



Gide Loyrette Nouel

**Real Property Investment Law in Russia**



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**Contents**

**TITLE ..... 3**

**INTERESTS IN REAL PROPERTY CAPABLE OF REGISTRATION ..... 4**

**THE DEVELOPMENT OF LAND ..... 4**

**LEASES ..... 5**

**COMMERCIAL LEASES ..... 5**

**TAX ..... 7**

**LEGAL COSTS REGARDING REAL PROPERTY ACQUISITIONS ..... 9**

**SECURITY USED IN REAL PROPERTY FINANCINGS ..... 10**

## TITLE

### **Full ownership**

#### *General*

Full ownership of real property is recognised by the laws of the Russian Federation.

In Russia the title to the land on which a building is located is not always linked to the title to the building. It is commonplace for the owner of the building to be different from the owner of the underlying land plot. For example, it is a common situation in Moscow that a building is located on land leased to the building's owner. The main rules on the acquisition, possession, disposal and use of developed real property are contained in the Russian Civil Code. While the rules in respect of land are contained in the Russian Land Code.

Apart from full ownership, other titles to land recognised by Russian law:

- **permanent use of land** – this type of title to land is used for land held by the State or municipal enterprises, as well as government authorities. Certain individuals and legal entities who held this type of title before the entry into force of the Russian Land Code are obliged to acquire the ownership or to conclude a lease of the land. However, permanent use does not allow the free disposal of the land;
- life-long, inheritable **possession of land** – this is a form of title which could be acquired by individuals prior to the introduction of the Russian Land Code, and may be conserved by such individuals. It allows the possession and use of the land and such rights can be inherited.

#### *Acquisition*

An agreement relating to the transfer of real property must be made in writing. Almost all real property transactions, including lease agreements for not less than one calendar year, are subject to State registration.<sup>1</sup> Only land registered in the State Land Cadastre may be purchased or sold.

Almost any real property right and any modification of such right should be registered in the Register of Rights to Real Property and Transactions. Therefore, any property right, mortgage, lease, easement or beneficial ownership of a building or of land should be registered, failing which the relevant right may be declared null and void.

### **Limitations on acquisition**

Generally, real property may be acquired by residents and non-residents. Individuals and legal entities have the same rights to acquire and dispose of real property. With some exceptions, the Russian Federation and municipalities may freely dispose of all land which they own.

Certain limitations are established in respect of the acquisition of land and rights to land for foreign individuals and legal entities. These limitations primarily concern land located near national borders as well as agricultural land which may not be owned by non-residents but may be leased.

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<sup>1</sup> Federal Law on the State Registration of Real Property and Transactions.

**Restrictions on private ownership of land**

Land owned by the State or a municipality cannot be acquired for construction purposes when:

- they cannot be alienated;
- they correspond to a specific exception under Federal Law; and
- they are reserved for State or municipal needs.

According to Article 27(4) of the Russian Land Code, land cannot be alienated if certain facilities are located or built on them. These facilities include, in particular:

- wildlife preservation areas and national parks;
- permanent military camps;
- military tribunals;
- federal security service facilities;
- nuclear plants and nuclear materials storage facilities;
- military and civil cemeteries; and
- engineering and communication facilities used for the protection of Russian national borders.

**INTERESTS IN REAL PROPERTY CAPABLE OF REGISTRATION**

In Russia leases, mortgages, and easements (servitude), amongst other interests, are capable of registration.

In accordance with the general provisions on sale and purchase contracts set forth in the Civil Code, the seller must sell property free from any rights of third parties except when the purchaser has expressly agreed to purchase encumbered property. If the seller does not comply with this rule, the purchaser has the right to claim a price reduction or to terminate the sale agreement if it cannot be proved that the purchaser knew or should have known of the existence of these rights of third parties.

For the purpose of this rule, the existence of rights of third parties is determined at the time of completion of the sale agreement. Claims of third parties that are brought to the knowledge of the seller prior to completion of the sale agreement and further recognised as legitimate are also taken into account.

