

## Skolkovo as a Model of Modernized Russia

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Even before Dmitry Medvedev was elected President of Russia, he was contemplating the idea of creating a special area in Russia that would seek to stimulate scientific research, combined with a practical and commercial application of its results. On March 18, 2010, President Medvedev announced that a municipality just outside Moscow called Skolkovo was chosen to become, in his own words, a “model of the city of the future that should become the largest experimental ground for the new economic policy”—an ambitious goal indeed.

On September 28, 2010, two federal laws were adopted to implement President Medvedev’s initiative: Federal Law No. 244-FZ “On the ‘Skolkovo’ Center for Innovation” (the “Skolkovo Law”) and the Federal Law No. 243-FZ “On Amending Certain Legal Acts of the Russian Federation in Connection With the Adoption of the Federal Law ‘On the ‘Skolkovo’ Center for Innovation’” (the “Law on Amendments”).

According to these new laws, an unprecedented legal regime will be put in place within the Skolkovo project area. As a result, Skolkovo residents will enjoy special legal treatment in a wide range of areas, including taxation, customs, land use and development, and migration, accounting, licensing, technical regulations, social and medical insurance, education, fire safety, healthcare, sanitary and epidemiological control, and advertising. Skolkovo will even have its own form of local governance.

Branded as an “innovation center”, Skolkovo will be run by a management company entrusted with a wide range of rights and powers necessary for the implementation of the project’s objectives.

This special treatment proposed by the Skolkovo Law and the Law on Amendments will only be granted to “project participants”. A “project participant” is (i) a Russian legal entity; (ii) created specifically for purposes of conducting research activities; (iii) officially granted the status of project participant; and (iv) whose permanent

executive body is physically located within the Skolkovo area (this last provision in item (iv) will come into legal effect only on January 1, 2014, so until then project participants may be based anywhere in Russia and still enjoy the privileges that come with such status). “Research activity” for the purposes of the Skolkovo Law includes research, development and the commercialization of the results of research activities as well as other similar types of activities, and must be conducted within one (or more) of the following areas: (1) energy saving and energy efficiency; (2) nuclear technology; (3) space technology; (4) medical technology for development of equipment and medicines; and (5) strategic computer technologies and software. A legal entity obtains the status of a project participant from the moment of its inclusion into the registry of project participants kept by the management company of the Skolkovo project.

The Skolkovo Law provides that the status of project participant will automatically expire 10 years from the date of its award (i.e., from the date of the recipient’s inclusion into the registry of project participants), or earlier in the event of a liquidation or reorganization of the relevant legal entity (if the reorganization was not authorized by the management company).

Other significant provisions of the Skolkovo Law and the Law on Amendments are set forth as follows below.

### Tax and Other Fiscal Incentives

The Law on Amendments introduces significant tax incentives for project participants. They will be granted an exemption from the payment of VAT for a term of 10 years after being awarded the status of project participant. This exemption, however, will not be applicable to VAT payments made in connection with imports of goods or equipment by project participants (the appropriate exemption granted in such cases is discussed below in the section headed “Customs Regulations”). This exemption will terminate on the first date of the tax period within which the aggregate profit of a project participant exceeds RUB300 million (compounded from January 1 of the year when the annual revenue of this project participant exceeds RUB1 billion).

An exemption from the payment of corporate profits tax will also be available for project participants for a term of 10 years from being awarded the status of project participant. This exemption will terminate from the first date of the tax period within which the annual revenue of the project participant exceeds RUB1 billion.

Although a 10-year grant of exemptions from VAT and corporate profits tax is one of the most material incentives

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of the Law on Amendments, from a practical point of view the effect of these exemptions may be limited since most such projects usually generate profits only after a period of around five years. An argument could be made that the exemption should have been granted not from the time that the status of project participant is granted, but, for example, from the date requested by the project participant.

Also significantly, project participants will have the right to pay, for a period of 10 years after being awarded project participant status, mandatory pension insurance contributions at a rate of 14% of employees' salaries (as opposed to the rate of 26% of employees' salaries for regular Russian companies starting from January 1, 2011). Project participants will be exempt from making any contributions to the social insurance fund and to the mandatory medical insurance fund for the same period of 10 years.

Finally, project participants whose annual revenue does not exceed RUB1 billion will be allowed to use a simplified accounting system for their books and records under Chapter 26.2 of the Russian Tax Code. This exception terminates after the first year in which the annual revenue of the project participant exceeds RUB1 billion.

#### **Customs Regulations**

The Skolkovo management company will provide customs brokerage services to project participants. The concept is that project participants will not deal directly with the Russian customs authorities, but will deal through the management company, which will be responsible for the submission of the necessary documents and for communications with customs officials. The necessary customs charges and duties will be paid by the management company on behalf of project participants to the customs authorities; the value of such customs charges and duties will be subsequently reimbursed to the management company in the form of subsidies paid to the management company. The VAT paid in connection with the import of goods or equipment will also be reimbursed in the form of subsidies to the management company or by granting VAT-exempt status to the project participants.

#### **Regulation on Land Use and Development**

The Skolkovo Law provides that land plots, buildings and structures within the territorial boundaries of the project will be the property of the Skolkovo management company, which will in turn have the right to lease (but not to sell or encumber) such land plots, buildings and structures to project participants, without any right of sublease and for the sole purpose of the implementation of the project's objectives. Further terms and conditions upon which land plots are to be leased to project participants will be set forth in regulations adopted by the management company.

The management company will devise a master plan on the use of Skolkovo's land, as well as the rules of real estate construction that will supersede the existing Russian

regulations on this point. The management company will also issue all necessary permits and approvals regulating land use and real estate development and commissioning. It will also regulate the construction of roads and other utilities (water, electricity, etc.) within the land boundaries of the project.

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#### **Use of Foreign Workforce and Additional Provisions**

The project participants will be able to attract and employ foreign workers on the terms set forth by applicable Russian laws, with certain important exceptions. Specifically, there will be no need for the employer to seek permission from the Russian migration authorities to attract foreign workers or to comply with the quotas established by the migration authorities regarding foreign specialists. And it will be the management company that will take care of collecting and submitting the paperwork required for obtaining visas and work permits for foreigners. Such work permits will be issued for the duration of the employment contracts concluded by the employer with the prospective foreign employee, but for no longer than three years, with an option for multiple extensions of this term. The same exemptions are available for family members of Skolkovo foreign employees.

The Law of Amendments also provides that the management company will adopt regulations related to administrative and other such areas which shall apply within the boundaries of Skolkovo. It should be noted that a large number of the regulations that should be adopted by the management company will likely contradict or run alongside existing Russian laws and rules, potentially generating confusion and an inconsistent application of laws. As a result, although Skolkovo is an ambitious undertaking that is expected to become a showcase for a modernized Russia, it is far too early to predict how the Skolkovo Law and the Law on Amendments will be implemented and applied in practice and whether such unique regulations will contribute to or hinder Skolkovo's future success. □