NORTH CAROLINA JOURNAL OF INTERNATIONAL LAW AND COMMERCIAL REGULATION

Volume 15 | Number 2 Article 2

Spring 1990

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I. Introduction

The many pieces of legislation[1] adopted as part of President Mikhail S. Gorbachev's economic reform, known as *perestroika*,[2] are designed to stimulate Western investments in the Soviet economy. While *perestroika* is a major shift in Soviet policy and attitude towards the West, some still question the profit making potential in a centrally planned economy that is founded on the principles of mandating state ownership as a means of production,[3] prohibiting the use of hired labor, and rejecting the concept of profit as an incentive for efficiency.[4] Until recently, the Soviet Union regarded foreign trade as a necessary evil; Soviet enterprises only imported products that were not produced domestically.[5] To prevent the negative economic

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1 For an overview of the *glasnost* and *perestroika* legislation, see Kraus, *Soviet Reforms, 1985-1988: An Overview*, 1 GLOBAL ECON. POL'Y 12 (1989).

2 *See generally* M. GORBACHEV, PERESTROIKA: NEW THINKING FOR OUR COUNTRY AND THE WORLD (1987). For a discussion of measuring the economic success or failure of *perestroika*, see E. HEWETT, REFORMING THE SOVIET ECONOMY: ECONOMY VERSUS EFFICIENCY 365-91 (1988). *See also* Allison, *Testing Gorbachev*, 67 FOREIGN AFF. 18 (1988); Balassa, *Conditions for Perestroika to Succeed*, 1 GLOBAL ECON. POL'Y 24 (1989); Rogers, *Glasnost and Perestroika: An Evaluation of the Gorbachev Revolution and Its Opportunities for the West*, 16 DEN. J. INT'L L. & POL'Y 209 (1988). For a critical evaluation of *perestroika*, see Osakwe, *The Death of Ideology in Soviet Foreign Investment Policy: A Clinical Examination of the Soviet Joint Venture Law of 1987*, 22 VAND. J. TRANSNAT'L L. 1, 5-6 (1989) ("*[P]erestroika* is a blueprint for disaster from the best intentions.").

3 *See* KONST. SSR art. II. For a discussion of the constitutional requirement of state-owned industry and its relation to foreign joint venture participation, see Dunn, *The New Soviet Joint Venture Regulations*, 12 N.C.J. INT'L L. & COM. REG. 171, 175-77 (1987).

4 *See* Ioffe, *Law and Economy in the USSR*, 95 HARV. L. REV. 1591, 1592-94 (1982). For background on past Soviet leaders' attitudes towards material incentives to increase productivity, see Armstrong, *Private Enterprises in a Planned Economy: Implementation and Nullification of Soviet Law*, 16 CORNELL INT'L L.J. 49, 50-52 (1983).

5 Soviet enterprises have traditionally been prohibited from importing products, even if not domestically available, unless they could show the country could not produce

effects of importing, exports were allowed only to the extent of imports.[6] Because import and export transactions were handled exclusively by state controlled foreign trade organizations (FTOs), foreign companies could not trade directly with Soviet enterprises or consumers.[7] Joint ventures between Western and Soviet enterprises were prohibited. In 1987, the Soviet Union undoubtedly shifted its policy towards foreign trade by adopting the joint venture legislation and limiting the foreign trade monopoly.[8] However, the Soviet economic system, based on state control and central planning (*Gosplan*),[9] remained largely unchanged, thereby causing legitimate concern among foreign investors. On December 2, 1988, the Council of Ministers adopted legislation that introduced considerable changes to the Soviet economic system.[10] Although the legislation was enacted

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or develop such products. For example, the Ministry of Foreign Trade lobbied for nine years before gaining permission in 1981 to negotiate the purchase of Western technology for the manufacture of tractors. H. GARDNER, SOVIET FOREIGN TRADE: THE DECISION PROCESS 137 (1983).

[6] As part of foreign trade planning, the State Planning Committee compiles "control figures" and forwards them to the Ministry of Foreign Trade. After these figures pass through the Ministry hierarchy, the Ministry prepares an annual export-import plan and sends it to the State Planning Committee. The final export-import plan must meet approval by the Council of Ministers and becomes law after confirmation by the Supreme Soviet. *Id.* at 8-9.

[7] *Id.* at 62-67.

[8] Joint ventures were, however, already allowed in most other Eastern European countries, including Hungary, Yugoslavia, Romania, Poland, Czechoslovakia, and Bulgaria. *See generally* Brank, *Perestroika in Eastern Europe: Four New Joint Venture Laws in 1989*, 21 LAW & POL'Y INT'L BUS. 1 (1989); Buzescu, *Joint-Ventures in Eastern Europe*, 32 AM. J. COMP. L. 407 (1984); Scriven, *Joint Venture Legislation in Eastern Europe: A Practical Guide*, 21 HARV. INT'L L.J. 633 (1980). For sources on joint ventures in Hungary, see Eichmann, *Joint Ventures in Hungary: A Model for Socialist States?*, 20 LAW & POL'Y INT'L BUS. 257 (1988); Borg & Lafeber, *Joint Ventures in Hungary*, 13 REV. SOCIALIST L. 317 (1987). For sources on joint ventures in Yugoslavia, see Comment, *Yugoslavia: Law on Foreign Investments*, 28 I.L.M. 1543 (1989); Artisien & Buckley, *Joint Ventures in Yugoslavia: Comment*, 18 J. WORLD TRADE L. 163 (1984). For sources on joint ventures in Romania, see Burgess, *Direct Foreign Investment in Eastern Europe: Problems and Prospects of Romania's Joint Venture Legislation*, 6 LAW & POL'Y INT'L BUS. 1059 (1974); Morse & Goekjian, *Joint Investment Opportunities with the Socialist Republic of Romania*, 29 BUS. LAW. 133 (1973). For sources on joint ventures in Poland, see Burzynski, *The Polish Law of 1986 on Joint Ventures*, 3 FLA. INT'L L.J. 51 (1987); Jodach, *Ownership and Investment in Poland*, 18 CORNELL INT'L L.J. 63 (1985). For a source on joint ventures in Czechoslovakia, see Bakes, *Czechoslovakia: Joint Ventures*, 29 EUR. TAX'N 88 (1989). For a source on joint ventures in Bulgaria, see Liebman & McCrae, *Joint Ventures in Bulgaria*, 14 DROIT ET PRACTIQUE DU COMMERCE INT'L 797 (1988).

[9] The Soviet economic system is divided generally among three categories of agencies, all subordinate to the Supreme Soviet and the Council of Ministers: 1) *physical planning agencies*, including the Science and Technology State Committee, State Supply Committee (Gossnab), State Planning Committee (Gosplan), and State Price Committee; 2) *financial planning agencies*, including the Finance Ministry and State Bank (Gosbank), the latter controlling the Foreign Trade Bank (Vneshtogbank); and 3) *operative agencies*, including the Ministry of Foreign Trade, State Committee for Foreign Relations, Industrial Ministries, and FTOs not affiliated with specific operating agencies. These agencies coordinate economic activity by means of various annual and five-year central economic plans. H. GARDNER, *supra* note 5, at 1-15.

[10] Hungary has gone even further by becoming the first socialist European country to adopt a uniform code governing all forms of enterprises (general and limited partnerships,

in response to Western criticism, many questions of great concern to foreign investors have remained unanswered.

II. The Soviet Business Environment

Until the 1970s Soviet central planners considered foreign markets to be uncontrollable, and they avoided foreign trade whenever possible.[11] Factories were rewarded on the basis of the quantity produced, leaving factories and employees without incentive to meet the qualitative demands of foreign markets. Soviet consumers, who feared that an open economy would lead to unemployment and inflation, rejected integration into the world market.[12] Domestic enterprises were able to import products that could not be produced domestically.[13] Exports were needed to obtain foreign currency to pay for imports. All foreign trade transactions were made at controlled prices through foreign trade organizations (FTOs), and under the direction of the Ministry of Foreign Trade.[14]

The trend toward integration into the world market began in the late 1960s after several years of trade deficit. In 1967, the Ministry of Foreign Trade created the network of export councils to promote communication between the industrial ministries and the FTOs on matters of export and production.[15] One year later, the industrial ministries established associations to promote exports.[16] These associations were allowed to participate directly in promoting exports, but were unable to engage in transactions with foreign companies.[17] In the 1970s, several proposals were made to decentralize foreign trade,[18] and in 1978, export and import enterprises were created

limited liability companies, and joint-stock corporations) and by allowing foreigners minority participation without special permission. *See Hungary: Memorandum of the Hungarian Chamber of Commerce*, 29 EUR. TAX'N 125, 125 (1989).

[11] The traditional Soviet aversion to foreign trade may have resulted from both a fear of dependence on the world market and a belief that the Soviet central planning process could not include international market values. H. GARDNER, *supra* note 5, at 137.

[12] For discussions of Soviet and Western perceptions of each other before and after *perestroika*, see Yankelovich, *Listening to the Public*, in PERESTROIKA PAPERS: AN EXERCISE IN SUPPLEMENTARY DIPLOMACY 110-31 (Kingston ed. 1988).

[13] *See supra* note 5 and accompanying text.

[14] Though FTOs are under the administrative control of the Ministry of Foreign Trade, they enjoy independent legal status and operate on the basis of "economic accountability," known as *khozraschet*. *See* O. IOFFE & P. MAGGS, THE SOVIET ECONOMIC SYSTEM: A LEGAL ANALYSIS 115-33 (1987). For more complete discussions of the FTOs' role in the Soviet economic system, see generally J. QUIGLEY, THE SOVIET FOREIGN TRADE MONOPOLY: INSTITUTIONS AND LAWS (1974); Butler, *The State Monopoly of Foreign Trade and the Family of Socialist Legal Systems*, 2 CONN. J. INT'L L. 215 (1987); Shillinglaw & Stein, *Doing Business in the Soviet Union*, 13 LAW & POL'Y INT'L BUS. 1, 3-18 (1981).

[15] H. GARDNER, *supra* note 5, at 73.

[16] *Id.* at 73-74.

[17] *Id.* at 74.

[18] The three most important features of this reorganization were the following: 1) FTOs were allowed to operate on a basis of *khozraschet*; 2) a Board of Directors was established for each FTO, with equal representation from industry and the Ministry of Foreign

within the FTOs to handle transactions regarding specific products.[19] To create closer contact between the FTOs and Soviet enterprises, the FTOs were placed under Boards of Directors with equal representation from the industrial ministries and the Ministry of Foreign Trade.[20] However, as nothing was done to create a closer contact between Soviet enterprises and foreign companies, the state trading monopoly remained largely unchanged. In 1986 the Central Committee and the Council of Ministers agreed to reform the foreign trade system by allowing agencies and enterprises to engage independently in foreign trade.[21] The State Foreign Economic Commission was formed to regulate and coordinate closer contact between ministries and agencies engaged in foreign trade.[22] While the agencies are eager to establish FTOs, enterprises show little interest.[23] Therefore, most Soviet enterprises are still handled through FTOs under the Ministry of Foreign Trade and other agencies.

Recognizing that more than eighty percent of world trade is conducted within the General Agreement on Tariffs and Trade (GATT),[24] in 1986 the Soviet Union made inquiries into joining the GATT, and submitted a petition requesting that the Soviet Union be given observer status at the 1986 Uruguay Round.[25] The Soviets argued that their participation in GATT was appropriate since they were part of an interdependent world economy.[26] The petition was rejected, and subsequent Soviet proposals for accession to the GATT have been rejected. GATT membership would enhance the Soviet world trade position, which is crucial to its economic stability in light of the drop in oil and gas prices.[27] The United States op-

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Trade; and 3) the foreign trade offices of the FTOs were transformed into firms with greater responsibilities. *Id.* at 68-70.

19 Smirnov, *Legal Status of a Foreign Trade Association*, FOREIGN TRADE (No. 10) 38, 38 (1978).

20 Although the Boards of Directors apparently play a direct role in the management of the FTO, the General Director exercises great control over the FTO. Shillinglaw & Stein, *supra* note 14, at 6-7.

21 Butler, *Introductory Note* to *Union of Soviet Socialist Republics: Decree on Joint Enterprises with Western and Developing Countries*, 26 I.L.M. 749, 749 (1986).

22 *See* Butler, *Legal Reform in the Soviet Union*, HARRIMAN INST. F., Sep. 1988, at 1, 6.

23 Gardner, *Restructuring the Soviet Foreign Trade System*, 23 COLUM. J. WORLD BUS., Summer 1988, at 7, 9.

24 General Agreement on Tariffs and Trade, *opened for signature* Oct. 30, 1947, 61 Stat. (5), (6), T.I.A.S. 1700, 55 U.N.T.S. 308, as amended, *reprinted in* 1 GATT BASIC INSTRUMENTS AND SELECTED DOCUMENTS 13 (1952).

25 *See* Note, *Soviet "Participation" in GATT: A Case for Accession*, 20 N.Y.U. J. INT'L L. & POL. 477, 477-78 (1988) [hereinafter Note, *Soviet Participation*].

26 *See* Kennedy, *The Accession of the Soviet Union to GATT*, 21 J. WORLD TRADE L., Apr. 1987, at 23, 24. The Soviet Union and China are the two most important countries excluded from the GATT. The following nonmarket economies have obtained full GATT membership: Romania (since 1971), Hungary (since 1973), Poland (since 1967), and Yugoslavia (since 1966). *See id.*

27 Aronson, *The New Soviet Joint Venture Law: Analysis, Issues, and Approaches for the Ameri-*

poses Soviet GATT membership because of the incompatibility of the Soviet economic and political system with the free market principles of GATT.[28] The Soviets, however, continue to regard GATT accession to be in the interest of both the Soviet Union and the GATT members.[29]

The Soviets have taken steps to become more integrated in the world economy, demonstrated by their interest in joining the International Monetary Fund (IMF) and its sister organization the International Bank for Restructuring and Development (IBRD) or the World Bank.[30] The inconvertible ruble makes such membership almost impossible,[31] but the Soviets announced recently that the ruble is intended to become at least partially convertible by the early 1990s.[32]

A. Cooperatives

Cooperatives are based on agreements between Soviet and foreign partners to develop or produce products jointly for sale on do-

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can Investor, 19 LAW & POL'Y INT'L BUS. 851, 890-91 (1987). The U.S.S.R. earned considerable profits from the oil price hikes in 1974 and 1979 and allegedly encouraged the Arab States to use oil as a weapon against the West. *Hearings Before the Subcommittee on National Security Economics of the Joint Economic Committee of the United States (Economic Reforms in the USSR),* 100th Cong., 1st Sess. 23-24 (1987) (statement of D. Wigg, Deputy Assistant Secretary of Defense Policy Analysis) [hereinafter *Hearings*].

28 In 1987, the U.S. Government outlined its position regarding Soviet participation in international organizations before a Senate subcommittee:

> Today, the Soviet Union's ability to participate effectively or constructively in international economic decision-making remains doubtful. . . . [A] huge, "closed," non-market economy with few connections to the West would be difficult [for the West] to absorb on economic grounds alone. In addition, there is the fear that the Soviet Union's desire for a place at the table stems more from a bent for political troublemaking than from any desire to participate responsibly.

Hearings, supra note 27, at 25.

But see Note, *Soviet Participation, supra* note 25, at 499-510 (discussing advantages for both the U.S.S.R. and the West from Soviet GATT membership).

29 The Soviet Union is expected to reapply for GATT observer status in 1990. van Brabant, *Planned Economies in the GATT Framework: The Soviet Case,* 4 SOVIET ECON. 3, 5 (1988).

30 Sherr, *Joint Ventures in the USSR: Soviet and Western Interests with Considerations for Negotiations,* COLUM. J. WORLD BUS., Summer 1988, at 25, 27. The Soviet Union attended the Bretton Wood conference and in 1946 signed the Articles of Agreement that led to the establishment of the International Monetary Fund (IMF) and the World Bank. Sokil, *Soviet Participation in the GATT, IMF, and World Bank,* 1 GLOBAL ECON. POL'Y 79, 80 (1989). However, the U.S.S.R. failed to ratify the Agreement and was not invited to attend the 1947 Geneva Conference leading to the formation of GATT. *Id.* Instead, the U.S.S.R. established the Council for Mutual Economic Assistance (CMEA or COMECON) in 1949 both to achieve a status in the world economy GATT could not provide it and to keep state information from being divulged. *Id.* at 80-81. For a thorough discussion of East-bloc participation in the IMF and World Bank, see generally V. ASSETTO, THE SOVIET BLOC IN THE IMF AND THE IBRD (1988).

31 Sokil, *supra* note 30, at 87-88. Although the currencies in Romania, Hungary, Poland, and China also are inconvertible, these countries remain members of the IMF and the World Bank. *Id.* at 81.

32 *See infra* notes 146-48 and accompanying text.

mestic or foreign markets.[33] Though a cooperative resembles a joint venture, the cooperative partners do not combine to form a legal entity.[34] If the Soviet enterprise is authorized to engage directly in foreign trade transactions, and if the cooperative will not require a license transfer, the agreement can be negotiated directly between the parties.[35] Otherwise, the cooperative is arranged through FTOs, or state committees, such as the State Committee on Science and Technology or State Committee for Foreign Economic Relations.[36] The Law on the State Enterprises encourages Soviet enterprises to enter cooperatives and joint ventures in order to develop economic relations with foreign companies.[37] Cooperative arrangements focus primarily on needed machinery and technology for Soviet enterprises.[38] Instead of importing machinery or technology, Soviet enterprises engage in cooperatives with foreign enterprises in possession of the appropriate machinery or technology. This arrangement is less expensive than importing machinery and, more importantly, does not require the use of foreign currency. Also, cooperatives are usually preferable to licensing technology, and provide Soviet enterprises with valuable insight into Western produc-

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33 For discussions of the different cooperative agreements, see Pedersen, *Joint Ventures in the Soviet Union: A Legal and Economic Perspective*, 16 HARV. INT'L L.J. 390, 391-93 (1975), and Hoya & Stein, *Drafting Contracts in U.S.-Soviet Trade*, 7 LAW & POL'Y INT'L BUS. 1057 (1975). On June 1, 1988, the Supreme Soviet adopted a new, more restrictive "Law on Cooperatives." 28 I.L.M. 719 (1989). *See also* Rabinovich, *The Procedure for Signing Transactions with Soviet Foreign Trade Organizations*, 22 INT'L LAW. 143 (1988).

34 Joint ventures are contractual arrangements between two or more enterprises creating an identifiable entity to undertake joint production, marketing, or other activities. The parties contract to pool their resources and agree to manage the operation jointly and share the risks associated with the venture. Berman, *Joint Ventures Between United States Firms and Soviet Economic Organizations*, 1 INT'L TRADE L.J. 139, 144 (1975-76). The cooperative, on the other hand, represents "a sale of capital equipment and technology, but it is also marked by a relatively high degree of interdependence between the parties involved, continuing transfers over a period of several years, and the creation of organizational ties, although the partners maintain their separate identities." Pedersen, *supra* note 33, at 391. The cooperative may also be viewed as a joint venture with no joint equity. *See* Scriven, *Cooperation in East-West Trade: the Equity Joint Venture*, 10 INT'L BUS. LAW. 105 (1982).

35 For a discussion of Soviet licensing law, see Armstrong, *Transferring U.S. Technology to the Soviets: Some Practical Legal Problems*, 16 INT'L LAW. 737 (1982). Most industrialized nations restrict Eastern Bloc transfers of technology with potential military uses through membership in the Coordinating Committee Multilateral Export Controls (COCOM). *See* Aronson, *supra* note 27, at 887-91.

36 *See supra* notes 6-9 and accompanying text.

37 The Law on the State Enterprises provides that:

> Enterprises implement their economic ties, with firms in the capitalist and developing countries, on the basis of the principles of mutual advantage and equal rights. The main methods of developing these ties are cooperative production, scientific technical arrangements on a longterm and balanced basis, and the creation of joint enterprises and production facilities.

Law on State Enterprise, adopted June 30, 1987, by the U.S.S.R. Supreme Soviet, 1987 Ved. Verkh. Sov. SSSR No. 26, item 385, para. 19(3).