**THE DEVELOPMENT OF LAND**

Typically the development of agricultural land in Russia begins with the purchase of the agricultural land. The rezoning of agricultural land is subject to consent of the executive body of the relevant Russian constituent entity. The rezoning will require the preparation of initial authorisation documentation (in Russian “*iskhodnaya razreshitelnaya dokumentatsia*”). It is necessary to obtain a *Sanepidnadzor* clearance as to selection of the land. This is a clearance granted by the health and epidemiology controlling body. Rezoning also requires a *Santekhnadzor* expert opinion. This necessitates an examination of the land by a special environmental expert from the local office of the Federal Service for Environmental, Technological and Nuclear Supervision.

The next step is planning the connections to public utilities. The technical specifications for connection of the project to public utilities (electric power, heating, water supply and sewage, gas, etc.) are provided by the organisations responsible for public utility networks.

An authorisation from the local executive body is required to perform design and survey investigation work. An authorisation from the regional executive body is required to implement an investment project for construction of real property.

There will need to be a performance of design and survey investigation. Afterwards, the construction project documentation should be elaborated. A construction project agreement will need to be concluded with the local architecture and town planning authorities and a separate agreement with organisations responsible for public utility networks.

In order to obtain the *Sanepidnadzor* clearance, the project documentation must comply with sanitary regulations. The *Santekhnadzor* experts will examine the construction project.

The next step is obtaining the construction permit from local executive body. The construction project should be registered with the local architectural and construction supervision authority (in Russian “*Archstroynadzor*”). An authorisation by local architecture authority is required to perform ground works. The construction works must be performed by a duly licensed construction company.

After the completion of the works and subject to the works compliance with the project documentation, a permit to commission project should be obtained from local executive body. After the permit to commission the project is obtained, the BTI measurements are made and the project is commissioned. The final step is the registration of title to real property.

## **LEASES**

Leases are mainly governed by the Russian Civil Code. Buildings, constructions and land may be leased pursuant to the Russian Civil Code and Russian Land Code rules. Certain limitations on the possibility to sell certain types of land, as described above, are also applicable to leases. Article 22(2) of the Russian Land Code states that land can be leased subject to the exceptions provided in article 27(4) of the Russian Land Code.

There is a maximum 49 year lease term for land. However, the maximum term is less for certain categories of land, for example agricultural land. The lease of other types of real property between private persons allows for a free determination of the lease term, except in certain cases. Leases of residential property are subject to a specific legal regime described in the Russian Civil Code which limits their term to a maximum of five years.

## **COMMERCIAL LEASES**

### **No specific statute**

There are no specific regulations governing commercial leases in Russia. Commercial leases are regulated in the same manner as general civil leases.

### **Form**

As a rule, leases must be in written form and are subject to State registration if they are concluded for a term not less one year. If lease agreements do not contain sufficient information as to the leased property, they may be declared null and void.<sup>2</sup>

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<sup>2</sup> Article 697(3) of the Russian Civil Code.

**Duration**

Leases may be concluded for a specific or an indefinite term. The maximum term of lease agreement for land is 49 years.<sup>3</sup> This maximum 49 year lease term equally applies to State, municipal and agricultural land.<sup>4</sup> If the term is not specified, the lease agreement is deemed to be concluded for an indefinite term.

**Termination**

Lease agreements for an indefinite term may be terminated at any time by either party with three months notice. Lease agreements for a definite term may be terminated only by mutual agreement of the parties, or by the court upon request of one of the parties in certain cases stipulated by law. The landlord of a State or municipal land may terminate lease agreements for a term exceeding five years, if the court authorizes him to do so subject to a substantial breach of contract by the tenant.

**Right of renewal**

Unless otherwise provided by law or the lease agreement, the tenant who duly performs its obligations has a priority right of renewal of the lease agreement upon expiration of the lease term.

The tenant must notify the landlord of its intention to renew the lease agreement within a reasonable time before expiration of the term unless a specific term for such notice is provided in the lease agreement. According to court practice, this notice is binding upon the landlord during a period of one year starting from the date of expiration of the lease agreement. An absence of written notice is deemed a waiver of such right.

