appraisers from the list of the Government Commission;
- 3) sale assets at a discount of at least 50% of the market value of the assets;
- 4) making a payment to the federal budget in the amount of at least 15% of the market value of assets indicated in the report on independent assessment of the market value of assets 20 ;
- 5) in the case of transactions (operations) related to public joint-stock companies (PJSC):

- a. if, as a result of a transaction (operation) with shares, the PJSC retains its status:
 - i. placement at organized auctions of up to 20% of the acquired block of shares;
 - ii. the start of the placement - no later than one year from the date of the transaction (operation), and the period for its implementation - no more than three years from the date of the start of such placement;
- b. in the case of reorganization of a business entity in the form of merger with a public joint-stock company:
 - i. placement of shares of the PJSC to which the merger was carried out at organized trading in a quantity equivalent to up to 20% of the shares of the merged company, taking into account the conversion rate of shares of such companies upon merger;
 - ii. implementation of such placement within three years from the date of the transaction (operation);
- c. in the event of termination of the public status of a PJSC or liquidation of such a company as a result of the implementation (execution) transactions (operations):
 - i. placement at organized auctions of up to 20% of shares of a public joint-stock company (newly created or as a result of the acquisition of public status by a joint-stock company);
 - ii. acquisition of public status by a JSC and the conduct of such placement - no more than three years from the date of the transaction (operation).
- 6) establishing key performance indicators (KPI) for buyers and/or the business entity being acquired by them. KPIs must provide, among other things, for the preservation of technological potential and the main type of economic activity, the preservation of jobs and the fulfillment of obligations under contracts concluded by them with other legal entities, with the submission of a recommendation to the executive authority to monitor the achievement of such indicators;
- 7) if there is a call option:
 - repurchase of an asset at its market value on the date of exercise of such an option;
 - the presence of an economic benefit for the resident owner of the asset and a limitation on the validity period of the permit (usually no more than two years from the date of implementation (execution) initial transaction (operation));
- 8) payment in any of the forms:
 - transferring money to accounts of the type "WITH";
 - conducting settlements on transactions (operations) in rubles in the banking system of the Russian Federation without transferring funds outside the Russian Federation;
 - transfer to accounts opened in banks and other financial market organizations located outside the territory of the Russian Federation (only with payment by installments);
- 9) the applicant has other permits provided for by the legislation of the Russian Federation, which are necessary for the implementation (execution) of the transaction (operation), information about which is provided by the applicant.

Depending on specific circumstances, approval from the Government Commission may be required for:

- acquisition and alienation of shares 21;
- transactions that directly or indirectly establish, change or terminate the rights of ownership, use or disposal:
 - (a) shares 22 ; or
 - (b) shares in the authorized capital of LLCs or other rights that make it possible to determine the conditions for the management of such LLCs or the conditions for their implementation of entrepreneurial activities 23 ;
- change in the rights of ownership, use and/or disposal of more than 1% of shares or votes in credit, insurance and other financial institutions 24;
- transactions related to the payment of the authorized capital of foreign companies in an amount exceeding the equivalent of 15,000,000 rubles 25

From the list of transactions subject to approval, it follows that it is required not only for contracts for the purchase and sale of shares and stakes, but also for most transactions that may arise in practice. For example, the Ministry of Finance classifies trust management agreements, agreements on the transfer of powers of the sole executive body, and voluntary reorganization as such transactions (operations) with LLC shares. At the same time, the specified list is open 26 , and the concept of "operation", based on the meaning of the word itself, can include any type of action (for example, an additional issue of shares, redemption of shares/stakes, conversion, etc.).

The restrictions apply to any transactions that are aimed not only at the direct acquisition of shares/stakes in Russian business entities, but also indirectly - that is, any transactions in foreign jurisdictions that may lead to the establishment, change or termination of rights to shares or stocks in Russian companies will require approval if such transactions meet the criteria of counter-sanction restrictions..

However, an exception has been established for foreign securities if they are recorded and (or) stored outside the territory of the Russian Federation, and settlements on them are carried out on accounts (deposits) that are opened in the name of residents in foreign banks or other financial market organizations located outside the territory of the Russian Federation., and information about which was disclosed by residents 27.

In relation to transactions with shares/participants of certain types of enterprises, instead of the consent of the Government Commission 28 (general rule), permission from the President of the Russian Federation is required (for example, in relation to companies engaged in the processing of oil, petroleum raw materials and the production of processed products 29).

Restrictions on real estate transactions

As with transactions involving shares/interests, the consent of the Government Commission is also required for certain transactions involving Russian and foreign real estate.

The consent of the Government Commission, obtained in a manner similar to transactions with shares and stakes in LLCs, is required for the acquisition or alienation of Russian or foreign real estate under a transaction concluded between:

- a resident and a person of an unfriendly state³⁰ ;
- a resident and a friendly non-resident, if the subject of the transaction is real estate acquired by friendly non-residents from unfriendly non-residents after February 22, 2022³¹.

At the same time, the Government Commission allowed residents to alienate real estate (with the exception of aircraft and sea vessels) in favor of legal entities of unfriendly states 32 .

In addition, the above restrictions on real estate transactions do not apply if settlements are made through accounts (deposits) opened for residents in foreign banks, other financial market organizations located outside the Russian Federation, and, information about which was disclosed by residents to the tax authorities of the Russian Federation 33.