38 For a discussion of whether the joint venture will replace the cooperative, see Miller & Surowell, *Co-production in the USSR: Joint Production Without Joint Ventures*, 23 COLUM. J. WORLD BUS., Summer 1988, at 61.

tion and marketing methods.[39]

B. *Joint Ventures*

The law permitting joint ventures (*Sovmestije predprijatija*) between Soviet enterprises and foreign partners was adopted on January 13, 1987, under Decrees issued by the Presidium of the Supreme Soviet and the Council of Ministers.[40] On September 17, 1987,[41] March 17, 1988,[42] December 2, 1988,[43] and March 7, 1989,[44] the Council of Ministers passed Decrees amending the joint venture legislation. In addition to this legislation, Soviet ministries have issued a number of administrative regulations concerning Soviet joint venture law.[45]

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39 For a discussion of the motives for engaging in cooperatives and joint ventures with Western enterprises, see Pedersen, *supra* note 33, at 393-97.

40 The Supreme Soviet authorized the establishment of Soviet joint ventures with foreign participation on Jan. 13, 1987. Decree of the Presidium "On Questions Concerning the Establishment in the Territory of the U.S.S.R. and Operation of Joint Ventures, International Amalgamations and Organizations with the Participation of Soviet and Foreign Organisations, Firms and Management Bodies," 1987 Ved. Verkh. Sov. SSR No. 6352-XI, *translated and reprinted in* D. KELLEY & J. SAUL, THE SOVIET JOINT ENTERPRISE DECREE: LAW AND STRUCTURE 35 (1989). The Council of Ministers that same day issued the Decree "On the Procedure for the Creation on the Territory of the USSR and the Activities of Joint Enterprises with the Participation of Soviet Organizations and Firms of Capitalist and Developing Countries." 1987 SP SSSR No. 9, item 40, *translated and reprinted in* 26 I.L.M. 749, 749-58 (1987) [hereinafter Joint Venture Decree 49]; *also translated and reprinted in* D. KELLEY & J. SAUL, *supra*, at 36-45.

By comparison, the Chinese government adopted joint venture legislation in 1979 that allowed foreign investors to own shares in Chinese joint ventures. For discussions of the Chinese experience with joint ventures, see Gelatt, *Legal and Extra-legal Issues in Joint Venture Negotiations*, 1 J. CHINESE L. 217 (1987); Bloomfield, *Legal Aspects of Joint Ventures in China*, 14 INT'L BUS. LAW. 327 (1986); Rich, *Joint Ventures in China: The Legal Challenge*, 15 INT'L LAW. 183, 209 (1981) (joint venture law "sloppy and inconsistent" and "on its face, replete with ambiguities and open to questions"); Note, *The Joint Venture Law of the People's Republic of China: Business and Legal Perspectives*, 7 INT'L TRADE L.J. 73, 110 (1981-83) ("consistently imprecise," and "significantly ambiguous"); Comment, *The United States-People's Republic of China Income Tax Treaty: Opening the Door to Increased Economic Cooperation*, 13 N.C.J. INT'L L. & COM. REG. 527, 527 n.3 (1988) (Chinese joint venture law generally successful). For a recent comparison of the Soviet and Chinese joint venture legislation, see Mirabito, *Prospects for Western Investment: A Comparison of Joint Venture Law in the Soviet Union, Yugoslavia and China*, 12 B.C. INT'L & COMP. L. REV. 103, 110-17, 127-35 (1989).

41 Decree of the U.S.S.R. Council of Ministers of Sep. 17, 1987, "On Additional Measures to Streamline Foreign Economic Activity in the New Conditions of Economic Management," 1987 SP SSSR No. 1074 [hereinafter Decree 1074].

42 Decree of the U.S.S.R. Council of Ministers of Mar. 17, 1988, 1988 SP SSSR No. 352.

43 Resolution of the U.S.S.R. Council of Ministers of Dec. 2, 1988, "On Further Developing the Foreign Economic Activity of State, Cooperative, and Other Public Enterprises, Associations, and Organizations," 1988 SP SSSR No. 1405, *reprinted in* D. KELLEY & J. SAUL, *supra* note 40, at 114-21, *from the English version of* Ekonomicheskaya Gazeta, Dec. 29, 1988, at 17-18 [hereinafter Decree 1405].

44 Decree of the U.S.S.R. Council of Ministers of Mar. 7, 1989, "On Measures of State Regulation of Foreign Economic Activity," 1989 SP SSSR No. 203.

45 *E.g.*, Regulation of the U.S.S.R. State Bank and the U.S.S.R. Bank for Foreign Economic Affairs of Sep. 22, 1987, "Procedure for Crediting and Settlement of Accounts of Joint Ventures, International Amalgamations and Organizations of the U.S.S.R. and other

1. *Organizing the Joint Venture*

The process of organizing the joint venture is crucial and may determine the profitability of the venture to the foreign investor.[46] The process includes the negotiation and signing of the foundation documents, usually a letter of intent.[47] The foreign partner should address a number of problems unique to the Soviet legal economic system before signing the foundation documents.[48] The foreign partner that fails to address these problems in a timely fashion may find Soviet authorities and the Soviet joint venture partner unwilling to amend the foundation documents to favor the foreign joint venture partner.

The letter of intent does not obligate the negotiating parties to form a joint venture,[49] but serves to outline the foundation documents under which the joint venture is conducted.[50] Another main purpose of the letter of intent is to ensure protection for the foreign joint venture partner during the negotiation process.[51] In negotiat-

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CMEA Countries, as well as of Joint Ventures with the Participation of Soviet Organisations and of Firms from Capitalist and Developing Countries," No. 149, *reprinted in* D. KELLEY AND J. SAUL, *supra* note 40, at 72-91; Regulations of the U.S.S.R. Ministry of Finance of Nov. 24, 1987, "Concerning the Procedure for Registering Joint Ventures, International Amalgamations and Organizations Established in the Territory of the U.S.S.R. with the Participation of Soviet and Foreign Organizations, Firms and Authorities," No. 224, 92-97; Instructional Circular No. 53-13-09 of the U.S.S.R. Ministry of Finance and the U.S.S.R. Central Board of Statistics of Feb. 27, 1987, "On Accounting and Bookkeeping Procedures at Joint Ventures, International Amalgamation and Organizations Established in the U.S.S.R. Territory," *reprinted in* D. KELLEY AND J. SAUL, *supra* note 40, at 56-57; Regulation of the U.S.S.R. Ministry of Finance of May 4, 1987, "On the Taxation of Joint Ventures," No. 124, *reprinted in* D. KELLEY AND J. SAUL, *supra* note 40, at 58-63, *as partially amended by* Regulation of the U.S.S.R. Ministry of Finance of Nov. 30, 1987, "On Partial Changes in the Taxation of Joint Ventures," No. 226, *reprinted in* D. KELLEY AND J. SAUL, *supra* note 40, at 64-66 [hereinafter Joint Venture Tax Reg.].

The text of these and other regulations may be obtained in English translation through the U.S.S.R. Chamber of Commerce and Industry, "Vneshekonomservice," 5/2 Kuibyshev Street, Moscow 103735, U.S.S.R.

46 "It will be stressed, first of all, that the establishment of a JEO [joint economic organization] is a fairly crucial process which shapes the decisive prerequisites for its effective operation and lays the foundations for its activity." USSR ACADEMY OF SCIENCES, THE LEGAL STATUS OF JOINT VENTURES IN THE USSR 61 (1989).

47 Before preliminary discussions ever begin, one joint venture partner has taken the initiative to form the enterprise and locate partners. Although the initiative may be either Soviet or foreign, *id.*, the foreign partner will usually in practice take the initiative. The foreign partner contacts the Soviet partner either directly or through ministerial channels.

48 Osakwe, *supra* note 2, at 9. For a discussion of the various aspects of Soviet law that negotiators should consider, see generally W. BUTLER, SOVIET LAW (1988).

49 USSR ACADEMY OF SCIENCES, *supra* note 46, at 73-74.

50 *Id.* at 70-73.

51 *See infra* note 54 and accompanying text.

ing the foundation documents,[52] the foreign company may be required to furnish a potential Soviet joint venture partner with technical information and documents regarding the foreign company's technological contribution to the venture.[53] Unless it is addressed in the letter of intent, this exchange of information between two unrelated companies presents inherent difficulties. The exchange may itself constitute an activity that requires export licensing.[54] Moreover, the foreign company has to ensure that its property is adequately protected, especially in the case where the parties do not agree to form a joint venture.[55]

Under the original Joint Venture Decree, the foundation documents were reviewed, then submitted to the Council of Ministers for approval by regional and central ministries and agencies.[56] The documents then had the force of law as to matters involving the joint venture and could supersede contrary law, even the Joint Venture Decree.[57] To ease the approval process for smaller joint ventures,[58] the Central Committee and the Council of Ministers amended the procedure in 1987.[59] The amendment provided that joint ventures

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[52] One commentator has noted the following characteristics of Soviet negotiating behavior:

1) suspicion of U.S. and an expectation of hostility;

2) reluctance to compromise;

3) perception that concessions by other side indicate weakness following which Soviets should stick to original proposal or take harder line;

4) use of "red herring" technique; *i.e.* making startling proposals to stir up anxiety, later withdrawing some of them in order to demand a concession in return;

5) extensive use of publicity as a means of negotiation;

6) stubborn commitment to oft-repeated positions, replaced only by new, stubbornly pursued commitments;

7) willingness to abandon a position or commitment suddenly without particular concern for continuity or credibility;

8) reluctance to use informal meetings as negotiating tools;

9) pursuit of "agreements in principle;"

10) frequent use of propaganda in negotiations, sometimes as a primary objective of the negotiations, sometimes as a means of achieving agreement;

11) tendency to react to changes in international tension. C. JÖNSSON, SOVIET BARGAINING BEHAVIOR: THE NUCLEAR TEST BAN CASE 41-54 (1979).

For a more recent discussion of Soviet negotiating styles, see R. SMITH, NEGOTIATING WITH THE SOVIETS 48-62 (1989).

[53] Joint Venture Decree 49, *supra* note 40, para. 2. In practice, preliminary feasibility reports are always required. Detailed, objective, and timely coordinated reports are thought to aid the parties in their formulation of the foundation documents. U.S.S.R. ACADEMY OF SCIENCES, *supra* note 46, at 59-60.

[54] *See supra* note 35 and accompanying text.

[55] The joint venture legislation provides strict confidentiality requirements which apply once the joint venture is organized. However, the Soviets have recognized that foreign companies often have disclosure obligations in other jurisdictions and have negotiated appropriate exceptions to the confidentiality requirements. *See* Dean, *Updating Soviet Joint Venture Law and Practice*, 23 COLUM. J. WORLD BUS., Summer 1988, at 53, 57.

[56] Decree 1074, *supra* note 41.

[57] Joint Venture Decree 49, *supra* note 40, para. 2.

[58] USSR ACADEMY OF SCIENCES, *supra* note 46, at 74.

[59] Once the foundation document is approved and the joint venture is registered, the

can be approved by lower levels of the ministries and departments and the regional councils of ministers.[60]

The foundation documents may contain any provisions that are not contrary to Soviet law.[61] The Joint Venture Decree specifies a number of matters pertaining to the foundation and operation of the joint venture that shall be determined in the foundation documents. The following must be specified: the subject and objectives of the joint venture's activity,[62] its location,[63] the partners,[64] the size of authorized capital powers of its managerial bodies,[65] the procedure for decision-making by the management, primarily its Board,[66] the procedure for transferring rights to industrial property by the partners to a joint venture,[67] the protection of the rights to industrial property abroad,[68] the procedure for commercial use of the rights to industrial property,[69] the branch and representation openings,[70] the procedure for deciding the amount of annual deductions from profits into the reserve fund,[71] the listing of the joint venture's assets, their formation, and expenditure,[72] depreciation charges,[73] the furnishing of partners with information to aid in their exercise of control,[74] the content of collective contracts,[75] and liquidation procedures.[76] The Decree's enumeration is not exhaustive. The foundation documents must provide for other matters related to the foundation and operation of the joint venture.[77] Typically, a variety

joint venture acquires the rights of a legal person. Joint Venture Decree 49, *supra* note 40, para. 9. Until registration, the joint venture is forbidden to make any deals or sign any contracts. USSR ACADEMY OF SCIENCES, *supra* note 46, at 71. In addition, joint ventures may open settlement or current accounts with Soviet banks only after registration. *Id.* Once organized, the joint venture obtains legal status, and its property is fully protected under Soviet law. For a thorough discussion of the protection of property under Soviet law, see O. IOFFE & P. MAGGS, *supra* note 14, at 59-100.

60 It is unclear whether approval at a lower level provides the joint venture partner with the same legal rights provided by the approval of the Council of Ministers. Sherr, *supra* note 30, at 34.

61 For a comparison of the contract law in the Soviet Union and the United States, see E. FARNSWORTH & V. MOZOLIN, CONTRACT LAW IN THE USSR AND THE UNITED STATES (1987).

62 Joint Venture Decree 49, *supra* note 40, para. 7.

63 *Id.*

64 *Id.*

65 *Id.*

66 *Id.*, paras. 7 & 21.

67 *Id.*, para. 17.

68 *Id.*

69 *Id.*

70 *Id.*, para. 19.

71 *Id.*, para. 30.

72 *Id.*

73 *Id.*, para. 30.

74 *Id.*, para. 44.

75 *Id.*, para. 47.

76 *Id.*, paras. 7 & 51. For further relevant discussion, see USSR ACADEMY OF SCIENCES, *supra* note 46, at 72-73.

77 USSR ACADEMY OF SCIENCES, *supra* note 46, at 73.

of other important issues are covered by separate agreements that are incorporated by reference to the documents.[78] Because the joint venture operates on the basis of the foundation documents, it is very important that questions left unanswered by Soviet legislation are resolved in these foundation documents.[79]

3. *Operating the Joint Venture*

Among the issues to be addressed in operating the joint venture are the roles of the foreign partner in management, equity ownership, production and marketing control, labor relations, the relation to the state, dispute resolution, and dissolution. In addition, several financial considerations, including currency problems,[80] should be addressed.

a. *Ownership*

Until the Soviet Union adopted the joint venture legislation on January 13, 1987, foreigners were prohibited from owning equity in Soviet joint ventures.[81] The original Joint Venture Decree required more than fifty percent Soviet ownership of the joint venture.[82] The amendments passed on December 2, 1988, repealed the requirement of Soviet dominance.[83] The new Decree allows foreign participants to own up to ninety-nine percent of the shares in the joint venture.[84]

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[78] *See id.* at 72.

[79] *Id.* at 73.

[80] The partners are free to decide how to finance the venture. The Bank for Foreign Economic Relations and the State Bank both provide debt financing, and the joint venture may seek financing from foreign financial institutions and companies. For a discussion of the restructuring of the Soviet banking system, see Maggs, *Joint Enterprises in Relation to Soviet Banking and Finance Law*, 23 COLUM. J. WORLD BUS., Summer 1988, at 13. The Soviets have taken steps to make financing available in both rubles and foreign hard currency. In Jan. 1988, the Soviet Bank for Foreign Economic Relations (*Vneshekonombank*) allowed a Soviet joint venture to issue a 100 million Swiss Franc ten-year bond. *See* Vlachoutsicos, *Doing Business with the Soviets: What, Who and How?*, 23 COLUM. J. WORLD BUS., Summer 1988, at 67, 71.

[81] The Soviets were reluctant to allow foreign-owned equity in Soviet economic organizations, both by Western and East European investors. Pedersen, *supra* note 33, at 390. However, the Jan. 1987 decree of the Council of Ministers covering Eastern European partners, 1987 SP SSSR No. 48, provides no limits to foreign investors' rights of ownership, thus enabling Eastern European partners to control joint ventures completely. Other foreign investors may not own 100% of a joint venture, even after Decree 1405. *See* Decree 1405, *supra* note 43, para. 31.

[82] Joint Venture Decree 49, *supra* note 40, para. 5.

[83] Decree 1405, *supra* note 43, para. 31. However, most of the Eastern European countries had already allowed foreign dominance. Czechoslovakia now permits foreigners to wholly own companies on its soil. *Czechoslovakia Eases Joint Venture Law as it Embarks on Major Economic Reform*, Daily Executive Report, Apr. 23, 1990, at A-6, col. 2 [hereinafter *Czech Reform*]. The joint venture legislation of Bulgaria, Hungary, and Yugoslavia allow up to 99% foreign participation. In Poland the foreign participant may own from 25% to 100% of the enterprise but must invest a minimum of 25 million Zlotys. Romania is now the only country that limits foreign participation to 49%. *See* Albeseder, *Joint Venture Developments in Eastern Europe*, 29 EUR. TAX'N 270, 272-73 (1989).

[84] Decree 1405, *supra* note 43, para. 31.

The joint venture is not required to have a minimum capital,[85] and the participants are free to contribute cash or noncash assets.[86] Contributions made by the Soviet partner are likely to be buildings, machinery, real estate, and rubles, while contributions of the foreign partner are likely to be licenses, technology, machinery, and foreign currency.[87]

b. Management

Acquisition of Western management methods is one of the primary objectives in permitting foreigners to own equity in Soviet joint ventures; therefore, the law allows the partners to decide issues regarding management.[88] The original Joint Venture Decree required the Chairman of the Board and the Director General to be Soviet citizens.[89] This requirement was repealed, and under the new joint venture legislation, the Soviets have responded by allowing foreign citizens to be both Chairman and Director General.[90]

Representation on the Board is not required to be determined by ownership, but members of the board are "persons appointed by the participants."[91] Western investors are not likely to accept an arrangement in which they do not have at least an equal voice in management. Therefore, negotiators should contract for at least equal representation on the Board of Directors, or alternatively, that major decisions by the Board be made by unanimous decision. The new Joint Venture Decree provides that the principle of unanimous decisions is extended to all "fundamental issues."[92] Because the Decree does not provide guidelines, the term should be defined in the agreement.[93]

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85 "The Soviet state and the participants in a joint enterprise shall not be liable for its obligations, and the joint enterprise shall not be liable for the obligations of the Soviet State and of its participants." Joint Venture Decree 49, *supra* note 40, para. 18. Because the joint venture's liability is limited to its capital contribution, the lack of a minimum capital investment is somewhat surprising. Paragraph 18 further provides that affiliates established by the joint venture are not liable for the joint venture nor is the joint venture liable for its affiliates. *Id.*

86 The law requires the joint venture to transfer profits to reserve funds until this amount reaches 25% of the registered capital. *See infra* note 241 and accompanying text.

87 The Soviet and foreign venture partners value their respective contributions in rubles by agreement "with due regard for world market prices" and at the official exchange rate established by Gosbank on an agreed date. *See infra* notes 132-43 and accompanying text.

88 *See* Joint Venture Decree 49, *supra* note 40, para. 21.

89 *Id.*

90 Decree 1405, *supra* note 43, para. 31. While the management under the Romanian joint venture legislation must consist of Romanian citizens, the Bulgarian, Hungarian and Yugoslavian all allow foreign management. Albeseder, *supra* note 83, at 274-75. The Czechoslovakian legislation of Jan. 1, 1989, does not state whether the management must consist of Czechoslovakian citizens. Bakes, *supra* note 8, at 88.

91 Joint Venture Decree 49, *supra* note 40, para. 21.

92 Decree 1405, *supra* note 43, para. 31.

93 Major decisions may include the types and quantities of goods to be produced,

Even though the Board of Directors, partners, and government officials have vested interests in the joint venture, the on-site management must be free to make decisions without excessive interference. Soviet enterprises traditionally have been operated by one-person management in which only one director is responsible.[94] Because one-person management does not allow shared management, the foreign joint venture partner should contract for a departure from Soviet tradition, especially when one considers the managerial secrecy generally surrounding Soviet enterprises. Given the benefits derived by the management participation of the Western partner, the Soviets are likely to depart from these traditions.[95]

c. *Labor Relations*

Labor relations in the Soviet Union are highly regulated and raise some important issues in operating the joint venture.[96] Except

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sources and types of raw materials and components, export and domestic marketing, and labor relations policies. Aronson, *supra* note 27, at 873. In a recently signed joint venture agreement, major decisions included provisions on additional funding from partners and outside loans, business expansion plans, and allocation of awards, bonuses, and reserve funds, all of which required a unanimous vote by the Board of Directors. Laurita & McGloin, *US-Soviet Joint Ventures: Current Status and Prospects*, 23 COLUM. J. WORLD BUS., Summer 1988, at 43, 48-49. Another list of "fundamental" considerations includes the following: annual budgets; investment and construction plans; comprehensive production and marketing plans; potential changes in the purposes of the joint venture; transactions that may be made in excess of given amounts; purchases of various types of property; loans in excess of given amounts and given repayment periods; amendments to foundation documents and contracts; changes in capital structure and amount of capitalization, including reversion to ownership shares, transfers of shares, and mergers with other juridical persons; establishment of other branches or representation offices; election of key personnel, including the Chairman of the Board and Director General, and their continuation in office; approval of important documents such as profit and loss accounts, financial statements, and tax returns; periodic or special distribution (or nondistribution) of specified company funds; acquisition, use, and disposition of intellectual property rights; and termination and liquidation of the joint venture. E. THEROUX & A. GEORGE, JOINT VENTURES IN THE SOVIET UNION: LAW AND PRACTICE 21-22 (1989).