The tenant's right of renewal does not entail a right to keep the previous contract terms unchanged. Any changes to the lease agreement must be mutually agreed by the parties.

Where the landlord ignores the priority right of the tenant and enters into a lease agreement with a third party, the tenant has the right to claim in court, at its own discretion, either the transfer to its benefit of the rights and obligations of this third party under the lease agreement and the indemnification of any damages suffered in connection with the landlord's refusal to renew the lease or the indemnification of its damages.

Where the tenant continues to use the property after the lease term has expired and the landlord does not formally object to such behaviour, the lease agreement is renewed at the previous terms and conditions.

**Pre-emption right of the tenant**

The Russian Land Code gives the tenant of a land a priority right (with certain exceptions) to purchase the land, if the land is sold.

Owners of buildings located on land owned by the State or municipalities have a priority right to acquire the land, if the land is sold.

**Rent and rent cap**

The rent must be determined in the lease agreement. The rent is set freely by the parties. In most cases there are no statutory rent caps in Russia. This is, however, subject to some exceptions, for example state owned land leases.

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<sup>3</sup> The Federal Privatisation of State and Municipal Property Act and the Federal Trade of Agricultural Lands Act.

<sup>4</sup> The Federal Privatisation of State and Municipal Property Act and the Federal Trade of Agricultural Lands Act.

**Rent review**

Rent is adjusted in accordance with contractual provisions of the lease agreement. Adjustment indices based on the official inflation rate are sometimes used. A lease agreement may provide a landlord with a right to change the rent in case of substantial changes in the economic situation or tax burden.

**Costs not rechargeable to tenants**

According to Article 616 of the Russian Civil Code, the tenant is not obliged to perform capital repairs on the leased property, such responsibility is imposed on the landlord. This provision may be changed by agreement between the parties.

**Improvements**

Unless otherwise specified in the lease agreement, pursuant to the Russian Civil Code, the tenant is entitled to the reimbursement of the cost of non-removable improvements if the permission of the landlord for such improvements was obtained.

**Assignment**

The assignment of a lease by the tenant is not permitted without the prior consent of the landlord.

**Sublease**

The tenant is entitled to sublease the leased real property subject to the consent of the landlord provided that the term of such sublease does not exceed the term of the head lease agreement.

The Russian Land Code entitles the tenant to sublease the leased land with a simple notification of the owner, unless otherwise provided in the lease agreement.

**TAX****Transaction costs***Sale of land and buildings***VAT**

The direct sale of real property is subject to VAT at a rate of 18%. Russian VAT broadly follows the EU system. The difference between output VAT and input VAT is paid to the Federal budget.

From a tax point of view, the sale of shares in a real property company is more advantageous than the direct sale of real property since unlike the sale of real property, the sale of shares is not subject to VAT.

**Transfer tax**

There is no transfer tax in Russia

**Taxation of capital gains***Capital gains realised by legal entities*

Capital gains realised by legal entities are taxed in Russia under general profit tax rules.

The maximum profit tax rate is 24% (6.5% is payable to the federal budget, a maximum of 17.5% is payable to the regional budget (a minimum of 13.5%). Capital gains are computed as the market sales price of a real property less the net book value.

If the seller of the real property is a foreign company, the following issues should be taken into consideration:

- profit tax should be withheld by the Russian purchaser;
- if the capital gains cannot be determined (confirmation of the net book value/acquisition cost is not available), tax at a rate of 20% applies to the sales price;
- it is common to sell the shares of the company which owns the real property since certain double tax treaties provide for an exemption from withholding tax on income from sale of shares in such companies;
- if the purchaser of the shares in the real property company is also a foreign company which is not tax registered in Russia, there is no mechanism requiring payment of profit tax in Russia.

#### *Other*

For tax purposes, real property is be depreciated over its useful life, which is established by the tax payer. The minimum life for the majority of buildings is 30 years. Certain property is not depreciable for profit tax purposes and, in particular, land and property which is reconstructed or modernised for longer than 12 months.