Conclusions

Thus, counter-sanctions regulation is woven from a large number of acts and clarifications, which complicates interpretation and often requires additional clarification from government agencies.

When planning M&A transactions, companies should consider a combination of factors: 1) the nature of the transaction (operation); 2) its subject composition; 3) the changes that the transaction will lead to in relation to the share/stocks, other management rights and real estate.

One of the key aspects is that this regulation may affect a wide range of activities, covering different types of transactions, economic sectors and types of assets. This highlights the need to carefully study and analyze counter-sanction measures in the context of each transaction in order to assess their potential impact and take the necessary measures to comply with the law and minimize risks.

Notes:

1. Federal Law No. 281-FZ of 30.12.2006 "ABOUT special economic measures and coercive measures", Federal Law No. 390-FZ of 28.12.2010 "ABOUT security", as well as Federal Law No. 127-FZ "ABOUT measures of influence (counteraction) against unfriendly actions of the United States of America and other foreign states" from 04.06.2018.
2. Extract from the decision of the subcommittee of the Government Commission for Control over the Implementation of Foreign Investments in the Russian Federation from 07.07.2023 No. 171/5.
3. Rules for issuing permits by the Government Commission for Control over the Implementation of Foreign Investments in the Russian Federation for the purpose of implementing additional temporary economic measures to ensure the financial stability of the Russian Federation and other permits, provided for by separate decrees of the President of the Russian Federation, as well as the implementation of other powers for the specified purposes (Approved by Decree of the Government of the Russian Federation No. 295 of 06.03.2022), paragraph 5.
4. Their list was approved by the Order of the Government of the Russian Federation No. 430-r dated 05.03.2022.
5. Official explanation of the Bank of Russia No. 3-OR dated 02.06.2023, paragraph 1.

6. Concept "control" includes the ability of a person or a group of persons affiliated with him to: directly or indirectly control more than 50% of the votes, determine decisions in a legal entity (even if less than 50% votes), appoint a sole executive body or more than 50% collegial executive body, unconditionally elect more than 50% of the board of directors or other collegial management body, or exercise the powers of the management company.
7. Resolution of the Arbitration Court of the Moscow District in case No. A41-101031/2022 dated 10/23/2023.
8. Official explanation of the Bank of Russia No. 2-OR dated 18.03.2022, paragraph 1, subparagraph 1.1 ABOUT.
9. Official explanation of the Bank of Russia No. 2-OR dated 18.03.2022, paragraph 1, subparagraph 1.1 O
10. How is this term defined in Federal Law No. 57-FZ of 29.04.2008 "On the procedure for implementing foreign investments in business entities of strategic importance for ensuring the country's defense and state security."
11. Federal Law No. 57-FZ of 29.04.2008 "ABOUT the procedure for implementing foreign investments in business entities of strategic importance for ensuring the country's defense and state security", Article 3, Part 2, Clause 5.
12. As a rule, counter-sanction decrees refer to Decree of the President of the Russian Federation No. 95 "On the temporary procedure for fulfilling obligations to certain foreign creditors" dated 03/05/2022, paragraph 12.
13. Tax Code of the Russian Federation (part one) No. 146-FZ of 31.07.1998, subparagraph 2, paragraph 1, article 25.13; paragraph 2, Article 207.
14. See, for example, Decree No. 81.
15. See, for example, Decree No. 81, paragraph 1, subparagraph "b"); Decree No. 618, paragraph 1.
16. See, for example, Decree No. 737, paragraph 1, paragraph 5.
17. See, for example, Decree No. 81, paragraph 1, subparagraph "V".
18. See, for example, Decree No. 737, paragraph 1; Order of the President of the Russian Federation No. 357-RP dated 10/26/2022, paragraph 1.
19. Extract from the decision of the subcommittee of the Government Commission for Control over the Implementation of Foreign Investments in the Russian Federation No. 171/5 dated 07.07.2023.
20. In October 2023, the minimum size "voluntary direction of funds to the federal budget" increased to 15% of the market value of assets, the rate became universal regardless of the transaction price (see the extract from the minutes of the meeting of the subcommittee of the Government Commission for Control over the Implementation of Foreign Investments in the Russian Federation No. 193/4 dated September 26, 2023).
21. Decree No. 81, paragraph 1, subparagraph "b".
22. See, for example, Decree No. 737, paragraph 5. It is worth considering that this restriction does not apply to credit organizations and non-credit financial institutions.
23. Decree No. 618, paragraph 1.
24. Decree No. 737, paragraph 1.
25. Decree No. 126, paragraph 2.
26. Official clarifications of the Ministry of Finance of the Russian Federation No. 1 on the application of Decree of the President of the Russian Federation No. 618 of September 8, 2022, paragraph 1 ABOUT.
27. Decree of the President of the Russian Federation No. 844 of 08.11.2023 "On additional temporary economic measures related to the circulation of foreign securities", paragraph 9.
28. See, for example, Decree No. 618, paragraph 1.
29. Decree No. 520, paragraphs 2, 3.
30. Decree No. 81, paragraph 1.
31. Decree No. 81, paragraph 1.
32. Extract from the minutes of the meeting of the subcommittee of the Government Commission for Control over the Implementation of Foreign Trade investments in the Russian Federation No. 232/9 dated 03/07/2024, paragraph 2.
33. Official explanation of the Bank of Russia No. 2-OR dated 18.03.2022, paragraph 1, subparagraph 1.11.