94 Although assistant directors may conclude contracts in the name of the enterprise, the managing director undertakes sole responsibility. Pedersen, *supra* note 33, at 431. Because the managing director is alone responsible, the contract should provide for departure from the strict Soviet liability rules traditionally imposed on the director.

95 Aronson, *supra* note 27, at 875.

96 One source lists seven different employer-employee relationships that exist under Soviet law and employment contracts:

> 1) the employer is obligated to hire a specific employee who is obligated to work for the specific employer; 2) the employer is obligated to hire a specific employee who is obligated by law to work, but not obligated to work for the specific employer; 3) the employer is obligated to hire a specific employee who is under no obligation to work at all; 4) the employer is indirectly compelled by its production plan to hire a certain number of employees to meet production targets and hires an individual who is obligated by law to work, but not for that employer; 5) the employer is indirectly compelled by its production plan and hires an individual who is under no obligation to work; 6) the employer is under no obligation to hire, but the individual is under legal obligation to work; 7) the employer is under no obligation to hire, and the individual is under no obligation to work.

O. IOFFE & P. MAGGS, *supra* note 14, at 161.

for wages, vacation, and pension, the Soviet legislation allows labor relations to be stipulated in the joint venture agreement.[97] Even though negotiators should contract for labor relations that accommodate Western management methods, the foreign partner may be pressured to agree to the Soviet labor system.[98] Trade union committees should be included in the negotiations over the joint venture agreement, as Soviet law requires the joint venture to conclude collective bargaining agreements with trade unions.[99] With the exception of military personnel and collective farmers, all Soviet citizens are members of a trade union.[100] At the factory level, the local trade union committee administers all matters affecting the employees, enforces labor legislation and safety rules, and advocates employees interests in wage and dismissal matters.[101] The local unions should be included in the negotiations involving labor conditions, thereby avoiding potential disputes between management and employees.[102]

An employer's ability to exercise discretion over employees is important in maintaining quality control, but this ability is limited by Soviet labor law and the joint venture law, which provide various protection measures for the Soviet employees.[103] Products of marketable quality are of major concern to the foreign partner in the Soviet joint venture.[104] A state quality board (*Gospriyemka*) controls product quality. However, because the Soviet standard is not difficult to meet, higher product quality is required to compete in foreign markets.[105] The ability to trade in foreign markets is of special concern to the foreign partner since repatriation of profits depends on the income paid in foreign hard currency.[106]

Control over compensation of employees may enable the foreign partner to control product quality.[107] Many people mistakenly

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97 Joint Venture Decree 49, *supra* note 40, para. 48. *See* Carpenter & Smith, *U.S.-Soviet Joint Ventures: A New—Beginning in the Fall*, 43 BUS. LAW. 79, 82, 87-88 (1987).

98 Aronson, *supra* note 27, at 875.

99 Joint Venture Decree 49, *supra* note 40, para. 47.

100 Aronson, *supra* note 27, at 875.

101 O. IOFFE & P. MAGGS, *supra* note 14, at 159.

102 Aronson, *supra* note 27, at 877.

103 *See* O. IOFFE & P. MAGGS, *supra* note 14, at 157-78.

104 For a discussion of the product quality in selected industries, see generally M. HILL & R. MCKAY, SOVIET PRODUCT QUALITY (1988).

105 O. IOFFE & P. MAGGS, *supra* note 14, at 292-93. Soviet enterprises employ "enterprise standards" to reduce costs and guarantee the quality of supply sources; the industrial ministries likewise publish "industrial standards." By law, both sets must comply with the nation's "state standards" of adequate quality. *See* M. HILL & R. MCKAY, *supra* note 103, at 8-15. On Aug. 31, 1988, the U.S.S.R. State Committee issued regulations imposing ceilings on prices set by private enterprises. The regulations require private persons to set prices that are no greater than 10% above the state standard price. Decree on Certain Questions Concerning the System of Pricing in Connection with the Coming into Force of the U.S.S.R. Law "On Cooperatives in the U.S.S.R.," 12 BULL. NORM. AKT. MIN. & VED. SSR 3-4 (1988). *See* Osakwe, *supra* note 2, at 13 n.17.

106 *See infra* notes 144-59 and accompanying text.

107 For a discussion proposing the Soviets implement the Japanese labor system, see

believe that the Soviet Union is a country with vast resources of inexpensive labor. In reality, the Soviet Union is a country with labor shortage, due primarily to its ideological commitment to provide full employment.[108]

The Soviet government originally enforced a wage system which allowed very little differentiation between employees.[109] Wages paid to Soviet employees of the joint venture are regulated by the standards of Soviet law, which now provides for an incentive wage system.[110] Rather than wages being determined on state level, wages will be determined on the factory level.[111] This enables foreign partners to negotiate for a wage incentive system in the joint venture agreement.[112]

Soviet law guarantees citizens employment at the State minimum wage or above.[113] This constitutional guarantee entitles the Soviet employee to a degree of security to which some foreign employers are not accustomed. The joint venture partner can determine wages and bonuses, subject to the minimum wage guarantee.[114] While management now has the right to dismiss employees for reasons specified in Soviet legislation, the law originally required prior consent of the local trade union committee.[115] The legislation adopted on December 2, 1988, provides that issues of dismissal are decided between the partners.[116]

Despite these changes, and the changes that are occurring in the regulations, it remains difficult to dismiss employees.[117] Foreign partners are not likely to be given discretion to hire and fire, but negotiators may contract for objective performance and productivity

Khrutskiy, *Japan as a Model for Soviet Reform*, 1 GLOBAL ECON. POL'Y 31, 47 (1989) ("Restructuring in the Soviet Union would be better served by looking to Japan rather than the United States.").

108 Laurita & McGloin, *supra* note 93, at 49.

109 O. IOFFE & P. MAGGS, *supra* note 14, at 159-60.

110 Decree 1405 provides in part: "[M]atters concerning the employment and dismissal of staff, the amounts and conditions of pay and the amounts of remuneration of employees in Soviet rubles shall be decided by the joint venture." Decree 1405, *supra* note 43, para. 31.

111 *Id.*

112 Aronson, *supra* note 27, at 877.

113 *Id.*

114 Soviet law states that "provisions of work agreements deteriorating the situation of all workers and employees in relation to the law on labor of the U.S.S.R. and Union Republics are invalid." KZoT RSFSR (Labor Code), art. 5 (1964). This law applies to all agreements that establish labor conditions. USSR ACADEMY OF SCIENCES, *supra* note 46, at 136. Moreover, the U.S.S.R. considers this labor legislation to apply to Soviet citizens working abroad. *Id.* at 135-36.

115 O. IOFFE & P. MAGGS, *supra* note 14, at 174-75.

116 Decree 1405, *supra* note 43, para. 31.

117 The employee is free to terminate the labor contract by giving two months notice. O. IOFFE & P. MAGGS, *supra* note 14, at 169. Employees fall into three groups with respect to discharge: 1) ordinary employees with no special protection against discharge; 2) ordinary employees with special protection against discharge; and 3) employees with special responsibilities who may be discharged on both special and ordinary grounds. *Id.* at 170.

standards. The joint venture agreement may provide for committees to review complaints against employees and to bring cases before the local trade union committee.[118] Although foreign partners may have no choice but to agree to the Soviet constitutional employee guarantees, in order to enhance productivity the Soviets should be willing to accept some sort of disciplinary action against poor performance.[119]

Although the law provides that "the personnel of joint ventures shall be made up principally of Soviet citizens,"[120] it does not limit the number of foreigners permitted to be employed by the joint venture. Interpretations of the law indicate that the Soviets are reluctant to accept an unlimited number of foreign employees.[121] Therefore, it is important that the agreement provides for the employment of as many foreign employees as are required by the foreign partner.

d. *State Relations*

By law, the joint venture is independent from central planning and its assets are separate from the state budget.[122] Although foreign companies might find this independence advantageous, it could prove to be a disadvantage. The Soviet Central Plan determines the allocation of supplies and raw materials throughout the domestic economy.[123] Without integrating the joint venture into the central plan, the joint venture could face a shortage of needed materials.[124] This would necessitate suspending production or spending foreign currency to import needed supplies. This independence from central planning could therefore "undermine the benefits of having access to Soviet production materials."[125] To avoid a shortage of supplies, the joint venture should be coordinated with the Central Plan.[126] The management should project the needed raw materials and other supplies as well as a delivery timetable and submit these to central planning authorities.[127] The agreement should guarantee

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118 Aronson, *supra* note 27, at 876.

119 The U.S.S.R. Academy of Sciences has recognized the increasing role of joint ventures in setting terms and conditions of employment such as "questions of hire and dismissal of workers [and] the forms and size of payment. . . ." USSR ACADEMY OF SCIENCES, *supra* note 46, at 146.

120 Joint Venture Decree 49, *supra* note 40, para. 47.

121 Aronson, *supra* note 27, at 877.

122 Joint Venture Decree 49, *supra* note 40, paras. 6 & 15.

123 O. IOFFE & P. MAGGS, *supra* note 14, at 105-14.

124 Facilitating production, however, are recent regulations that enable joint ventures to qualify for one-year, renewable "general permits" for "the import and export of goods required" to operate the ventures. Regulations of Mar. 27, 1987, "For the Issuance of Permits for Shipping Goods and Property into and out of the U.S.S.R., and for Re-export of Goods," para. 2.4, *reprinted in* D. KELLEY & J. SAUL, *supra* note 40, at 104.

125 Aronson, *supra* note 27, at 877.

126 *See* Dore, *Plan and Contract in the Domestic and Foreign Trade of the USSR*, 8 SYR. J. INT'L L. & COM. 29, 87-89 (1980).

127 Aronson, *supra* note 27, at 877.

that the schedule is incorporated into the Central Plan. Provisions should also be made for access to supply reserves in the event of an unforeseen need. Negotiators should attempt to contract for freedom from unlimited government inspections and freedom to seek sources of supply outside the Soviet Union if Soviet domestic products fail to meet stipulated quality standards, to avoid some of the negative effects of being incorporated in the Central Plan.[128]

Apart from central planning, the law creates a different relation between the joint venture and the Soviet government. The FTOs are required to act as intermediaries for sales and purchases of domestic products.[129] Given the importance of the FTOs, the joint venture agreement should allow the joint venture partners to choose specific FTOs with experience in domestic sales. The reliance on FTOs for domestic marketing has both advantages and disadvantages for the foreign partner.[130] The FTO may prove useful to foreigners unfamiliar with the Soviet market and uncertain as to the demand for various goods, but foreign negotiators should contract for an alternative relationship with the domestic market. Because of the conflict between the Soviet interest in exports and foreigners' interest in domestic sales, the FTOs may receive directions from the Ministry of Foreign Trade to focus on exports rather than domestic sales, or may seek to prevent the joint venture from competing with Soviet enterprises.[131] In addition, the use of FTOs will raise costs since the FTO must be paid a commission. The potential foreign investor should, therefore, negotiate for the right to sell joint venture products directly to those domestic enterprises which enjoy foreign trade rights. Likewise, the joint venture should be able to obtain supplies directly from the appropriate ministry rather than through FTOs.

e. *Foreign Currency*

Foreign currency is required both for operating the joint venture and for repatriating profits in convertible currency.[132] Estab-

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[128] USSR ACADEMY OF SCIENCES, *supra* note 46, at 110-16.

[129] Although the joint venture may transact necessary export and import operations independently under Joint Venture Decree 49, *supra* note 40, para. 24, the joint venture's domestic purchases and sales must "be effectuated . . . through the respective Soviet foreign trade organizations." *Id.*, para. 26.

[130] For a discussion of the working relationship with the FTO, see Vlachoutsicos, *Where the Ruble Stops in Soviet Trade*, 64 HARV. BUS. REV., Sept.-Oct. 1986, at 82.

[131] *See* Aronson, *supra* note 27, at 855-61.

[132] For example, under the Polish joint venture legislation of Feb. 15, 1989, the joint venture must resell 15% of its export income, in foreign currency, to the Polish Foreign Exchange Bank. The President of the Foreign Investment Agency may lower this rate where economically justifiable at the establishment of the joint venture. After the standard resale of foreign currency, the joint venture may use or distribute any remaining currency. The profits for foreign shareholders are freely transferable. Czubinski, *Poland: New Foreign Currency Law and Joint Venture Activity*, 29 EUR. TAX'N 235, 236-37 (1989). On Apr. 20, 1990, the Czechoslovak Parliament adopted a similar measure, requiring joint ventures operat-

lishing the joint venture's operation and paying for imports and wages to non-Soviet employees requires foreign currency.

The foreign currency problem should be limited by maximizing ruble expenses and minimizing foreign currency expenses.[133] Also, the foreign currency needed to repatriate profits could be eliminated if the joint venture made noncash distribution to the foreign partner.[134] However, in most cases the problem cannot be eliminated. Without the guarantee of sufficient foreign currency to repatriate dividends or capital distributions, foreign companies are not likely to assume the joint venture risk. Although the law guarantees repatriation of profits,[135] it does not guarantee sufficient foreign currency, thereby leaving the joint venture on its own.[136] One solution is for the joint venture partners to agree to the foreign partner retaining the foreign currency profits in exchange for the Soviet partner retaining an equivalent share of ruble profits.[137] Assuming that each of the partners owns a fifty percent share with the joint venture realizing profits of one hundred dollars and one hundred rubles, each partner realizes profits of fifty dollars and fifty rubles. Instead the partners could agree that the foreign partner retain the one hundred dollars, in return for which the Soviet partner would retain its fifty rubles plus the rubles equivalent of fifty dollars. Another approach is for Soviet enterprises with accumulated foreign currency to purchase the products of the joint venture for foreign currency.[138]

Furthermore, the law is silent regarding the convertibility of rubles into foreign currency, which is significant to the joint venture that produces goods for the domestic market. One commentator has suggested that the joint venture agreement could permit the joint venture to borrow foreign exchange from foreign partners or foreign financial institutions.[139] The repayment of these loans in convertible currency should then be guaranteed by the Bank for Foreign Trade, rather than by the joint venture partner. Whatever means negotiators choose, it is important that the foreign investor is guaranteed sufficient foreign currency to repatriate profits in the event that ex-

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ing abroad to convert at least 30% of their hard currency profits into the Czech crown. *Czech Reform*, *supra* note 83, at A-7, col. 1.

[133] Sherr, *supra* note 30, at 28-29.

[134] See Note, *The 1987 Soviet Joint Venture Law: New Possibilities for Cooperation and Growth in East-West Relations*, 17 DEN. J. INT'L L. & POL'Y 581, 589-91 (1989) [hereinafter Note, *1987 Joint Venture Law*] for a discussion of import substitution, allowing the joint venture to use greater amounts of foreign currency, and countertrade.

[135] Joint Venture Decree 49, *supra* note 40, para. 32.

[136] Joint ventures require foreign currency for several reasons. For one, only profits from foreign sales may be transferred out of the U.S.S.R. *See id.*, para. 32. In addition, enterprises require foreign currency to import products and technology and to pay non-Soviet employees.

[137] Sherr, *supra* note 30, at 28.

[138] *Id.*

[139] Aronson, *supra* note 27, at 863.

ports fail to generate the income required for those purposes. Arguably, without such assurance, "the investment in the joint venture would be unjustifiably risky to the foreign partner and disproportionately beneficial to the Soviets."[140] Even though the law guarantees foreign partners that distributions of profits from the joint venture will be converted into foreign currency,[141] the law also provides that the joint venture will receive no state subsidies.[142] The joint venture is expected to generate the required foreign exchange entirely through export activities.

The law does, however, permit the joint venture to take advantage of the foreign currency credits from the State Bank and the Bank of Foreign Trade.[143] The credit provision is important to the joint venture, especially before it has been able to accumulate foreign currency, but is available only "if needed." If the foreign partner expects to rely on the foreign currency credit, it is important that the term is defined as broadly as possible.

f. Valuation

Currency problems in Eastern Europe, and the Soviet Union in particular,[144] cause considerable concern among foreign investors.[145] Recent Soviet interest in joining the International Monetary Fund and the World Bank demonstrates their intent of becoming integrated into the world economy.[146] Because membership is not possible with an inconvertible currency such as the ruble, the Soviets announced their intent to make the ruble at least partially convertible by the early 1990s. The December 2, 1988, legislation introduces both a new currency rate as of January 1, 1991, and auctions of foreign currency by *Vnesheconombank*.[147] The legislation also commissioned a feasibility study on the convertibility of the ruble.[148]

The problems concerning both the inconvertibility of the Soviet

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140 *Id.*

141 Joint Venture Decree 49, *supra* note 40, para. 32.

142 *Id.*, para. 23.

143 *Id.*, para. 27. However, the State Bank and the Bank for Foreign Economic Affairs may ensure that credits are put to specific uses, are secured, and are paid for timely. *Id.*, para. 28.

144 The Soviets have several incentives for setting a fair value to the ruble: 1) Fair rates will encourage foreign interest in joint ventures; 2) The more joint ventures prosper in the Soviet Union, the more the ruble spreads around the world; this alone may enhance the integrity of the ruble in the free market; and 3) An overvalued ruble harms chances for future respect in the international market. Note, *1987 Joint Venture Law*, *supra* note 134, at 589 n.52.

145 Kelley, *The Soviet Joint Enterprise Decree: An Executive Summary and Overview*, in D. KELLEY & J. SAUL, *supra* note 40, at 2.

146 *See supra* notes 30-32 and accompanying text.

147 Decree 1405, *supra* note 43, para. 16.

148 *Id.*

domestic currency and valuation should be addressed in the joint venture agreement. As the value of the ruble is not determined objectively on the international exchange market according to supply and demand, the exchange rate does not reflect the relative value of foreign currency. Valuation is particularly a problem in the formation, when the partners make their capital contributions.

Several models attempt to resolve the valuation problem in Western joint ventures with socialist economies.[149] The Soviet joint venture law incorporates the "calculation system," which provides valuation in both a specific foreign currency and the socialist currency on the basis of an agreed upon exchange rate.[150] The adopted calculation system is modified to value contributions in rubles according to the agreement reached "with due regard for world market prices," given the official exchange rate established by *Gosbank* on a date agreed upon by the partners.[151]

This method contains disadvantages in the imposition of an administrative burden on the joint venture and the difficulty in valuation of the Soviet contribution, typically real estate, machinery, or technology, which can not be readily compared to world market prices.[152] Even good faith efforts to establish reasonable values may be difficult due to the lack of precedent and comparable assets on the world market. Therefore, the meaning of world market prices should be carefully negotiated and defined in the agreement.

The official Soviet exchange rate for convertible currency causes a related problem.[153] Because the foreign joint venture partner most likely will contribute either foreign currency or assets valued in foreign currency, the foreign partner is significantly prejudiced when the contributions are converted to their ruble equivalent at the exchange rate set by the State Bank. The Soviets generally overvalue the ruble greatly in comparison to convertible currencies. This results in an undervaluation of the foreign partner's contribution and reduces the partner's fair share of profits.[154] Standard valuation is also important for goods purchased by the joint venture on the domestic market as prices are determined by the State Committee on prices based on policy directives issued by the Council of Ministers.[155] Without insertion of standard valuation in the joint venture

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149 *See* Pedersen, *supra* note 33, at 397-98.

150 Aronson, *supra* note 27, at 864.

151 Joint Venture Decree 49, *supra* note 40, para. 12.

152 USSR ACADEMY OF SCIENCES, *supra* note 46, at 102.

153 The effective Soviet exchange rate fluctuated between 0.823 and 0.678 rubles per dollar from 1972 to 1987. P. COWITT, 1986-1987 WORLD CURRENCY YEARBOOK 701, 706 (1989). In addition to these commercial rates, the Soviet Union offers a special exchange rate for non-commercial transactions, such as tourism. The ruble is significantly more expensive on this exchange, presently averaging $1.650 per ruble.