Interest on loans is deductible, provided that the loan satisfies certain conditions established by the applicable legislation.

#### **Leases**

##### *VAT*

Rental payments are generally subject to VAT at a rate of 18%.

Accredited representative offices of foreign entities registered in certain countries are exempt from VAT in respect of rent for offices and residential premises if certain conditions are met.

##### *Profit tax*

Income from leases is subject to profit tax. Rent fees are a tax deductible cost for the tenant.

#### **Financial leases**

There are certain types of tax benefits relating to financial leases.

#### **Land revenue tax**

There is no land revenue tax in Russia.

#### **Land tax**

Land tax is payable by the owner of the land. The rates of land tax are variable and depend on the location and use of the land. The rates are established by municipalities and may not exceed 1.5% of the cadastral value of a land.

**Property tax**

The owner of immovable property (with certain exceptions, including land) is subject to property tax at a rate established for each region of the Russian Federation. Property tax cannot exceed 2.2%.

The taxable base is the average annual value of the property (movable and immovable) accounted as fixed assets on the balance sheet of the owner.

The taxable base for foreign companies which do not create a permanent establishment in Russia is the inventory value of the immovable property which the foreign company owns in Russia.

**Transfer pricing rules**

Parties to real property transactions are free to determine prices. However, transfer pricing rules allow the tax authorities to control prices in certain cases listed in the Tax Code. In respect of these cases, tax authorities can adjust the actual price up to the market level (for both cross border and domestic transactions) where a given price differs from the market price by more than 20%.

**LEGAL COSTS REGARDING REAL PROPERTY ACQUISITIONS****Notary fees**

Notarisation of contractual documentation of real property transactions is no longer mandatory. State duties applicable to transactions involving real property are set forth by Article 333-33 of the Russian Tax Code.

The registration of title to real property in the Unified State Register of Rights costs RUR 7,500 (approximately EUR 220). The registration of a lease agreement in the Unified State Register of Rights costs RUR 7,500 (approximately EUR 220).

Notary duties for the legalization of contractual documents are established in the Russian Tax Code.

**Lawyers**

There are statutory restrictions on the fees of lawyers.

**Land Registry**

The State duty for the registration of title to real property or modification of that title in the Register of Rights to the Real Property and Transactions is as follows:

- for State registration of rights to real property and transactions related thereto – RUR 500<sup>5</sup> for individuals and RUR 7,500 for organisations;
- for State registration of a mortgage agreement – RUR 500 for individuals and RUR 2,000 for organizations;
- for State registration of easements – RUR 500 for individuals and RUR 2,000 for organizations.

**Publication**

There is no statutory publication requirement.

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<sup>5</sup> EUR 1 = approximately RUR 34.4

## **SECURITY USED IN REAL PROPERTY FINANCINGS**

The usual security package under a cross-border real property financing in Russia would include: a mortgage over the real property, an assignment/pledge of future lease/operation receivables, withdrawal arrangements on Russian bank accounts and possibly also parent guarantees (suretyships).

### **Mortgages**

Mortgages can be created over various types of immovable property, *inter alia*, over land and buildings. The mortgaged real property shall remain in use and possession of the mortgagor. The mortgage of a building or construction must include the mortgage of the underlying land, failing which it would be declared invalid.

The mortgage agreement must be governed by Russian law. The mortgage agreement does not need to be notarised, but is subject to State registration with the Unified State Register with a registration fee of RUR 2,000 (approximately EUR 60) payable at the moment of such registration.

A mortgagee does not have a right to directly acquire title to the mortgaged property upon default under the secured obligation. The mortgaged property needs to be sold at a public auction, once the execution has been carried out.

### **Pledges**

Subject to certain restrictions (e.g. unassignable rights), any property, including assets and claims may be pledged. A pledge can be created either by execution of a pledge agreement in writing or, in certain limited events, by operation of law.