154 Aronson, *supra* note 27, at 866.

155 O. IOFFE & P. MAGGS, *supra* note 14, at 39-40.

agreement, the profits accruing to the foreign partner could be determined arbitrarily by Soviet bureaucrats.

Standard valuation should also include import substitutes produced by the joint venture. Standard pricing is particularly important with respect to import substitutes produced by the joint ventures, because prices in the Soviet Union are determined by the State Committee on prices.[156] Standard valuation requires adjustment in the Central Plan, and could thus incur some resistance.[157] It has been suggested that prices should be fixed in terms of foreign hard currency[158] and then be converted to rubles for Soviet accounting purposes.[159] Domestic sales to the FTOs would then be made in convertible currency and the FTOs would sell the products on the domestic market for rubles, which then could be maintained in convertible currency accounts.

g. Dispute Resolution

Disputes between joint ventures and State organizations, or between the partners, can be resolved either by Soviet courts or by arbitration. Ordinarily, disputes between Soviet state organizations are settled in the State *Arbitrazh*, a combined court and administrative agency that adjudicates according to the Central Plan.[160] Given its orientation toward state interests and its commitment to protect the Central Plan,[161] the *Arbitrazh* is not suitable from the Western partner's perspective.[162] Instead, the agreement should provide for arbitration to resolve these conflicts.[163]

The Soviet Foreign Trade Arbitration Commission, with its international reputation for competence and fairness,[164] may prove to be an effective arbitration tribunal. An alternative is arbitration by a neutral tribunal operating under UNCITRAL Arbitration Rules.[165] Even though the agreement binds both parties to the decisions of the

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156 *Id.*

157 For a discussion of integration into *Gosplan*, see O. IOFFE & P. MAGGS, *supra* note 14, at 108-09 and 158-59.

158 For a discussion of the value of the ruble as against other currencies and gold, see P. COWITT, *supra* note 153, at 701-11.

159 Aronson, *supra* note 27, at 866-67.

160 Pedersen, *supra* note 33, at 398-99.

161 If the partners fail to stipulate the manner of settling disputes, the matter becomes one for the Soviet courts. *See* Joint Venture Decree 49, *supra* note 40, para. 20.

162 Pedersen, *supra* note 33, at 433-34.

163 Partners should even stipulate a specific arbitration tribunal rather than merely repeat the text of Joint Venture Decree 49, *supra* note 40, para. 20. USSR ACADEMY OF SCIENCES, *supra* note 46, at 76.

164 Pedersen, *supra* note 33, at 434-35.

165 In 1977 the American Arbitration Association and the U.S.S.R. Chamber of Commerce and Industry agreed on a model contract clause on arbitration providing for settlement of U.S.-U.S.S.R. commercial disputes in Stockholm, Sweden. However, use of the provision is optional. *See* Shillinglaw & Stein, *supra* note 14, at 18-19. For a discussion of whether disputes should be settled by an arbitration tribunal in a third country, see USSR

tribunal, it should include rules for enforcing the arbitration decision against the Soviet partner. Because arbitration is costly and time consuming, the parties should provide for informal dispute resolution to resolve minor conflicts that may arise during the operation of the joint venture.[166]

C. *Dissolution*

Foreign joint venture partners should be particularly careful in negotiating the dissolution of the joint venture. The Council of Ministers may liquidate a joint venture if its operations are not in accordance with the objective outlined in the foundation documents.[167] Because the law does not define the degree to which the joint venture would have to depart from its objective in order to trigger dissolution, the joint venture agreement should provide for standards that determine the objectives of the joint venture. The contract should also define and limit the circumstances justifying termination by the Soviet government. Arbitration should be required before the state can dissolve the joint venture. The joint venture agreement must provide the reasons for which the joint venture may be voluntarily dissolved.[168]

The joint venture law provides that the Soviet partners have a preferential right to acquire the shares of the foreign partners.[169] The shares can not be assigned to third parties without the permission of the State Foreign Economic Commission of the Council of Ministers and mutual agreement of the joint venture partners.[170] Furthermore, the Soviet priority right to joint venture shares could restrict foreign partners' profit maximization upon dissolution. The foreign joint venture partner should require a provision to prevent the Soviet priority right from being used to force a sale of shares to the Soviet partner at a lower price than would be available to a third party.[171] The agreement should also provide the foreign partner with preferential right to acquire the shares of the Soviet partners.

The Joint Venture Decree provides that upon dissolution or voluntary withdrawal the foreign partner is entitled to return of its contribution in cash or in kind.[172] The joint venture agreement should provide for monetary return of contributions, and prevent the for-

ACADEMY OF SCIENCES, *supra* note 46, at 77 (concluding "most rational" way to settle disputes would be arbitration in the U.S.S.R.).

166 Pedersen, *supra* note 33, at 436. *See* O. IOFFE & P. MAGGS, *supra* note 14, at 174-75 (Soviet labor law provides special procedures for settling labor disputes).

167 Joint Venture Decree 49, *supra* note 40, para. 51.

168 *Id.*, paras. 7 & 8.

169 *Id.*, para. 16.

170 *Id.*

171 Aronson, *supra* note 27, at 885-86.

172 Joint Venture Decree 49, *supra* note 40, para. 52.

eign partner from being forced to accept repayment in kind.[173] The joint venture agreement should ensure that the guarantee of repatriation of profits in convertible currency is permitted irrespective of the reason for terminating the joint venture.[174]

III. The Soviet Tax System

A. *General Structure*

Like those of most Eastern European countries, the Soviet tax system is comparatively simple.[175] Although some Soviet enterprises such as collective farms, cooperatives, and public organizations are technically separate from the state budget,[176] the means of production belong to the state. This fact makes it redundant to tax domestic entities. Similarly, the rejection of profit as an incentive and the lack of wage differentiation makes it less important to subject individuals to income taxation. However, the Soviet Union does tax both domestic entities and individuals.[177]

The turnover tax and the taxes on profits are the most important taxes imposed on Soviet entities.[178] The turnover tax is imposed only once during production and distribution.[179] The applicable rates are based on the product involved, the enterprise producing it, and the jurisdiction in which that enterprise is located.[180] Profits

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173 Aronson, *supra* note 27, at 886.

174 Sherr, *supra* note 30, at 35.

175 *See generally* Kuiper, *The Structure and Developments of Socialist Tax Law From a Western Point of View*, 39 BULL. INT'L FISCAL DOCUMENTATION 484 (1985); 1-2 J. VAN HOORN & T. NAGY, TAXATION IN THE EUROPEAN SOCIALIST COUNTRIES (1981); Stern, *Taxation in East European Countries*, 20 EUR. TAX'N 106 (1980).

176 Some state enterprises subject to taxation operate on the principle of economic *khozraschet* and thus are considered independent entities with capital, assets, budget, and accounts separate from the state budget. *See supra* note 14 and accompanying text.

177 In 1983, 91.75% of the total state revenue of 357.9 billion rubles was derived from taxes on state and nonstate enterprises while individual taxes accounted for only 9.25%. M. NEWCITY, TAXATION IN THE SOVIET UNION 48 (1986).

178 *See, e.g.*, Regulation of the U.S.S.R. Council of Ministers of June 30, 1975, "On the Approval of Regulations on the Turnover Tax," 1975 SP SSSR No. 17, item 108, at 330-56; Instructions of the U.S.S.R. Ministry of Finance of Dec. 31, 1975, *printed in* 9 BULL. NORM. AKT. MIN. & VED. SSR 12-32 (Sept. 1976); Decree of the Presidium of the U.S.S.R. Supreme Soviet of Mar. 1, 1979, "On the Income Tax on Cooperative and Public Organizations," 1979 Ved. Verkh. Sov. SSSR No. 10, item 156, at 152-53; and Decree of the U.S.S.R. Council of Ministers of Mar. 1, 1979, "On Exemptions from the Income Tax on Cooperative and Public Organizations," 1979 SP SSSR No. 7, item 40, at 161-64. Together these taxes in 1983 accounted for 89% of total revenue from the taxation of enterprises. M. NEWCITY, *supra* note 177, at 49.

179 The turnover tax is imposed on the receipts from sales of goods at the retail or wholesale level. The tax also falls on monies awarded pursuant to judicial or arbitral decisions over certain commercial disputes. M. NEWCITY, *supra* note 177, at 50.

180 The products subject to the turnover tax include commodities and manufactured goods, and the enterprises liable for payment include factories, industrial trading organizations, and cooperatives. *Id.* at 52. Neither the Statute on Turnover Tax nor the joint venture legislation indicates whether joint ventures are subject to this tax. *See* Howell, *Tax in the U.S.S.R.: The New Joint Venture Legislation*, 15 TAX PLAN. INT'L REV. 7, 9 (1988) (suggesting the turnover tax does not apply to joint ventures).

generated by Soviet enterprises are channelled into the state budget through what is ultimately a one hundred percent tax rate.[181]

The Soviet Union imposes two income taxes on Soviet individuals: 1) an income tax on the population, imposed on employees in factories and offices, recipients of other earned wages[182] or royalties,[183] and those engaged in professional practice;[184] and 2) a tax on bachelors, single citizens, and citizens with small families.[185] Individuals are taxed both on their domestic and foreign source income.[186] Additionally, local taxes are imposed under a 1981 Decree on Local Taxes and Collections[187] in three forms: 1) a tax on possessors of structures;[188] 2) a tax on land;[189] and 3) a tax on possessors of means of transportation.[190] All three taxes apply to foreign enterprises, and the first two to Soviet enterprises.

The Statute on the State Enterprises requires state enterprises to make a payment for labor resources.[191] This payment reimburses the state for job training, social and cultural opportunities, and other public services for employees and members of their families. This payment is not designated as a tax,[192] and it is unclear whether it

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181 Enterprises that operated separately were taxed originally at rates ranging from 10% to 81%. This system was amended in 1965 but has only been partially implemented. M. NEWCITY, *supra* note 177, at 53. Under the 1965 system the amount paid into the state budget is the difference between planned profits and the amount of profits used for internal needs and purposes. The rate of the deduction from profits is the difference between the amount of profits provided for in the joint venture's financial plan and the amount used for expenditures. *Id.* at 53-54. This difference is paid into the state budget. Fifty per cent of any profits in excess of this amount goes to the state budget, twenty-five per cent to higher authorities, and the enterprise keeps the remaining twenty-five per cent until the year-end reconciliation. At that time, the enterprise pays this latter amount into the state budget. *Id.* at 54-55. For alternative means of taxation under this system, see *id.* at 55-59.

182 The maximum tax rate of 13% applies to income in excess of 100 rubles per month. Income of less than 71 rubles is not taxable. *Id.* at 90.

183 The tax levied on royalties received within the Soviet Union varies between 1.5% on income of less than 180 rubles to 13% on income in excess of 1200 rubles. *Id.* at 95.

184 Individuals in private professional practice are taxed at rates substantially higher. On the first 300 rubles of income, the tax is only 15 rubles; the tax becomes 10% of income between 300 and 7,000 rubles. On income in excess of 7,000 rubles, however, the tax ranges from 14% to 69%. *Id.* at 102.

185 Single citizens and citizens with small families are taxed to encourage the growth of families. The taxes range from 2.8% on income of 71 rubles per month to 6.0% on income in excess of 90 rubles per month. *Id.* at 111. These rates apply only to employees in factories and offices or to individuals treated as such. All other wage-earners are taxed at a flat 6% tax rate. *Id.* at 112.

186 Decree of the Presidium of the U.S.S.R. Supreme Soviet of Oct. 20, 1983,"On the Income Tax on the Population," 1983 Ved. Verkh. Sov. SSSR No. 43, item 653, para. 5(5).

187 Decree of the U.S.S.R. Supreme Soviet of Jan. 26, 1981, "On Local Taxes and Dues," 1981 Ved. Verkh. Sov. SSSR No. 5, item 121, at 83-90.

188 For a discussion of the tax on possessors of structures, see M. NEWCITY, *supra* note 177, at 138-44.

189 For a discussion of the tax on land, see *id.* at 144-46.

190 For a discussion of the tax on possessors of means of transportation, see *id.* at 146-51.

191 M. NEWCITY, *supra* note 177, at 67-68.

192 *Id.* at 67.

applies to joint ventures.[193] The tax laws also impose a tax for the use of basic assets.[194] The tax consists of a percentage charge differentiated by industry and is paid on the book value of each enterprise's capital assets other than natural resources.[195] The tax provides an incentive to enterprises to economize the use of capital assets. Finally, employers are required to make social insurance contributions as a percentage of total wages including bonuses. The percentage varies from industry to industry with fourteen percent being the typical rate.[196] Under this system, the employee pays no social insurance.

B. *Taxation of Foreign Entities*

Although foreign entities had never been exempt from domestic taxes, the Soviet Union generally did not tax foreign entities until 1978. Taxes were rarely assessed because the FTOs would establish the applicable taxes after negotiation with the foreign entities,[197] often exempting foreign entities from taxation altogether.[198] In 1978 the Supreme Soviet adopted Decree 313[199] under which the Ministry of Finance on October 5, 1978, issued regulations, ending the favorable tax status of foreign entities.[200]

Decree 313 imposes a forty percent tax on foreign legal entities[201] for income derived from economic activity in the Soviet

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193 Note, *Soviet Taxation of United States Businesses: State of the Law and Recommendations*, 42 TAX LAW. 801, 818 (1989) [hereinafter Note, *Soviet Taxation*].

194 Basic assets include buildings, structures, transmission systems, power plants and equipment, measuring instruments and control devices, means of transportation, and other resources. Instructions from the U.S.S.R. Ministry of Finance of Mar. 12, 1973, "On the Procedures for the Remittance into the Budget of the Payment for Basic Production Resources and Working Assets by Enterprises and Economic Organizations Transferred to the New System of Planning and Economic Stimulation," BULL. NORM. AKT. MIN. & VED. SSSR No. 10, para. 1; *see also* M. NEWCITY, *supra* note 177, at 56 (tax equals percentage of non-depreciable value of assets, uninstalled equipment, and working assets not obtained through bank loans).

195 M. NEWCITY, *supra* note 177, at 55-57.

196 *Id.* at 67.

197 *Id.* at 174-75.

198 *Id.* at 175.

199 Decree of the Presidium of the U.S.S.R. Supreme Soviet of May 17, 1978, "On the Income Tax on Foreign Legal Entities and Individuals," Ved. Verkh. Sov. SSSR No. 20, item 313, at 277-80 [hereinafter Decree 313], *translated by* Maguire & Stein, *USSR: New Income Tax on Foreign Legal Entities and Individuals*, 9 TAX MGMT. INT'L J. 3, 8 (1978). *See also* Kuiper, *U.S.S.R.: New Tax Rules Affecting Foreigners*, 18 EUR. TAX'N 268 (1978); Leahy, *The New System of Taxation of Foreigners in the Soviet Union*, 6 REV. SOCIALIST L. 85 (1980); Martinez, *Soviet Personal Taxation of Foreigners*, 19 COLUM. J. TRANSNAT'L L. 489 (1981).

200 Regulations of the Ministry of Finance of Oct. 5, 1978, "On the Procedures for Applying the Decree of the Presidium of the Supreme Soviet of the U.S.S.R. of May 12, 1978, on the Income Tax on Foreign Legal Entities and Individuals," No. 152 [hereinafter Decree 313 Reg.], *translated by* Simons, *Instruction on the Manner for Applying the Edict of the Presidium of the Supreme Soviet of the USSR of 12 May 1978, "On Income Tax from Foreign Juridical and Natural Persons,"* 6 REV. SOCIALIST L. 85-100 (1980). *See also* Leahy, *U.S.S.R. Instruction Concerning the New System of Taxation of Foreigners*, 19 EUR. TAX'N 6 (1979).

201 The regulations implementing Decree 313 define the term "foreign legal entity" to

Union. "Income" is defined under Paragraph 11(d) of Decree 313 as "monetary sums received from the performance of work, rendering of services, exploitation of copyrights, rights to inventions, industrial designs, process or formulas and similar rights, and also from the carrying out on the territory of the U.S.S.R. of other types of activity authorized in accordance with the established order."[202]

Foreign legal entities are exempt from income tax with respect to the following types of income:

> 1. Amounts paid with respect to foreign trade transactions and other agreements providing for importation of goods into the USSR and the provision of services;
>
> 2. Amounts of interest paid with respect to bank accounts and deposits in credit institutions in the USSR pursuant to credit agreements and banking operations;
>
> 3. Amounts paid for the reproduction in the USSR of scientific and other journals published abroad;
>
> 4. Amounts paid for performances in the USSR by artistic, musical and sporting groups and individual performers and athletes, as well as for the production of performances, programs and engaging in other entertainments and sporting activities.[203]

Foreign legal entities may deduct business expenses related to the activities conducted in the Soviet Union.[204] The Regulations specifically allow the following deductions:

> 1. Expenses for raw materials used in the production of goods destined for sale in the USSR;
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> 2. Expenses for payments of wages and other remuneration to persons fulfilling orders for Soviet organizations, for the administration of the legal person, and to personnel of its representation in the USSR;
>
> 3. Expenses for that part of research and development work relating to the fulfillment of agreements with the USSR, as well as advertising expenses;
>
> 4. Other production expenses, including expenses for routine repairs;
>
> 5. Non-production expenses, including transportation expenses connected with the delivery of goods to the USSR.[205]

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include "a company, firm, corporation, enterprise, association, as well as other organizations established according to the laws and rules of a foreign state." Decree 313 Reg., *supra* note 200, para. 3(a), *discussed in* M. NEWCITY, *supra* note 177, at 180-82.

202 It has been suggested that this definition of income lends itself to include income from all listed activities even if conducted outside the Soviet Union. Maguire & Stein, *supra* note 199, at 5.

203 Decree 313 Reg., *supra* note 200, para. 8. In addition, the regulations provide that the Ministry of Finance, in consultation with other interested ministries or agencies, may exempt other categories of income from taxation on a case-by-case basis. *Id.*, para. 10.

204 Decree 313, *supra* note 199, para. 3. The Ministry of Finance may also consider requests of taxpayers to deduct other expenses associated with the activities giving rise to taxable income. *Id.*, para. 16, *discussed in* M. NEWCITY, *supra* note 177, at 192-94.

205 Decree 313 Reg., *supra* note 200, para. 16. The Ministry of Finance may decide on a case-by-case basis whether the taxpayer may deduct other expenses. Shillinglaw & Stein, *supra* note 14, at 69.

Decree 313 encourages Western countries to sign an agreement with the Soviet Union, under which business and personal income earned on the other signatory's territory are exempt from taxation.[206] Paragraphs 6 and 7 establish the rule of reciprocity in applying the Decree. These provisions allow the Soviets to vary the rates at which foreign legal entities and individuals are taxed in the Soviet Union in order to ensure that the income earned will be taxed at rates comparable to those rates applied to the income of Soviet enterprises and individuals in the jurisdictions of the foreign entity or individual. Paragraph 6 provides for the adjustment of tax rates on foreign entities in the Soviet Union to match the tax rates applied in the respective foreign state to similar categories of income of Soviet enterprises and individuals.[207] Likewise, Paragraph 7 provides that the taxation of foreign entities and individuals may be eliminated or limited because of agreement between the Soviet Union and foreign states.[208] In addition, Paragraph 7 provides that the taxes imposed under Decree 313 may be lowered or eliminated with respect to taxpayers of a foreign country when that foreign country has taken similar measures with respect to Soviet taxpayers.[209] The reciprocity provisions are worded "may" and not "must."[210] Therefore, the reciprocity treatment is subject to the discretion of the Ministry of Finance. Although Soviet authorities reportedly[211] have taken steps to apply reciprocity treatment, it has not yet been put into effect.[212]

Foreign entities in countries that have concluded a tax treaty with the Soviet Union are not required to file tax returns with respect to exempt income.[213] Otherwise, foreign legal entities are informed in advance of the necessity of filing tax returns,[214] and the entity must file its tax return for the previous calendar year with the Administration of State Revenues of the Ministry of Finance by February 1.[215] The Ministry of Finance or local fiscal authorities operating on its behalf then calculate[216] and send a payment notice. The foreign entity must respond with proper payment either in rubles or

206 *See infra* notes 258-320 and accompanying text.

207 *See* M. NEWCITY, *supra* note 177, at 194-96.

208 Decree 313, *supra* note 199, para. 7.

209 Pending the completion of the France-U.S.S.R. Tax Treaty, *infra* note 258, France lowered taxes on Soviet enterprises and individuals or exempted them from taxation altogether. 2 J. VAN HOORN & T. NAGY, *supra* note 175, at 119.

210 M. NEWCITY, *supra* note 177, at 195.

211 Shillinglaw & Stein, *supra* note 14, at 68.

212 M. NEWCITY, *supra* note 177, at 196.

213 Some uncertainty remains, however, in light of the 1980 Soviet requirement that U.S. and F.R.G. companies file tax returns even with no income to report. *See* M. NEWCITY, *supra* note 177, at 200-01.

214 Decree 313 Reg., *supra* note 200, para. 14.

215 *Id.*

216 The Ministry of Finance may require a foreign entity and its representatives to submit accounts, documents, and any other information required to calculate the tax due. Decree 313, *supra* note 199, para. 23.

foreign currency[217] to the Soviet State Bank no later than March 15.[218] Late payment is penalized at the rate of 0.05% per day of the assessed tax.[219]

Foreign taxpayers that disagree with the tax assessment may appeal to the Minister of Finance within one year of payment.[220] Nevertheless, the appellant must pay the determined tax on time.[221] The Ministry of Finance considers the appeal within three months and its determination is final.[222]

C. *Taxation of Foreign Individuals*

Foreign nationals residing in the Soviet Union are taxed on their income earned in the Soviet Union "in the manner and the amounts provided for by legislation of the U.S.S.R. for the impositions of income tax on Soviet citizens."[223] The Soviet marginal tax rate is thirteen percent, giving a significant advantage to most foreign nationals.[224] Foreign employers, unlike domestic employers, are not required to withhold income taxes,[225] but are assumed to be responsible for payment of the tax.[226] The regulations allow the payment in rubles or in foreign currency at the option of the taxpayer,[227] but it is unclear whether the taxes withheld from a foreigner whose salary is in foreign currency may receive payment in rubles.

If the foreigner is a resident of a country with which the Soviet Union has signed a tax treaty, residency is determined in accordance with the treaty.[228] Otherwise, residency is determined under Soviet law to include "citizen[s] of the relevant foreign state, regardless of the actual place of residence or domicile of that person."[229] Decree 313 does not distinguish between foreign citizens who are permanently in the Soviet Union and those who are temporarily in the Soviet Union as both are subject to taxation on income earned in the Soviet Union.[230]

D. *Taxation of Joint Ventures*

The Joint Venture Decree of January 13, 1987, included provi-

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217 *Id.*, para. 20.
218 *Id.*, para. 18.
219 *Id.*
220 *Id.*, para. 9.
221 *Id.*
222 *Id.*
223 *Id.*, para. 4.
224 M. NEWCITY, *supra* note 177, at 231-32. This treatment also means that the principle of reciprocity may apply.
225 Shillinglaw & Stein, *supra* note 14, at 75.
226 *Id.*
227 *Id.*
228 *See infra* notes 267-71 and accompanying text.
229 *See* M. NEWCITY, *supra* note 177, at 212.
230 *Id.* at 212-13.

sions regarding the tax treatment of the joint venture.[231] The original provisions were amended under the Decree adopted December 2, 1988.[232] The distinction between equity joint ventures and cooperative joint ventures is important for tax purposes.[233] While foreigners participating in cooperatives are subject to taxation under Decree 313, the joint venture and its foreign participants are subject to taxation under the joint venture legislation.[234]

The joint venture legislation is far from clear in defining the tax treatment of the joint venture and its participants. The tax rules under Decree 49 are subtitled "Taxation of Joint Ventures." The rules refer to the joint venture as the taxpayer and seem to indicate that the joint venture is a separate taxpayer. The joint venture is, however, *not* a corporate construction subject to double taxation. Instead, the joint venture is treated as a combination of a corporation and a partnership. First, the income is not passed through to the participants and may be accumulated in the joint venture. Second, the income is taxed only once, in the hands of the partners generally in accordance with their ownership in the joint venture. Whether income distributed to foreign participants can be characterized as dividends is questionable. If not so characterized, it would most often be considered business income derived from a permanent establishment. However, some of the Soviet tax treaties specifically include profits of a Soviet joint venture as dividends under the tax treaty. It is evident that the joint venture legislation does not expressly stipulate whether joint venture profits in general should be considered dividends for domestic tax purposes.[235] This is important, especially for the treaties that do not contain any provision concerning dividends or do not specifically include joint venture profits as dividends.[236] If the foreign taxpayer is not protected under a tax treaty, the question becomes redundant since the income will be taxed at the rates provided under the joint venture legislation.

Under the Decree a two year tax holiday is granted to joint ventures.[237] The December 2, 1988, legislation extended the tax holi-

[231] Joint Venture Decree 49, *supra* note 40, paras. 36-43. Pursuant to the joint venture legislation, the Soviet Ministry of Finance issued regulations on May 4, 1987, as partially amended on Nov. 30, 1987. *See* D. KELLEY & J. SAUL, *supra* note 40, at 64-66.

[232] Joint Venture Tax Reg., *supra* note 45, issued pursuant to Decree 43, *supra* note 186, para. 43.

[233] *See supra* notes 38-39 and accompanying text.

[234] For a discussion of the Chinese counterpart to this legislation, see Li, *China's Tax System: An Evaluation*, 17 DEN. J. INT'L L. & POL'Y 527, 546-48 (1989).

[235] Kuiper, *An East-West Model Tax Treaty: Is it Desirable?*, 29 EUR. TAX'N 179, 179 (1989) ("[I]t is questionable whether the distribution of profits by such an Eastern European joint venture can indeed be considered a dividend, as it is generally assumed.").

[236] *See infra* notes 281-94 and accompanying text.

[237] Joint Venture Decree 49 originally provided, "Joint enterprises shall be exempt from the payment of a tax on profit during the first two years of their activities." Joint Venture Decree 49, *supra* note 40, para. 36. According to this provision, the tax holiday

day to three years for joint ventures in the Soviet Far East.[238] After the tax holiday expires, joint ventures are taxed at a flat rate of thirty percent on taxable income, minus deductions.[239] For joint ventures located in the Soviet Far East, the tax is lowered to ten percent.[240] Deductions are allowed for the reinvestment of income into reserve funds or other funds established in the foundation documents for the development of production and technology.[241] If the income is distributed abroad, the foreign joint venture partner is assessed a twenty percent surtax.[242] However, the Ministry of Finance is authorized to lower the tax, or completely exempt *individual* joint ventures from taxation.[243]

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ran from the date of registration of the joint venture, lasting two years after the operations had begun. Thus, a joint venture with no taxable income in its first two years could not take advantage of the tax holiday. By contrast, the three-year tax holiday for joint ventures located in the Soviet Far East extended to "three years after [a joint venture] receive[d] declared profit." Decree 1405, *supra* note 43, para. 31; *as construed by* Osakwe, *supra* note 2, at 108 (citing Ekonomicheskaya Gazeta, No. 41, at 18-19 (1987)). This tax holiday, therefore, ran from the moment the joint venture declared its first profits. Decree 49 was amended to extend the tax holiday to two years "after receipt of a declared profit." Instruction No. 226 of the U.S.S.R. Ministry of Finance of Nov. 30, 1987, "On Partial Amendment of the Taxation of Joint Ventures."

238 Decree 1405, *supra* note 43, para. 31. The Decree created a special investment zone in the Soviet Far East to compete with Hong Kong for investments in undeveloped areas and the Pacific Rim. *See* Patterson, *U.S.S.R.: New Changes to Investment Laws in the U.S.S.R.*, 16 TAX PLAN. INT'L REV. 46, 47 (1989). Hungary and China have created similar economic zones. *See* Eichmannn, *supra* note 5, at 279-82, *and* Gelatt, *supra* note 40, at 244 n.90.

239 Joint Venture Decree 49, *supra* note 40, para. 36. The joint venture regulations lack guidelines for determining net income, however. It is presumed that the deductions allowed under Decree 313 also apply in determining net income of the joint ventures. *See U.S.S.R: Some Tax Aspects of Soviet Joint Venture Law*, 27 EUR. TAX'N 161, 162 (1987). The Joint Venture Tax Regulation provides that taxable income equals the difference between the balance profits and deductions into all the funds formed with the joint venture. Joint ventures receive deductions both for these payments to reserve funds, as well as for payments to the national budget for state insurance of Soviet and foreign employees and for pensions of Soviet employees. Joint Venture Decree 49, *supra* note 40, para. 49. *See* USSR ACADEMY OF SCIENCES, *supra* note 46, at 109.

240 Decree 1405, *supra* note 43, para. 31.

241 The law requires both 1) the transfer of profits to reserve funds until this amount reaches 25% of the registered capital, and 2) if required in the foundation documents, transfers to the funds covering research and development, improvement of production, and acquisition of technology. Joint Venture Tax Reg., *supra* note 232, para. 6. Though transferred funds are deductible, the amount of these annual deductions must be stipulated in the foundation documents. *Id.*

242 The Soviet Union is the only Eastern European country that imposes a repatriation tax. Other Eastern European joint venture tax rates include those of Bulgaria, at 30% or 40%; Czechoslovakia, at 20% or 40%; Hungary, at 40% or 50%; Poland, at 40%; Romania, at 30%; and Yugoslavia, at 10%. Albeseder, Večsei, & Woyszycki, *Corporate Tax Developments in COMECON Countries of Eastern Europe and Yugoslavia*, 17 TAX PLAN. INT'L REV. 19, 19-23 (1990).

243 Joint Venture Tax Reg., *supra* note 232, para. 16; *see* Decree 1405, *supra* note 43, para. 32 (also permitting Ministry of Finance to reduce income tax rates and taxes on profits transferred abroad). To obtain an exemption, the joint venture must submit an application and a calculation of taxes to its local finance body and substantiate the need for the exemption. *Id.*, para. 16.

The procedures on assessment and payment of the thirty percent income tax differ from the procedures under Decree 313. The joint venture assesses the tax due itself,[244] which is subject to auditing by the Ministry of Finance.[245] The tax is then paid in rubles[246] in four installments, due no later than fifteen days before the end of each quarter.[247] Unpaid amounts from the calendar year must be paid by April 1 of the following year.[248] Late payments are penalized at the rate of 0.05% per day of the assessed tax.[249] The foreign distribution surtax of twenty percent[250] is filed on a payment order, along with application for the transfer of income abroad with the Soviet Bank of Foreign Trade.[251] Neither the Joint Venture Decree nor the Regulations require the taxpayer to pay the tax in foreign currency.[252]

The tax assessment is appealable to the local finance bodies in the region where the joint venture is located.[253] The joint venture must pay its taxes pending the outcome of those appeals.[254] The appeal must be made within one month of the date that the joint venture is notified of the auditing results.[255] The local finance body is required to pass judgment on the appeal within one month after the appeal is filed.[256] That decision may be appealed within one month to the Ministry of Finance, whose decision is final.[257]

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244 Decree 1405, *supra* note 43, para. 9. The joint venture's accounting is governed by Joint Venture Decree 49, *supra* note 40, paras. 44-46 and Instructional Circular No. 53-13-09 of the U.S.S.R. Ministry of Finance and the U.S.S.R. Central Board of Statistics of Feb. 27, 1987, "On Accounting and Book-Keeping Procedures in Joint Ventures, International Amalgamation and Organisations Set up in the Soviet Territory." The rules provide that the joint venture shall keep operational bookkeeping and statistical records in accordance with the rules prescribed for state-owned enterprises. These accounting principles differ from Western principles in that their purpose is to provide statistical information for state planning. Therefore, the Soviets are studying the prospect of bringing their rules in compliance with Western accounting principles. Because of these differing purposes, foreign participants may want to establish an auditing commission in the foundation documents. USSR ACADEMY OF SCIENCES, *supra* note 46, at 110-11.

245 Joint Venture Tax Reg., *supra* note 232, paras. 17-18.

246 *Id.*, para. 10.

247 *Id.*, para. 7.

248 *Id.*, para. 8.

249 *Id.*, para. 11.

250 *Id.*, para. 12.

251 *Id.*, para. 13.

252 *Id.*, paras. 12-14. The procedure for paying the repatriation tax implies the tax must be paid in foreign currency. Note, *Soviet Taxation*, *supra* note 193, at 812. The Joint Venture Tax Regulation provides that the foreign participant must file a money order to the Soviet budget in the currency of transfer. Joint Venture Tax Reg., *supra* note 232, para. 13, *discussed in* USSR ACADEMY OF SCIENCES, *supra* note 46, at 105.

253 Joint Venture Tax Reg., *supra* note 232, para. 19.

254 *Id.*

255 *Id.*

256 *Id.*

257 *Id.*

E. Double Tax Treaties

The Soviet attitude towards trade with the West is reflected by the tax treaties now in effect. Until 1980, the Soviet Union had signed only two tax treaties with Western countries; today seventeen tax treaties are in force and others are pending.[258]

1. Taxes Covered

The scope of the Soviet tax treaties are of three different types. The first type is illustrated by the treaty with the United States which briefly states that "taxes and dues provided for by All-Union legislation"[259] are covered under the treaty. The tax treaties with Denmark, Germany, Netherlands, Norway, Spain, and Sweden are far

[258] The Soviet Union has signed the following tax treaties: Convention for the Avoidance of Double Taxation, June 20, 1973, U.S.-U.S.S.R., 27 U.S.T. 1, T.I.A.S. No.8225 [hereinafter U.S.-U.S.S.R.]; Convention for the Avoidance of Double Taxation, Feb. 15, 1980, Norway-U.S.S.R., *reprinted in* 28 EUR. TAX'N sec. C (Supp. July 1988) [hereinafter Norway-U.S.S.R.]; Convention for the Avoidance of Double Taxation, Apr. 10, 1981, Austria-U.S.S.R., *reprinted in* 25 EUR. TAX'N sec. C (Supp. May 1985) [hereinafter Austria-U.S.S.R.]; Convention for the Avoidance of Double Taxation, Oct. 13, 1981, Sweden-U.S.S.R., *reprinted in* 25 EUR. TAX'N sec. C (Supp. Jan. 1985) [hereinafter Sweden-U.S.S.R.]; Convention for the Avoidance of Double Taxation, Nov. 24, 1981, F.R.G.-U.S.S.R., *reprinted in* 28 EUR. TAX'N sec. C (Supp. July 1988) [hereinafter F.R.G.-U.S.S.R.]; Convention for the Avoidance of Double Taxation, Feb. 26, 1985, Italy-U.S.S.R., *reprinted in* 29 EUR. TAX'N sec. C (Supp. Jan. 1989) (not yet in force) [hereinafter Italy-U.S.S.R.]; Convention for the Avoidance of Double Taxation, July 31, 1985, U.K.-U.S.S.R., *reprinted in* 26 EUR. TAX'N sec. C (Supp. May 1986) [hereinafter U.K.-U.S.S.R.]; Convention for the Avoidance of Double Taxation, Oct. 29, 1982, Cyprus-U.S.S.R., Ved. Verkh. Sov. SSSR No. 40 (Oct. 5, 1983), item 600, at 647-56 [hereinafter Cyprus-U.S.S.R.]; Convention for the Avoidance of Double Taxation, Mar. 1, 1985, Spain-U.S.S.R., *reprinted in* 27 EUR. TAX'N sec. C (Supp. Nov. 1987) [hereinafter Spain-U.S.S.R.]; Convention for the Avoidance of Double Taxation, Oct. 4, 1985, France-U.S.S.R., *reprinted in* 26 EUR. TAX'N sec. C (Supp. June 1986) (not yet in force) [hereinafter France-U.S.S.R.]; Convention for the Avoidance of Double Taxation, June 13, 1985, Canada-U.S.S.R., [hereinafter Canada-U.S.S.R.]; Convention for the Avoidance of Double Taxation, Jan. 18, 1986, Japan-U.S.S.R., *reprinted in* 29 EUR. TAX'N sec. C (Supp. Sep. 1989) [hereinafter Japan-U.S.S.R.]; Convention for the Avoidance of Double Taxation, Oct. 21, 1986, Denmark-U.S.S.R., *reprinted in* 28 EUR. TAX'N sec. C (Supp. May 1988) [hereinafter Denmark-U.S.S.R.]; Convention for the Avoidance of Double Taxation, Sep. 5, 1986, Switzerland-U.S.S.R., *reprinted in* 28 EUR. TAX'N sec. C (Supp. Nov. 1988) [hereinafter Switzerland-U.S.S.R.]; Convention for the Avoidance of Double Taxation, Nov. 21, 1986, Netherlands-U.S.S.R., *reprinted in* 27 EUR. TAX'N sec. C (Supp. July 1987) (not yet in force) [hereinafter Netherlands-U.S.S.R.]; Convention for the Avoidance of Double Taxation, July 31, 1987, Malaysia-U.S.S.R., *reprinted in* 28 EUR. TAX'N sec. C (Supp. Sep. 1988) [hereinafter Malaysia-U.S.S.R.]; Convention for the Avoidance of Double Taxation, Oct. 6, 1987, Finland-U.S.S.R., *reprinted in* 28 EUR. TAX'N sec. C (Supp. Sep. 1988) [hereinafter Finland-U.S.S.R.]. For a discussion of the role of socialist tax treaties, see Debatin, *The Role of Tax Treaties as an Instrument of Economic Cooperation between "Capitalist" and "Socialist" Countries*, 39 BULL. INT'L FISCAL DOCUMENTATION 393 (1985), and Kuiper, *East-West Tax Treaties*, 15 EUR. TAX'N 185 (1975). In addition the Soviet Union has signed the COMECON (CMEA) Multilateral Double Taxation Avoidance Treaty for Individuals, May 27, 1977, *reprinted in* 25 EUR. TAX'N sec. C (Supp. Feb. 1985). The following Eastern European countries are parties to the COMECON (CMEA) treaties: Bulgaria, Czechoslovakia, Hungary, German Democratic Republic, Mongolia, Poland, Romania, and the Soviet Union.

[259] U.S.-U.S.S.R., *supra* note 258, art. 1, para. 1(b).

more detailed and provide that "the income tax on foreign legal persons, the income tax on the population, the agriculture tax, the tax on the owners of buildings, the ground tax and the tax on the owners of means of transportation"[260] are covered by the treaty. A third approach is shown by the treaties with Finland, France, Italy, Malaysia, and the United Kingdom. This approach provides for coverage of the income tax on foreign legal entities and "the population."[261] The treaties with Finland and Malaysia were signed after the adoption of the Soviet joint venture legislation and cover both the thirty percent joint venture tax and the twenty percent repatriation tax.[262] The Finnish treaty covers "the tax on profits from joint ventures derived and transmitted abroad by foreign persons."[263] All tax treaties include provisions which apply to identical or similar taxes imposed after the signature of the treaty.[264] Consequently, the thirty percent joint venture tax, imposed after most of the treaties were signed, is covered under this provision of the treaty. The twenty percent repatriation tax is not an income tax, and it is questionable whether it would qualify as an "identical or similar tax." This is especially true for the French, Italian, and United Kingdom treaties. Yet, the treaties provide protection in the form of nondiscrimination provisions which generally are not limited to the taxes covered by the treaty.

2. *Personal Scope*

Treaties usually apply to persons who for tax purposes are residents of one or both of the contracting states.[265] The Soviet joint venture is not considered a taxable entity for tax purposes. Income is not taxed at the entity level, instead it is taxed only once it is distributed to the joint venture participants. As a consequence, the participants are covered under the personal scope of the treaty, but the

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260 Denmark-U.S.S.R., *supra* note 258, art. 2, para. 1(b); F.R.G.-U.S.S.R., *supra* note 258, art. 2, para. 1; Netherlands-U.S.S.R., *supra* note 258, art. 2, para. l(b); Norway-U.S.S.R., *supra* note 258, art. 2, para. 1; Spain-U.S.S.R., *supra* note 258, art. 2, para. 2(b); Sweden-U.S.S.R., *supra* note 258, art. 2, para. l(a).

261 Finland-U.S.S.R., *supra* note 258, art. 2, para. l(a); France-U.S.S.R., *supra* note 258, art. 2, para. l(a); Italy-U.S.S.R., *supra* note 258, art. 2, para. l(a); Malaysia-U.S.S.R., *supra* note 258, art. 2, para. l(b); U.K.-U.S.S.R., *supra* note 258, art. 2, para. 1(b).