A pledge agreement must include information on the pledged property, the value of the pledged property, the substance, scope and term for the performance of the obligation secured by the pledge, and the party who will remain in possession of the pledged property during the term of the pledge agreement.

As a general rule, pledges of movable property do not require any registration and become effective upon execution of the pledge agreement. There are exceptions regarding pledges of certain movable assets such as shares in a joint-stock company. Share pledges need to be registered with the relevant company's shareholder register (which can be maintained by an independent registrar) and becomes effective upon such registration.

Whenever a pledged asset is subject to State registration (for instance patents and trademarks), pledges over such property are also subject to State registration and the relevant pledge agreement shall not be considered effective until its registration.

Subsequent pledges are permitted unless expressly prohibited by a preceding pledge agreement. As a principle, claims under subsequent pledges shall be satisfied from the value of the pledged property which remains after satisfaction of claims under preceding pledges. The pledgor must provide each subsequent pledgee with information about all existing pledges of the relevant property. If the pledgor fails to do so and such failure causes any losses to pledgees, the pledgor will be liable for all such losses.

It is possible to establish different types of pledges under Russian law, such as:

- pledge of goods in circulation;
- pledge of rights;
- pledge of shares;
- pledge of rights to bank accounts agreements.

Although these types of pledges are frequently used in practice, given the uncertainties of Russian law and court practice, particular care needs to be taken when deciding upon taking security over assets such as future claims and bank account agreements.

### **Suretyship**

Under a surety agreement, a surety assumes liability before a creditor of another person (primary debtor) for the performance by such primary debtor of his obligation towards the creditor in full or in part. A surety agreement may be concluded in order to secure both obligations of the debtor which have already arisen, and those which will arise in the future.

In the event that the primary debtor fails to perform or improperly performs the obligation secured by a surety agreement, the surety and the debtor shall be liable to the creditor jointly and severally, unless the law or the surety agreement provides for the subsidiary liability of the surety. This means that, upon default under the secured obligation, the creditor may require the discharge of the obligation directly from the surety rather than first applying for such discharge to the primary debtor. The surety may invoke the same objections as those available to the debtor against the creditor.

A surety agreement must be concluded in writing and must allow sufficient identification of the secured obligation. The absence of a written document makes a surety agreement void. A surety agreement would generally provide for the scope of liability of the surety. In the absence of such provision, the surety will be liable before a creditor in the same scope as the primary debtor, including payment of interest, reimbursement of court expenses for recovery of the debt and other losses of the creditor caused by improper performance or non-performance of the primary debtor's obligation.

Surety agreements are free from registration with any public bodies and are not subject to any stamp duty or documentary tax.

### **Bank guarantee**

By virtue of the bank guarantee, a bank, another lending institution, or an insurance company (guarantor) gives at the request of the debtor a written commitment to pay to the creditor a cash amount in accordance with the conditions of the commitment given by the guarantor upon the creditor's presentation of a written demand that such amount be paid.

A bank guarantee is similar in some respects to a surety agreement. It may, however, only be issued by a properly licensed bank, lending institution or insurance company. A bank guarantee must clearly indicate its term of validity, which, as a rule, is linked to the term of the loan agreement between the creditor and the debtor. Failure to indicate the term of validity in the bank guarantee makes such bank guarantee void.

Unlike in a surety agreement, the obligation of the guarantor vis-a-vis the creditor does not depend upon the secured (primary) obligation of the debtor. This means that the guarantor may not refuse payment under the guarantee based on any defences arising from the relations between the creditor and the debtor or based on the invalidity of the primary obligation secured by the bank guarantee, and is obligated to pay to the creditor upon submission by the latter of a written demand and documents required under the bank guarantee. The guarantor may thus refuse to honour its payment obligation only if the claim for payment and documents provided are inconsistent with the requirements of the bank guarantee itself or if the guarantee has already expired.



### *About the Law Firm*

**Gide Loyrette Nouel** is an international law firm that has been advising real estate investors since 1920. Gide Loyrette Nouel has been present in Central and Eastern Europe since 1991.

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