262 *See supra* notes 239-52 and accompanying text.

263 Finland-U.S.S.R., *supra* note 258, art. 2, para. l(a)(3).

264 Austria-U.S.S.R., *supra* note 258, art. 2, para. 2; Canada-U.S.S.R., *supra* note 258, art. 2, para. 2; Cyprus-U.S.S.R., *supra* note 258, art. 2, para. 2; Denmark-U.S.S.R., *supra* note 258, art. 2, para. 2; Finland-U.S.S.R., *supra* note 258, art. 2, para. 2; France-U.S.S.R., *supra* note 258, art. 2, para. 2; F.R.G.-U.S.S.R., *supra* note 258, art. 2, para. 2; Italy-U.S.S.R., *supra* note 258, art. 2, para. 2; Japan-U.S.S.R., *supra* note 258, art. 2, para. 2; Malaysia-U.S.S.R., *supra* note 258, art. 2, para. 2; Netherlands-U.S.S.R., *supra* note 258, art. 2, para. 2; Norway-U.S.S.R., *supra* note 258, art. 2, para. 2; Spain-U.S.S.R., *supra* note 258, art. 2, para. 3; Switzerland-U.S.S.R., *supra* note 258, art. 1, para. 2; U.K.-U.S.S.R., *supra* note 258, art. 2, para. 2; U.S.-U.S.S.R., *supra* note 258, art. 1, para. 2.

265 1977 OECD Model Income Tax Convention, art. 1.

question remains whether the joint venture is covered.[266] The answer is generally that the joint venture is considered a permanent establishment and, as such, is covered under the treaty.

3. *Residency*

Soviet law defines "resident" as a "citizen of the relevant foreign state, regardless of the actual place of residence or domicile of that person."[267] Decree 313 does not distinguish between foreign citizens who are permanently in the Soviet Union and those who are merely temporarily in the Soviet Union;[268] both are subject to taxation on income earned in the Soviet Union. The Soviet tax treaties provide protection from these national rules. The residency provision under the U.S. tax treaty defines "resident" as a corporation created or organized under the laws of the respective countries, or an individual recognized as a resident for tax purposes in the respective countries.[269] In contrast, the definitions of residency under the other treaties are more in line with the OECD Model Tax Treaty of 1977. The Danish tax treaty considers these factors in determining residency: 1) permanent home or center of vital interests; 2) habitual abode; 3) citizenship; or 4) mutual agreement.[270] A corporation is considered a resident of the state under which laws it was created, or if it was created under the laws of neither state, it shall be deemed to be a resident of the state in which its place of effective management is situated.[271]

4. *Permanent Establishment*

Under the treaties with the United States, Denmark, France, Italy, Norway, and Sweden, the permanent establishment is termed "permanent representation,"[272] while the Austrian treaty terms the permanent establishment as a "representative agency."[273] There is no substantive difference between the different terms. Under the U.S. treaty a permanent establishment is defined narrowly to include an office or representative bureau established by a resident of the other contracting state.[274] Most other Soviet tax treaties define permanent establishment as an agency, an office, or any other fixed place of business through which a resident of a contracting state car-

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266 Kuiper, *supra* note 235, at 183.
267 M. NEWCITY, *supra* note 177, at 212.
268 *See supra* notes 228-30 and accompanying text.
269 U.S.-U.S.S.R., *supra* note 258, art. 2, paras. 3 & 4.
270 Denmark-U.S.S.R., *supra* note 258, art. 1, para. 4.
271 *Id.*, art. 1, paras. 2 & 5.
272 U.S.-U.S.S.R., *supra* note 258, art. 4, para. 2; Denmark-U.S.S.R., *supra* note 258, art. 5; France-U.S.S.R., *supra* note 258, art. 4; Italy-U.S.S.R., *supra* note 258, art. 4; Norway-U.S.S.R., *supra* note 258, art. 4; Sweden-U.S.S.R., *supra* note 258, art. 4.
273 Austria-U.S.S.R., *supra* note 258, art. 4.
274 U.S.-U.S.S.R., *supra* note 258, art. 4, para. 2(a).

ries on business in the other contracting state.[275] Except for the U.S. treaty, all Soviet tax treaties define the permanent establishment negatively.[276] The treaty includes a provision similar to Article 5(1) of the OECD Model, under which residents shall not be deemed to have a permanent establishment in the other contracting state merely because the business is carried out through a broker, commission agent, or any other agent of an independent status, provided that such persons are acting in the ordinary course of business. Furthermore, the fact that a resident controls or is controlled by a resident of the other contracting state is a reason for treating one of them as a permanent establishment of the other.

5. *Building Sites and Constructions*

The Eastern European tax treaties generally provide favorable tax treatment for building sites and constructions,[277] which under the OECD Model are considered permanent establishments if they exist for a period exceeding twelve months. The Soviet tax treaties provide that building sites and constructions are considered permanent establishments after eighteen, twenty-four or even thirty-six months.[278]

6. *Tax Treatment under the Soviet Tax Treaties*

In comparison to the OECD Model, the Soviet tax treaties emphasize tax exemption rather than tax credit. This emphasis on exemption stems from the reciprocity treatment which encourages countries to sign agreements with the Soviets to exempt income from source taxation.[279] The reciprocity approach benefitted the Soviets since Eastern investments in the West were more common than Western investments in the East.[280]

a. *Dividends — Is Joint Venture Income Included?*

The Soviet joint venture is an entity whose income is taxed in the hands of the participants. The joint venture is not treated as a partnership where the income, gain, or loss is passed through to the

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[275] *See* 1977 OECD Model Income Tax Convention, art. 5, paras. 1 & 2 (similar provisions).

[276] *Id.*, art. 5, para. 3.

[277] *See* Kuiper, *supra* note 235, at 183.

[278] *E.g.*, Austria-U.S.S.R., *supra* note 258, art. 4, para. 2 (twenty-four months); Denmark-U.S.S.R., *supra* note 258, art. 5, para. 4 (twenty-four months); Finland-U.S.S.R., *supra* note 258, art. 4, para. 2 (thirty-six months); France-U.S.S.R., *supra* note 258, art. 4, para. 4 (twenty-four months); Italy-U.S.S.R., *supra* note 258, art. 6 (thirty-six months); Sweden-U.S.S.R., *supra* note 258, art. 5, para. 1 (eighteen months); U.K.-U.S.S.R., *supra* note 258, art. 5, para. 2(a) (twenty-four months); U.S.-U.S.S.R., *supra* note 258, art. 3, para. 1(d) (thirty-six months).

[279] *See supra* notes 206-12 and accompanying text.

[280] Kuiper, *supra* note 235, at 179-80.

partners, nor is it subject to double taxation as is true with a corporate structure.[281] Whether the income qualifies as dividends under the treaty is questionable,[282] unless the treaty includes the income as dividends or the income is considered dividends under the laws of the contracting state.[283] Instead, the joint venture would most likely be considered a permanent establishment, and the income derived from the establishment would be taxed at the rate stipulated under the domestic law of the country of source, with no ceiling on the withholding tax. In the case of the Soviet joint venture, the foreigner would be subject to the thirty percent joint venture tax.

Two of the Soviet tax treaties (the Finnish and Malaysian treaties) were concluded after the adoption of joint venture legislation, and the treatment of joint venture income is specifically addressed in both treaties. For example, the treaty with Finland states:

> The term "dividend," as used in this Article, means income from shares or income from other rights, which is subjected to the same taxation treatment as income from shares by the laws of the contracting States of which the legal person making distribution is a resident. *That term also means profits of a joint venture created under the laws of the U.S.S.R. which are remitted from the U.S.S.R. and which belong to a resident of Finland participating in the joint venture.*[284]

The treaty with Malaysia similarly includes joint venture income as "dividends." Unlike the Finnish treaty, this treaty does not provide exemption, but limits the Soviet withholding tax to fifteen percent.[285]

The remaining Soviet treaties were all concluded before the adoption of the joint venture legislation and do not expressly include joint venture income. The income may nevertheless be covered as dividends if an interpretation of the treaty allows inclusion or the income is characterized as dividends under domestic law. The Soviet treaty with the United Kingdom, for example, contains this definition:

> The term "dividends" as used in the Article shall have the meaning which it has under the taxation law of the Contracting State which the person (in case of the United Kingdom, the company) paying the dividend is a resident and shall include any item which is treated under that law as a dividend or distribution.[286]

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281 *See supra* note 266 and accompanying text.

282 The 1977 OECD Model Income Tax Convention defines dividends as
> income from shares or "jouissance" rights, mining shares, founder's shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

1977 OECD Model Income Tax Convention, art. 10, para. 3.

283 Finland-U.S.S.R., *supra* note 258, art. 7, para. 2.

284 *Id.*, art. 9, para. 3 (emphasis added).

285 Malaysia-U.S.S.R., *supra* note 258, art. 8, para. 2.

286 Most of the Soviet treaties, however, follow an approach similar to the Denmark-

This treaty refers to domestic law for the classification of joint venture income. Despite the fact that Soviet law does not expressly declare that the income derived from the joint venture is dividends, the legal framework indicates that the income should be considered dividends.[287]

The USSR Academy of Sciences deals with the problem indirectly; "[w]ith respect to the tax payments of a joint venture international agreements may provide for exemptions regarding . . . the income tax of a joint venture itself."[288] This reference would make little sense unless the income is considered dividends. Otherwise, the income most often would be profits derived from carrying on business through a permanent establishment, which generally would not be granted exemption. At the same time, the provisions contained under Finnish and Malaysian tax treaties evidence that legislators and negotiators consider the joint venture income to be dividends. If the income is not generally considered dividends, the door would have been opened to extensive treaty shopping resulting in virtually all Soviet joint ventures being set up with Malaysian and Finnish intermediaries as the foreign partner.[289]

As the tax treaties with the United States and Switzerland do not contain any provision concerning dividends, income earned by U.S. or Swiss participants in Soviet joint ventures receives no relief from the thirty percent joint venture tax.[290] However, these taxpayers will escape the repatriation tax by arguing that the tax is discriminatory.[291] In contrast, all other Soviet tax treaties contain rules on dividends and protection against both the joint venture tax and the repatriation tax.

U.S.S.R. treaty, which is more in line with the OECD Model: "The term 'dividends', as used in this Article, means income from shares, participations or other similar rights, which for taxation purposes are treated as income from shares according to the laws of the Contracting State of which the person making the distribution is resident." Denmark-U.S.S.R., *supra* note 258, art. 8, para. 2; *cf.* 1977 Model Income Tax Convention, *supra* note 282.

[287] Decree 49 section 41 provides that: "*Unless provided otherwise by a treaty between the USSR and the respective foreign state,* the portion of the profit due to a foreign participant of a joint venture shall, when transferred abroad, be levied with a tax in the amount of 20%." Joint Venture Decree 49, *supra* note 40, para. 41 (emphasis added). The provision that can "provide otherwise" however, would not be the provision on dividends since the repatriation tax is not an income tax. The dividents provision, rather, "provides otherwise" to the provisions prohibiting discriminatory tax treatment.

[288] USSR ACADEMY OF SCIENCES, *supra* note 46, at 107.

[289] For example, on joint venture income, a Danish partner would face taxation with no reduced ceiling, while her Finnish counterpart would be exempt from all such taxation. This encourages the Danish partner to organize a Finnish subsidiary as the joint venture partner. The tax treaties do not specifically prevent this type of treaty shopping. For a discussion of this problem, see Weizman, *Treaty Shopping: Do Viable Prevention Methods Exist?*, 4 J. STRATEGY INT'L TAX'N 191 (1989).

[290] *See supra* notes 239-42.

[291] *See generally* Weizman, *Taxation of Soviet Joint Ventures: Discriminatory Tax Treatment?*, 17 TAX PLAN. INT'L REV. 31 (1990).

According to Article 10 of the OECD Model, dividends may be taxed in both states, but the tax rate in the country of source may not exceed fifteen percent, or five percent in the case of "substantial holding." While the treaties with Austria, Cyprus, Finland, and the United Kingdom all provide exemption for dividends,[292] the other Soviet tax treaties allow source country taxation.[293] None of the Soviet treaties contain a "substantial holding" provision similar to the OECD Model.[294] The treaties, except for those with the United States and Switzerland, define the term "dividends" in terms similar to Article 10 of the OECD Model.

b. Interest

According to the OECD Model interest income can be taxed in the source country, but the tax cannot exceed ten percent. The Swiss tax treaty, unlike the U.S. treaty, does not contain any provision regarding interest. The U.S. tax treaty provides exemption for interest.[295] This exemption, however, relates only to interest on loans that are connected with the financing of U.S.S.R.-U.S. trade.[296] The treaties with Austria, Denmark, Finland, Italy, Japan, Norway, Spain, Sweden, and the United Kingdom also provide exemption for interest, but the exemption applies to all interest income.[297] The remaining treaties allow source country taxation: Canada (fifteen percent), France (ten percent), Germany (fifteen percent), and Malaysia (fifteen percent).[298] The term "interest" is defined in accordance with Article 11 of the OECD Model.[299] The Canada-U.S.S.R. treaty limits the source country taxation to a fifteen percent tax rate

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292 Austria-U.S.S.R., *supra* note 258, art. 8, para. 1; Cyprus-U.S.S.R., *supra* note 258, art. 7, para. 1; Finland-U.S.S.R., *supra* note 258, art. 7, para. 1; U.K.-U.S.S.R., *supra* note 258, art. 8, para. 1.

293 Canada-U.S.S.R., *supra* note 258, art. 8, para. 2 (15%); Denmark-U.S.S.R., *supra* note 258, art. 8, para. 1 (15%); France-U.S.S.R., *supra* note 258, art. 7, para. 2 (15%); F.R.G.-U.S.S.R., *supra* note 258, art. 7, para. 2 (15%); Italy-U.S.S.R., *supra* note 258, art. 8, para. 1 (15%); Japan-U.S.S.R., *supra* note 258, art. 7, para. 2 (15%); Malaysia-U.S.S.R., *supra* note 258, art. 9, para. 2 (15%); Netherlands-U.S.S.R., *supra* note 258, art. 7, para. 2 (15%); Norway-U.S.S.R., *supra* note 258, art. 7, para. 1 (20%); Spain-U.S.S.R., *supra* note 258, art. 8, para. 1 (18%); Sweden-U.S.S.R., *supra* note 258, art. 8, para. 1 (15%).

294 OECD Model Income Tax Convention, art. 10, para. 2(a).

295 U.S.-U.S.S.R., *supra* note 258, art. 3, para. 1(g).

296 *Id.*

297 Austria-U.S.S.R., *supra* note 258, art. 9; Denmark-U.S.S.R., *supra* note 258, art. 9, para. 1; Finland-U.S.S.R., *supra* note 258, art. 8, para. 1; Japan-U.S.S.R., *supra* note 258, art. 8, para. 1; Italy-U.S.S.R., *supra* note 258, art. 11; Norway-U.S.S.R., *supra* note 258, art. 11, para. 1(a); Spain-U.S.S.R., *supra* note 258, art. 9, para. 1; Sweden-U.S.S.R., *supra* note 258, art. 9, para. 1; U.K.-U.S.S.R., *supra* note 258, art. 9, para. 1.

298 Canada-U.S.S.R., *supra* note 258, art. 9, para. 1; France-U.S.S.R., *supra* note 258, art. 8, para. 1; F.R.G.-U.S.S.R., *supra* note 258, art. 8, para. 1; Malaysia-U.S.S.R., *supra* note 258, art. 11.

299 "Interest," as in the Denmark-U.S.S.R. treaty, for example, denotes income from loans, bank deposits, Government loans, debt-claims, and any other income considered interest under the laws of the contracting state of which the taxpayer is a resident. Denmark-U.S.S.R., *supra* note 258, art. 9, para. 2.

on gross interest.[300] However, interest arising in a contracting state is taxable only in the state of residency if it is paid: 1) to the government of that other state; 2) to the central bank of that other state; or 3) in respect of a loan made, guaranteed, or ensured by the government of the other state or public body.[301]

c. Royalties

The Soviet tax treaties define "royalty" in far greater detail than Article 12(2) of the OECD Model.[302] The general rule under the OECD Model is that the source country, in the absence of permanent establishment, can not tax royalties. Most of the tax treaties provide exemption for royalties.[303] The treaties with the following countries, however, allow source country taxation: Canada (fifteen percent), Japan (ten percent), Malaysia (ten/fifteen percent), Spain (five percent).[304] Even though royalties paid to a Western licensor are subject to Soviet withholding tax, this tax is usually borne by the Soviet partner.

7. Elimination of Double Taxation

Because the Soviet tax treaties with the United States, Austria, Cyprus, Denmark, Norway, Sweden, and Switzerland do not provide for the elimination of double taxation,[305] the method for elimination of double taxation is to be determined under national law. While the other Soviet tax treaties provide for the elimination of double taxation, they allow the Soviet Union to have the matter settled under Soviet law.[306]

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300 Canada-U.S.S.R., *supra* note 258, art. 9, para. 2.

301 *Id.*, art. 9, para. 3.

302 For example, the Denmark-U.S.S.R. treaty covers income of any kind derived from the sale, use, or transfer of the rights to use the following: copyrights on scientific, artistic, and literary works; inventions; rationalization plans; industrial designs and models; trade marks and service marks; trade names; computer and calculator programs; means of sound reproduction; audio and video tapes; films; and trade secrets, experience, and knowledge. Denmark-U.S.S.R., *supra* note 258, art. 7, para. 2.

303 Austria-U.S.S.R., *supra* note 258, art. 7, para. 1; Cyprus-U.S.S.R., *supra* note 258, art. 10, para. 1; Denmark-U.S.S.R., *supra* note 258, art. 7; Finland-U.S.S.R., *supra* note 258, art. 9, para. 1; France-U.S.S.R., *supra* note 258, art. 6, para. 1; F.R.G.-U.S.S.R., *supra* note 258, art. 9, para. 1; Italy-U.S.S.R., *supra* note 258, art. 5, para. 1; Netherlands-U.S.S.R., *supra* note 258, art. 9, para. 1; Norway-U.S.S.R., *supra* note 258, art. 5, para. 1; Sweden-U.S.S.R., *supra* note 258, art. 7, para. 1; Switzerland-U.S.S.R., *supra* note 258, art. 8, para. 1; U.K.-U.S.S.R., *supra* note 258, art. 10, para. 1; U.S.-U.S.S.R., *supra* note 258, art. 3, para. 1(a).

304 Canada-U.S.S.R., *supra* note 258, art. 10, para. 2; Japan-U.S.S.R., *supra* note 258, art. 9, para. 2(b); Malaysia-U.S.S.R., *supra* note 258, art. 11, para. 2; Spain-U.S.S.R., *supra* note 258, art. 9, para. 1.

305 The 1977 OECD Model Income Tax Convention provides means for avoiding double taxation, through either the credit method or the exemption method. 1977 OECD Model Income Tax Convention, arts. 23A & 23B.

306 Canada-U.S.S.R., *supra* note 258, art. 17, para. 2; Finland-U.S.S.R., *supra* note 258, art. 14, para. 1; France-U.S.S.R., *supra* note 258, art. 15, para. 5; F.R.G.-U.S.S.R., *supra* note

8. *Nondiscrimination*

Nondiscrimination of foreign nationals with regard to tax treatment[307] is a requirement that is included in all Soviet tax treaties.[308] The nondiscrimination provisions in Soviet treaties differ significantly from Article 24 of the OECD Model. Except for the treaties with Norway and Italy,[309] all treaties have adopted the Soviet reciprocity approach. Article 12 of the Norway-U.S.S.R. tax treaty provides:

> 1. A resident of a Contracting State shall not be subjected in the other Contracting State to taxes and duties which are other or more burdensome than those to which nationals of that other State in the same circumstances are subjected.
>
> 2. The taxation of representation maintained by a resident of a Contracting State in the other Contracting State shall not be less favorable than the taxation of residents of that other State who carry on the same activities.[310]

While the other provisions differ, Article 10 of the U.S.-U.S.S.R. treaty contains the nondiscrimination provision that is most commonly used in the Soviet tax treaties:

> 1. A citizen of one of the Contracting States who is a resident of the other Contracting State shall not be subjected in that other Contracting State to more burdensome taxes than a citizen of that other Contracting State who is a resident thereof carrying on the same activities.
>
> 2. A citizen of one of the Contracting States who is a resident of the other Contracting State or a representation established by a resident of the first Contracting State in the other Contracting State shall not be subjected to more burdensome taxes than are generally imposed in that State on citizens or representations of residents of third States carrying on the same activities. However, this provision shall not require a Contracting State to grant to citizens or representations of residents of the other Contracting State tax benefits granted by special agreements to citizens or representations of a third State.
>
> 3. The provisions of paragraphs 1 and 2 of this article shall

258, art. 19, para. 2; Italy-U.S.S.R., *supra* note 258, art. 12(b); Japan-U.S.S.R., *supra* note 258, art. 20; Malaysia-U.S.S.R., *supra* note 258, art. 21, para. 2; Netherlands-U.S.S.R., *supra* note 258, art. 18, para. 2; Spain-U.S.S.R., *supra* note 258, art. 16; U.K.-U.S.S.R., *supra* note 258, art. 20, para. 2.

307 Nondiscrimination treaty provisions ensure that each party refrains from imposing a heavier tax burden on the other party's nationals. For a thorough discussion of discriminatory tax treatment, see C. VAN RAAD, NONDISCRIMINATION IN INTERNATIONAL TAX LAW (1986).

308 *See* Austria-U.S.S.R., *supra* note 258, art. 14; Canada-U.S.S.R., *supra* note 258, art. 17, para. 2; Cyprus-U.S.S.R., *supra* note 258, art. 23; Denmark-U.S.S.R., *supra* note 258, art. 17; Finland-U.S.S.R., *supra* note 258, art. 15; France-U.S.S.R., *supra* note 258, art. 13; F.R.G.-U.S.S.R., *supra* note 258, art. 20; Italy-U.S.S.R., *supra* note 258, art. 14; Japan-U.S.S.R., *supra* note 258, art. 21; Malaysia-U.S.S.R., *supra* note 258, art. 22; Norway-U.S.S.R., *supra* note 258, art. 12; Netherlands-U.S.S.R., *supra* note 258, art. 9; U.K.-U.S.S.R., *supra* note 258, art. 21; U.S.-U.S.S.R., *supra* note 258, art. 9.

309 Italy-U.S.S.R., *supra* note 258, art. 14; Norway-U.S.S.R., *supra* note 258, art. 12.

310 Norway-U.S.S.R., *supra* note 258, art. 12, paras. 1-2.

> apply to taxes of any kind imposed on the All-Union or Federal level, the Republic or state level and on the local level.[311]

Paragraph 1 is the standard provision that a citizen of one of the contracting states who is a resident of the other contracting state will not be subject in that other contracting state to more burdensome taxes than a citizen of that other contracting state. Paragraph 2, however, is somewhat different than both the United States and OECD Model Tax Treaties, using as its test for nondiscrimination the tax treatment of nationals or representations of third states, rather than the treatment of nationals or representations of that other state.

The Model Treaties prohibit one contracting state from imposing more burdensome taxes on the permanent establishments of the other contracting state than it imposes on its own enterprises.[312] In negotiating the U.S.-U.S.S.R. treaty, this approach was considered inappropriate because of the significant differences between business enterprises and their taxation in the U.S.S.R. and the United States.[313] The same approach was followed in the U.S. treaties with Poland and Romania, while the U.S. treaty with Hungary followed the United States Model Tax Treaty.[314]

A third approach, also adopting reciprocity, is embodied in the treaties with Finland, Canada, and West Germany. Article 20 of the F.R.G.-U.S.S.R. tax treaty provides:

> A Contracting State shall not subject a person resident in the other Contracting State to taxation which is higher or more burdensome than that to which this State would subject a person who is a resident of a third State with which no Convention for the avoidance of double taxation has been concluded.[315]

These nondiscrimination provisions depart somewhat from the OECD Model and other treaties in providing that a contracting state may not impose on the residents of the other contracting state more burdensome taxation than it imposes on the residents of a third state with which it has not concluded a double taxation treaty. Other treaties apply a principle of reciprocity to the tax treatment of residents or citizens who do not maintain representations in the other contracting state, and the principle of third state taxation to those residents or citizens who do not maintain representations there. The treaty with Germany applies the third state taxation principle to all residents, regardless of whether or not they maintain a representation in the other contracting state.

Applying the principles of nondiscrimination in countries that

311 U.S.-U.S.S.R., *supra* note 258, art. 10, paras. 1-3.
312 *See* 1977 Model Income Tax Convention, art. 24, para. 4.
313 M. NEWCITY, *supra* note 177, at 295.
314 *Id.*
315 F.R.G.-U.S.S.R., *supra* note 258, art. 20.

mandate state ownership of the means of production is difficult since discriminatory tax treatment is determined by comparing the treatment of domestic taxpayers to the treatment of foreign taxpayers. However, in the case of the Soviet Union, domestic entities are integrated into the state and the income is channelled into the state budget, thereby giving rise to what is ultimately equivalent to a one hundred percent tax rate. This appears to give the Soviet government a free hand with respect to the tax rates levied on foreign entities. In addition, the OECD Commentary provides that discrimination can be justified where a state provides favorable taxation to its own public bodies and services that are integral parts of the state.[316] However, this exception does not apply to state enterprises carrying on gainful undertaking.[317] Therefore, the Soviet Union is prohibited from subjecting foreign residents, whether individuals, entities, or joint venture partners, to discriminatory tax treatment. This would apply, for example, to a repatriation tax that must be levied both on foreign and domestic residents in order to comply with the nondiscrimination requirement.[318] In addition, the OECD Commentary provides that when a tax is imposed on both nationals and foreigners in the same circumstances, the basis and methods of assessment must also be the same.[319] This should prevent the Soviet government from requiring foreign individuals or entities to pay their taxes in hard currency. The key factors when applying nondiscrimination is whether different tax treatment is provided for taxpayers "in same circumstances." The OECD Commentary indicates that the taxpayers are in the same circumstances if they are in substantially similar circumstances, both in law and in fact, under the country's laws and regulations.[320]

IV. Western Tax Treatment

The Western treatment of the joint venture and its participants is important for the Soviet government's ability to attract Western investments and achieve the goals of *perestroika*. Western tax laws often discriminate against Soviet joint ventures, but by extending its network of tax treaties the Soviet Union has reduced this treatment significantly. However, certain Western tax measures remain unfavorable. These measures are usually not aimed solely at investments in joint ventures, nor are they aimed at participation in Eastern European joint ventures. While the tax treatment in Western countries

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316 The 1977 OECD Model Income Tax Convention, art. 24, para. 7 commentary.

317 *Id.*

318 If a repatriation tax or remittance tax is to be levied on both foreign and domestic taxpayers, it will take the form of a transfer tax. *See, e.g.*, Weizman, *supra* note 291, at 32 (discussing the German *Reichsfluchtsteuer*).

319 The 1977 OECD Model Income Tax Convention, art. 24, para. 7 commentary.

320 *Id.*, para. 3.

differ, the following discussion focuses on the Internal Revenue Code (IRC) of 1986, and tax measures that are important for U.S. investors.[321]

A. *Classifying the Joint Venture for Tax Purposes*

As discussed above, the joint venture for Soviet tax purposes is treated as a corporation whose income is taxable only in the hands of the joint venture participants.[322] Classification as a corporation or a partnership for Western tax purposes is important for many reasons, as discussed below. While most developed countries classify foreign entities largely in accordance with the foreign classification, a corporation does not exist for federal tax purposes in the United States, unless the entity satisfies the following criteria provided for by the Code: continuity of life, centralized management, limited liability, and free transferability of interests.[323] In determining whether the necessary legal relations have been established, foreign law is applied.[324] At least three of the criteria must be present for an entity to qualify as a corporation.[325] Like a partnership, the Soviet joint venture generally lacks continuity of life, because the joint venture needs to be dissolved in the event of bankruptcy or exclusion of any of the participants. However, the joint venture has limited liability and will qualify as a corporation if it has both centralized management or free transferability of interest. Because the qualification of the joint venture is based on criteria that can be arranged to qualify it as either a corporation or a partnership,[326] it is important that the question is addressed in the process of negotiation and approval of the foundation documents.

For a U.S. investor it is generally preferable that the joint venture be characterized as a partnership for U.S. tax purposes. First,

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321 Investments in a Soviet joint venture also raise a number of burdensome compliance issues for a U.S. investor. *See* Patrick, *A Review of U.S. Tax Laws Applicable to Cooperative International Business Venture: What Distinctions Should be Made*, 2 TAX NOTES INT'L 306, 311-12 (1990). The question of compliance is especially burdensome for participants in countries where entities are subject to an accounting system which serves central planning purposes. *See supra* note 244.

322 *See supra* note 235 and accompanying text.

323 Treas. Reg. 301.7701-2(a)(1) (1990).

324 *Id.* 301.7701-1(c) (as amended by T.D. 7515, 42 Fed. Reg. 55,612 (1977)).

325 *See* Treas. Reg. 301.7701-2(a)(3) (1990). The requirement was established in Morrissey v. Commissioner, 296 U.S. 344 (1935), but in P.G. Larson v. Commissioner, 66 T.C. 159 (1976), an entity was considered a partnership even though fewer than three of the criteria were present.

326 In Priv. Ltr. Rul. 9,002,052, a U.S. trust and exempt foundation organized a West German Gesellschaft mit beschankter Haftung (G.m.b.H.) in accordance with German law. The Internal Revenue Service had previously ruled that the company should be considered a partnership for tax purposes. However, in Rev. Rul. 77-214, 1977-1 C.B. 408, the Service ruled that a German G.m.b.H. should be classified as a corporation for U.S. tax purposes. Both rulings indicate that the company was arranged to qualify as a partnership or corporation.

the U.S. investor would be able to avoid the many antideferral measures under U.S. tax law; second, this would allow the U.S. investor to take advantage of a net operating loss in the joint venture. This is especially important since the net operating loss is completely unregulated under Soviet tax law, and the allowance of net operating losses is at the discretion of the Ministry of Finance.

B. *Organizing the Joint Venture*

1. *Inbound and Outbound Transfers*

In some jurisdictions taxpayers are not taxed upon the removal of assets from the jurisdiction, but in most countries outbound transfers may be subject to taxation. The taxation of a U.S. corporation's outbound and inbound transfers is governed by I.R.C. section 367, which limits the extent to which a foreign corporation may claim nonrecognition. The provision is mainly aimed at outbound transfers and precludes nonrecognition where one of the principal purposes of the transfer is tax avoidance. Of the different types of transfers covered by I.R.C. section 367(a), the reference to I.R.C. section 351, which provides nonrecognition for direct transfer of property to a foreign corporation, is the type of transfer most important for U.S. participation in Eastern European joint ventures.[327] Whether such transfers are subject to recognition for the U.S. participant depends initially on whether the transaction has tax avoidance potential.[328] The transaction needs to have only tax avoidance as "one of its principal purposes."[329] The transfer may nevertheless be subject to taxation if the transferred property consists of "tainted assets," which include inventory, accounts receivable, installment obligations, stock, and securities.[330] In the event such property is transferred, a toll charge is imposed equivalent to the income related to the tainted assets.[331] Even though the assets subject to the toll charge are essentially "liquid or passive investment assets," it is not unlikely that the U.S. participant would fund the joint venture with such assets. In this event the participants should be aware that transferred assets may be tainted.

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[327] In addition, I.R.C. § 367(a) covers the complete liquidation of a foreign subsidiary (*see* I.R.C. § 332 (1990)) and the acquisition of stock in a domestic corporation's assets by a foreign corporation in a qualified reorganization (*see* I.R.C. § 354 (1990)). I.R.C. § 367(a) (1990).

[328] Previously, the taxpayer had to file a request for a ruling with the Service within 183 days of the transfer to achieve nonrecognition. Act of Oct. 4, 1976, tit. X, § 1042(e), 90 Stat. 1634, 1834 (repealed 1988).

[329] The standards applied are set forth in Rev. Proc. 68-23, 1968-1 C.B. 821.

[330] *Id.*

[331] *Id.*

2. *Transfer of Intangible Property*

Because *perestroika* seeks to attract Western technology to the Soviet Union, the assets transferred from the West are often intangibles. In 1986, the United States enacted legislation that should prevent loss of tax revenues, resulting from transfer or licensing to a related foreign entity of intangibles developed by expenses deductible in the United States.[332] A new attribution standard was adopted under I.R.C. section 367(d), which provides that the income earned by a foreign entity from the use of intangibles transferred or licensed to it by a related U.S. corporation transfers substantially all rights to intangible property to a foreign entity.[333] The corporation will then be deemed to have received U.S. source income equivalent to the income attributable to the intangible property transferred.[334]

3. *Debt Financing*

Soviet joint ventures may be funded with a combination of debt and equity. Similar to the "earnings-stripping" provision[335] for subsidiaries in the United States, U.S. corporation's outbound investment debts may result in treating the interest payment as nondeductible dividends. While the earnings-stripping provision provides a safe harbor where the debt/equity ratio of the payor does not exceed one and five-tenths (1.5) to one,[336] there is no similar safe harbor for outbound investments. However, a number of cases have recognized outbound investments using a five to one debt/equity ratio.[337]

C. *Accumulation of Joint Venture Income*

The fact that certain countries disallow their residents from accumulating or sheltering income in foreign corporations is often considered an unfavorable tax measure, and one that may affect Western participation in Soviet joint ventures. It is, however, advantageous for taxpayers taxed on a current basis to arrange their foreign business operations through a joint venture, because by arranging a fifty percent ownership in the joint venture, the taxpayer would most often escape current taxation.

1. *Taxation as a Controlled Foreign Corporation (CFC)*

Foreign corporations controlled by residents are taxed on a current basis in the United States, Canada, France, the United Kingdom,

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332 *See* I.R.C. § 367(d) (1990).
333 *See id.* (d)(2)(A).
334 *See id.* (d)(2)(C).
335 *See* I.R.C. § 163(j) (1990).
336 *Id.* (j)(2)(A)(ii).
337 Patrick, *supra* note 321, at 308.

Japan,[338] and Australia (effective July 1990).[339] While the extent and types of income subject to this tax treatment differ, U.S. tax rules are generally considered restrictive because they include as Subpart F Income, not only passive income, but also certain types of business income. The Soviet joint venture is taxed as a CFC, if the U.S. person's share capital in the joint venture exceeds fifty percent.[340] A U.S. person[341] is defined as a participant with a share capital of at least ten percent.[342] Various attribution rules make it impossible to avoid the treatment by channelling the investment through foreign subsidiaries.[343] The CFC treatment may be avoided only by structuring the participation below the ownership subject to the taxation. The U.S. participant may nevertheless be taxed on a current basis, if the joint venture participation qualifies as a Foreign Personal Holding Company (FPHC)[344] or is subject to the accumulated earnings tax.[345]

2. *Taxation as a Passive Foreign Investment Company (PFIC)*

The PFIC is a tax measure used only in the United States. Even though the PFIC provisions like the CFC provisions are directed at deferral, the PFIC provisions apply to foreign corporations whose passive income exceeds seventy-five percent, or to corporations over fifty percent of whose assets are held for investment.[346] Under these rules, U.S. corporations may be subject to taxation even where there is no U.S. control. In addition, the PFIC tax may be triggered to a Soviet joint venture where its capital generates passive income before it is an operating business.[347] In order to avoid the taxation, the joint venture would have to eliminate the asset test for the PFIC classification.

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338 For a thorough comparison see B. ARNOLD, THE TAXATION OF CONTROLLED FOREIGN CORPORATIONS: AN INTERNATIONAL COMPARISON (1986).

339 *See* Krever, *The Australian Controlled Foreign Company Attribution System*, 1 TAX NOTES INT'L 217, 217 (1989).

340 *See* I.R.C. § 957(a) (1990); Patrick, *supra* note 321, at 307.

341 *Id.* § 957(c).

342 *Id.* § 951(b).

343 *See id.* § 958.

344 In order to trigger the FPHC provisions, not more than five U.S. citizens or residents must own more than 50% of the value of the outstanding shares of a foreign corporation. *Id.* § 552(a)(2).

345 The accumulated earnings tax, a supplement to the ordinary income tax, is levied on corporations formed to avoid "income tax with respect to its shareholders" by their accumulation of earnings and profits instead of distribution of the same. *Id.* § 532(a). The earnings tax is 27.5% on the first $100,000 and 38.5% on taxable income in excess of $100,000. The earnings tax is, however, overridden by the FPHC provisions. *Id.* § 532(b).

346 *Id.* § 1296(a).

347 Patrick, *supra* note 321, at 310.

3. *Taxation as a Foreign Investment Company (FIC)*

The FIC provision is likewise aimed at tax deferral.[348] These rules, however, apply to public owned foreign corporations[349] whose investments are primarily made in foreign securities, typically mutual funds. The U.S. shareholder in a PFIC is entitled to deferral at the corporate level, but on the sale of the stock, the earnings and profits generated by the FIC are treated as ordinary income to the extent gain is recognized.[350] To trigger FIC taxation, the U.S. shareholder must own more than fifty percent of the voting stock in the investment company.[351]

D. *Consolidation*

Though the Soviet joint venture is granted a two or three year tax holiday,[352] it may take longer than that before the joint venture is profitable. A possible consolidation between the joint venture and the joint venture participant would allow the participant to absorb a net operating loss in the joint venture. While consolidation between domestic and foreign corporations is disallowed in some jurisdictions, it is allowed under Danish tax law.[353] For U.S. participants, consolidation with foreign corporations is specifically disallowed.[354]

E. *Foreign Tax Credit*

Almost all developed countries provide domestic relief from double taxation either by taxing on a territorial basis, thereby providing exemption for foreign source income, or allowing taxes paid on foreign income to be offset against domestic taxes. The United States, on the other hand, taxes its residents and citizens on a worldwide basis,[355] and is among the few countries that limit and "pool" the foreign taxes that can be used as credits against domestic

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348 *See* I.R.C. § 1246 (1990).

349 *See id.* § 1246(b).

350 *Id.* § 1246(a)(1).

351 *Id.* § 1246(b)(2).

352 *See supra* notes 237-38 and accompanying text.

353 The Danish Corporation Tax Act permits such consolidation provided the following criteria are met: the foreign entity is classified as a corporation for Danish tax purposes; the fiscal years for the parent and subsidiary are identical; and the domestic corporation owns as much of the foreign corporation as is permitted under the laws of the subsidiary's country of residence. Dik, *Denmark: Taxation of Dividends Received by Resident Companies from Foreign Subsidiaries*, 25 EUR. TAX'N 187, 189-90 (1985) (discussing sec. 31 of the Danish Corporation Tax Act). Since foreign law is generally applied in determining whether an entity qualifies as a corporation in Denmark, the Soviet joint venture would likely qualify as a corporation for Danish tax purposes. The Danish tax authorities further require that the foreign subsidiary be subject to essentially the same taxation as in Denmark.

354 I.R.C. § 1504(b)(3) (1990).

355 *See id.* § 61.

taxes.[356] The credit that can be utilized by the U.S. taxpayer is subject to the overall foreign tax credit limitation, determined by the ratio of foreign source to the effectively connected income generated by the taxpayer.[357] In addition, I.R.C. section 904(d)(3) provides a separate foreign tax credit calculation for dividends paid by each foreign corporation in which U.S. ownership exceeds fifty percent. The limitation applies to income earned by a U.S. investment in a foreign corporation directly or through a foreign subsidiary.[358] As a result U.S. joint venture participants will either pay a residual tax on the joint venture's earnings or generate excess credits on income that can not be averaged with other foreign source income subject to lower taxation.[359] If the U.S. joint venture participant is not subject to the separate calculation, the foreign taxes may be "pooled" in the general limitation basket, which would be included in the global calculation.[360]

F. Foreign Sales Corporation (FSC) Qualification?

The FSC legislation is a tax measure that could work in favor of the Soviet joint venture. The FSC was enacted to encourage U.S. exportation through foreign corporations.[361] The legislation provides that the U.S. exporter is granted an exemption based on the corporation's export income.[362] The exemption generally amounts to fifteen percent of the FSC's export income. Even though the Soviet joint venture could qualify as a FSC, the jurisdiction in which the FSC is organized must also qualify.[363] In order for a jurisdiction to qualify it must have an acceptable exchange of information agreement with the United States.[364] The qualifying countries are either on the published FSC-list or the country may apply for permission to organize FSCs within its jurisdiction.[365] Because the current U.S.-U.S.S.R. Tax Treaty does not provide for exchange of information, the Soviet Union will not qualify for FSC purposes.[366] To attract the FSC, the Soviet Union would also have to provide beneficial tax

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356 The foreign tax credit limitation raises burdensome compliance issues for the U.S. investor. One commentator concludes, "The most troublesome compliance issues that all United States multinational businesses struggle with are found in the enormously expanded labyrinth of foreign-source income restrictions." Mattson, *U.S. Tax Law Impedes U.S. Joint Ventures Abroad*, 2 TAX NOTES INT'L 231, 233 (1990).

357 I.R.C. § 904(a) (1990).

358 *See id.* § 904(d)(3).

359 *See* Patrick, *supra* note 321, at 312.

360 *Id.* at 312-13.

361 Weizman, *The Making of an Export Subsidy: DISCs and FSCs in Compliance with the GATT*, 12 WORLD COMPETITION L. & ECON. REV. 57, 57-58, 69 (1989).

362 *See* I.R.C. § 921 (1990).

363 *See id.* § 922(a)(1)(A).

364 *See id.* § 922(a)(1)(D)(i).

365 For a list of the countries that have been certified for FSC purposes, see Weizman, *supra* note 361, at 70 n.53.

366 The U.S.-U.S.S.R. treaty does not provide for exchange of information, but notifi-

treatment for the FSC, since the FSCs are organized solely in countries which exempt the FSC from taxation.[367]

G. *Bilateral Taxation*

For many years the United States has sought to prevent the use of treaty shopping.[368] The 1981 Draft United States Model Tax Convention Article 16 contains an anti-abuse measure that disallows third country residents from taking advantage of the tax treaty.[369] The U.S.-U.S.S.R. Tax Treaty does not contain an anti-abuse provision, and such a provision would be unnecessary since this treaty probably is the most unfavorable Soviet tax treaty. If the Soviet Union were to follow the U.S. recommendations, and include anti-abuse provisions in its tax treaties, it would subject the Soviet joint venture to a treatment that would prevent third country residents (including U.S. participants) from receiving treaty benefits for investments made through the Soviet joint venture, in countries whose treaties with the U.S.S.R. include the abuse approach. To avoid this the joint venture would have to prove that there is a business purpose and substance behind the joint venture.

H. *Sale of Equity in the Joint Venture*

I.R.C. section 865(a) and (f) provide that the sale or exchange of stock in a foreign corporation with less than eighty percent foreign ownership is treated as U.S. source income, even if the corporation is actively conducting business abroad.[370] Since U.S. taxpayers are interested in income being classified as foreign source income, the U.S. participant would achieve this only by owning more than eighty percent of the share capital in the Soviet joint venture. However, this could qualify the joint venture as a CFC, thereby subjecting gain from the sale or exchange of the equity to taxation under I.R.C. section 1248. This section provides that the gain is treated as ordinary income rather than long-term capital gain. For I.R.C. section 1248 to apply, the corporation must have consitituted a CFC at some time during the five year period preceding the disposition.[371]

V. Conclusion

The sweeping changes in the internal policies of the communist

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cation in the event new statutes within the scope of the treaty are adopted. *See* U.S.-U.S.S.R., *supra* note 258, art. 12.

367 By 1987 almost 95% of all FSCs were organized in the U.S. Virgin Islands, Barbados, and Jamaica. Weizman, *supra* note 361, at 71 n.64. For a list of countries that provide special tax benefits for FSCs, see *id.* at 71 n.63.

368 *See* Weizman, *supra* note 289, at 194-97, 211-24.

369 *Id.* at 211-14.

370 I.R.C. § 865(f) (1990).

371 I.R.C. § 1248(a).

world led to a shift in Soviet foreign trade policy. Soviet efforts to join GATT, the International Monetary Fund, and the World Bank are evidence of an acceptance of international trade and a desire to integrate into the world economy. The Soviet Union was denied GATT membership and observer status because the Soviet centrally planned economic system is seen as incompatible with the free trade principles of GATT. On the other hand, Hungary and Poland were granted GATT accession despite their planned economies. It may be argued that due to its immense size and political influence, the Soviet Union poses a greater threat of disruption to GATT than Hungary and Poland. The rejection of Soviet applications to join the IMF and the World Bank are more puzzling. While the inconvertible ruble would make membership in the IMF and the World Bank impractical, the equally inconvertible yuan did not preclude China from becoming a member. If the Soviets make the ruble convertible as planned by the beginning of the 1990s, further exclusion from the IMF and the World Bank can no longer be justified.

The Soviet joint venture legislation has been criticized from an economic and legal viewpoint. Some question the possibility of making profits in a centrally planned economy. Also, the joint venture legislation, based on the concept of negotiation, has been criticized as incompatible with the Soviet law of state ownership. Yet, questions left unanswered by the joint venture legislation are generally negotiable in the foundation document. One aspect that is not negotiable is the risk of failure which the Soviet joint venture legislation places squarely on the foreign joint venture partner. The ability of a joint venture to accumulate foreign currency is key to the success of the joint venture and the foreign partner because hard currency is necessary to import needed technology and raw materials, to employ non-Soviet employees, and to repatriate profits.

As the foreign investor's gain in access to the Soviet consumer market conflicts with the Soviet government's interests in importing, the joint venture legislation clearly favors the interests of the Soviet Government. The FTOs' monopoly over foreign trade transactions does not allow the joint venture to trade directly with Soviet enterprises or consumers. The currency problems, however, remain the biggest obstacle for foreign investors. The inconvertible ruble makes valuation and pricing impossible and subjects foreign partners' profits to arbitrary determinations by Soviet bureaucrats. The anticipated resolution of the foreign trade monopoly and the inconvertible ruble problems should remove the main obstacles to foreign investors.

Like most Eastern European tax systems, the Soviet tax system is comparatively simple. Although some enterprises are separate from the state budget, by law the means of production belong to the state, thereby making it redundant to tax domestic entities. While taxation of foreign entities appears important, until 1978 the Soviet Union did not subject foreigners to domestic taxes. The principle of reciprocity, shown in particular by Decree 313 Paragraphs 6 and 7, governs current Soviet taxation. Additionally, it is important to note that the taxation of foreigners is also negotiable with the Soviet Government.

The large number of income tax treaties signed by the Soviet Union in the 1980s is added evidence of a change in Soviet attitude towards the West. The U.S.-U.S.S.R. Treaty, signed in the 1970s, was characterized by being brief, and did not contain a provision concerning dividends. The 1986 Swiss treaty is similar to the U.S. treaty. This approach originally favored the United States because Soviet investments in the United States outweighed U.S. investments in the Soviet Union. Today, the treaty is viewed as unfavorable to U.S. investors because the treaty does not provide an exemption for dividend income. Therefore, U.S. participants in Soviet joint ventures are subject to the thirty percent joint venture tax, but not the twenty percent repatriation tax since this tax is discriminatory. A British joint venture participant would escape taxation completely. The renegotiating of a new tax treaty between the Soviet Union and the United States must be cheered since it would clearly lead to improvements in the economic relations between the U.S. and the U.S.S.R.

In the span of five years, *perestroika* has brought revolutionary change to the Soviet Union. Once isolated from the world economy, the Soviets, by seeking GATT membership, discussing the convertibility of the ruble, and unlocking the door to foreign investment, have called for the world's help in reviving its failing economy. The joint venture legislation, while far from perfect, is the clearest signal to date that Western investment is both welcomed and encouraged with adequate protection under Soviet law. Investors are well advised to monitor the progress of *perestroika* in light of its influence upon their financial success, and the Soviet Union is well advised to monitor the influx of Western investments to ensure the political and economic success of *perestroika*.

ADDENDUM

I. New Legislation on Taxation of Enterprises and Joint Ventures

1. Decrees of June 14, 1990

On June 14, 1990, the Supreme Soviet adopted two decrees: "On Taxation of Enterprises, Associations, and Organizations" ("Tax Decree" or "E.T.D."), and "On Procedure for Implementing the Decree on Taxation of Enterprises, Associations, and Organizations." The decrees will affect the taxation of foreign companies and joint ventures with foreign participation. Most of the rules will take effect primarily on January 1, 1991.

2. *Profits Tax (Tax Decree Articles 1-8)*

Taxpayers. The profits tax will be applied to "enterprises, associations, and organizations that operate on a cost-accounting basis, have an independent balance sheet, and are juridical persons."[372] Included are foreign companies, joint ventures with foreign participation, and foreign branches of Soviet joint ventures with foreign participation. While the effective date for most taxpayers is January 1, 1991, the profits tax became effective on July 1, 1990, for joint ventures with foreign participation.

Tax Assessment. The profits tax will be computed on a worldwide basis, and include income derived from sources within the U.S.S.R., on the continental shelf, and in the economic zones, as well as foreign source income.[373] The profits tax will be assessed on the basis of "the sales or work or services, other material valuables, and income from non-sales activities minus the sum of expenditures on these operations."[374] Income from non-sales activities include income derived from participation in joint ventures and leasing of property, interest income, dividends, and other income not directly related to the production and sale of products or performance of services. In determining the taxable income from sales and services, related expenditures and the turnover tax are deducted. The turnover tax is determined in accordance with Articles 14-16 of the Tax Decree, while deductible expenditures include cost of production or performance of services, including material expenditures, amortization for complete replacement of fixed assets, labor costs, state social insurance, compulsory medical insurance, payments for compulsory insurance on property, and interest on short-term bank credits,[375] transfers to reserve funds and similar funds,[376] and payments to repair funds.[377] The Tax Decree further provides that the enterprise or joint venture may deduct thirty percent of its expenditures on environmental protection and research and development of new technology.[378]

Tax Rates. The Tax Decree introduces a two-level tax system under which profits will be subject to federal and local taxation. The federal tax will be twenty-two percent, which amount will be paid into the union budget, while the rate of the local tax will be deter-

372 E.T.D. art. 1(1)(a).
373 E.T.D. art. 2(5).
374 E.T.D. art. 2(1).
375 E.T.D. art. 3(1).
376 E.T.D. art. 2(4).
377 E.T.D. art. 3(1).
378 E.T.D. art. 6(1)(a), (b).

mined under the laws of the Union and republics on the basis of agreement.[379] The total of taxes on profits to be paid into the local budgets will be limited to a maximum tax rate of twenty-three percent.[380] While the new forty-five percent rate will be applicable to Soviet domestic enterprises and joint ventures in which the foreign participation is less than thirty percent, the new tax law will retain the current tax rate on joint ventures that are more than thirty percent foreign owned.[381] These joint ventures will furthermore be entitled to special tax deductions and to a new five-year net operating loss carry-forward rule.

Excess Profits Tax. The Tax Decree introduces a new tax which will subject joint ventures and Soviet domestic enterprises to a tax of up to ninety percent of income considered to be "excess profits."[382] The term "excess profits" will be defined by the U.S.S.R. Council of Ministers, presumably on an industry-by-industry basis.

Tax Holiday. The tax holiday which is currently applicable to joint ventures will be restricted under Article 6 of the Tax Decree to apply only to more than thirty percent foreign owned joint ventures that are engaged in the production of material goods other than in the mineral extraction and fishing industries. The new legislation retains the current two year tax holiday, extended to three in the case of joint ventures established in the Far East Economic Zone.[383] As is the case under prior law, the tax holiday will begin to run from the time the joint venture declares a profit.

Compliance and Payment. As under prior law, the Tax Decree requires that taxable income and amoung of tax due be determined by the taxpayer.[384] Joint ventures with foreign participation, foreign companies, and individuals must still file their tax returns by March 15 of the year following the taxable year. All taxpayers must make advance payments equal to the amount of tax paid during the corresponding period of the preceding year; such payments must generally be made by the 15th and 28th of each month in equal parts of one-sixth of the quarterly profits tax, while joint ventures with foreign participation, foreign companies, and individuals must make their advance payments quarterly, no later than the 15th of the last month of the quarter.[385] The profits tax may be paid in rubles or foreign currency.[386]

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[379] E.T.D. art. 4(1), (2).
[380] E.T.D. art. 4(2).
[381] E.T.D. art. 5(1)(b).
[382] E.T.D. art. 4(3).
[383] E.T.D. art. 6(6)(a).
[384] E.T.D. art. 8(1).
[385] E.T.D. art. 8(4).
[386] E.T.D. art. 8(5).

3. *Branch Profits Tax (Tax Decree Articles 9-13)*

A foreign company that engages in commercial activities in the Soviet Union through a branch or permanent establishment will be subject to a thirty percent tax on profits. If it is not possible to determine the income derived by a branch or permanent establishment, the net income may be considered to be fifteen percent of revenues by agreement between the foreign company and the Union or republic.[387] If a branch of a foreign company is paid in goods or property, the branch profits tax will be based on a comparison of the contract price, the price as set by Soviet exporting organizations, and world market prices.[388]

All branches or permanent establishments of foreign companies will be required to register with the local tax authorities where the branch is located; registration must be made within a month after the beginning of operations, and again one month before the branch ceases to operate.

Foreign companies operating in the U.S.S.R. through a branch must declare the branch's taxable income in a report filed with the local tax authorities no later than April 15 of the year following the accounting year.[389] The report will be subject to annual auditing. If the branch terminates its activities, the report must be presented within a month after the date of termination. The foreign company must then make a payment order on a form approved by the U.S.S.R. Ministry of Finance. The tax is to be paid at the time specified by the payment order, either in rubles or foreign currency.

4. *Turnover Tax (Tax Decree Articles 14-16)*

The turnover tax, equivalent to a value-added tax, will apply to enterprises, associations, and organizations, including joint ventures with foreign participation, foreign companies and individuals. Only production and sale of goods are subject to the turnover tax. The conditions governing the turnover tax and the tax rate are to be extablished by the U.S.S.R. Council of Ministers.

Article 16 of the Tax Decree exempts specified products, industries, and organizations from the turnover tax; it specifically provides for a two year exemption starting from the date of the beginning of operations for enterprises producing commodities from local raw materials and wastes, provided that the value of the local materials used in the production does not exceed twenty-five percent of the total value of the commodity.[390] In addition, companies manufacturing mass production goods may retain up to thirty percent of the tax

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387 E.T.D. art. 10(3).
388 E.T.D. art. 10(4).
389 E.T.D. art. 13(2).
390 E.T.D. art. 16(1)(a).

on turnover resulting from an increase in their output compared with the preceding period in accordance with procedures established by the U.S.S.R. Council of Ministers.[391]

5. Export and Import Tax (Tax Decree Articles 17-19)

Included in the Tax Decree is a new export-import tax, which will apply to companies engaged in foreign trade activities. The tax will be based on the difference between Western market prices and Soviet prices, and will be calculated in rubles.

6. Tax on Resources Designated for Consumption (Tax Decree Articles 24-30)

The tax on resources designated for consumption will apply to virtually all taxpayers, except foreign individuals and joint ventures with foreign participation exceeding thirty percent.[392] The phrase "resources designated for consumption" includes all employee wages, money payments, income on stock owned by an employee collective, and the contributions of members of an employee collective to enterprise property. Certain specified taxpayers are exempted from the tax.

The rate of the tax will be established annually by the Supreme Soviet when approving the budget. The tax is to be paid quarterly in accordance with the profits tax procedures in Article 5.

7. Income Tax (Tax Decree Articles 31-33)

Dividends and income of Soviet participants from joint ventures will be subject to a flat fifteen percent tax.[393] Dividends from state securities are, however, exempt from taxation.[394]

The Tax Decree has retained the repatriation tax; foreigners will be subject to a fifteen percent withholding tax upon the transfer of income derived from participation in joint ventures. The new withholding tax is lower than the existing twenty percent rate.[395] The repatriation tax must still be paid in foreign currency, and will apply "unless otherwise provided by international agreements of the U.S.S.R. on tax matters."[396]

The new Decrees provide that the taxes on dividends and repatriation are to be collected at the source, and that the payor will be responsible as withholding agent.[397] A foreign participant in a joint

391 E.T.D. art. 16(2).
392 E.T.D. art. 24.
393 E.T.D. art. 31(2).
394 E.T.D. art. 31(4).
395 E.T.D. art. 31(1).
396 E.T.D. art. 31(2).
397 E.T.D. art. 31(3).

venture, and foreign companies who can claim protection under a tax treaty, must submit a request for refund in accordance with procedures established by the Ministry of Finance.[398] If the income has been transferred abroad, the request must be submitted within one year after the date of the transfer.

The new legislation also imposes a twenty percent tax rate on interest, dividends, rents, and royalities paid to foreign recipients.[399] Income from freight paid by foreign companies in connection with international transportation will be taxed at a six percent tax rate. A foreign recipient who can claim protection from these taxes under a tax treaty must make a request similar to one made under Article 31. Finally, Article 33 of the Tax Decree provides for a new seventy percent entertainment tax, which became effective on July 1, 1990.

8. *Special Provisions (Tax Decree Articles 34-35)*

Article 34 will carry on the reciprocal approach of Soviet tax law, providing that protection from Soviet taxes under the Tax Decree can be claimed under a tax treaty to which the Soviet Union is a party, or may be suspended or limited on a reciprocal basis when the foreign country has instituted similar measures under which Soviet companies' tax liability with respect to the same or equivalent taxes is suspended or limited. The reciprocal taxation in the foreign country must be attested to by the tax authorities in the country in question.

Article 35 will seek to eliminate double taxation. Relief is not based on a credit system; instead, Article 35 provides that the amount of profits or income derived from abroad will be included in the income subject to Soviet taxation, and taxes on income derived from foreign sources will then be deductible for purposes of calculating the income taxable in the U.S.S.R.

9. *Compliance Rules (Tax Decree Articles 36-41)*

The Tax Decree contains tough new enforcement measures and penalties. Article 37 provides that the taxpaying company and its "officials" will be responsible for compliance. If the taxpayer fails to provide the accounts and balance sheet required, the taxpayer will be subject to a fine of 110 percent of the tax calculated for the preceding accounting period.[400] Failure properly to keep accounts or to file on time will result in a penalty of ten percent of the tax owed.[401] In cases of concealment or understatement of income, the taxpayer is subject to a fine of double the amount of taxes owed. A foreign

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398 E.T.D. art. 31(5).
399 E.T.D. art. 32(1), (2).
400 E.T.D. art. 37(1).
401 E.T.D. art. 37(3).

company with a Soviet branch or permanent establishment, which is required to register with the local tax office but fails to do so, will be treated as a tax evader and subjected to fines equal to double the income generated by the enterprise. Officials responsible for the filing and accounting are subject to a penalty ranging from 100 to 300 rubles ($160 to $480) in cases of negligence. The officials are subject to imprisonment for up to two years or a fine from 200 to 1000 rubles in cases of intentional concealment or understatement of income.[402]

II. New Legislation on Taxation of Individuals, Foreign Citizens, and Stateless Persons

On April 23, 1990, the Decree "On the Income Tax Payable by Citizens of the U.S.S.R., Foreign Citizens, and Individuals without Citizenship" ("I.T.D.") was adopted, and on April 25, 1990, the procedural decree to implement the legislation was adopted by the Supreme Soviet.

Taxpayers. The Decrees apply to Soviet and foreign nationals residing in the U.S.S.R., as well as stateless persons with residency in the U.S.S.R. The legislation provides that individuals residing in the U.S.S.R. for more than 183 days out of the year are considered residents for tax purposes.[403]

Taxable Income. While all types of income generally are included in taxable income, the Decrees enumerate a number of exceptions as well as deductions to offset gross income.[404] The new Decrees introduce a provision which provides relief from multiple taxation; it states that the amounts of income taxes paid abroad are "calculated" for purposes of determining the taxable income in the U.S.S.R., and that the amount of tax owed to the U.S.S.R. cannot exceed the amounts of taxes paid abroad.[405] It appears from the language of this provision that relief is provided on the basis of credit. Finally, the legislation explains that if rules established in an "international agreement" are contrary to the rules under the legislation then the rules under the agreement will apply.[406]

Tax Rates. The Decrees contain new tax rates for individuals. The tax rates applying to individuals were previously based on various sets of rules, depending on the type of income and the taxpayer's marital status. The new legislation has retained this approach. The basic tax rate is now imposed at a maximum of sixty percent for income exceeding 3,000 rubles. The amount of income that can be

402 E.T.D. art. 37(6).
403 I.T.D. art. 1.
404 I.T.D. art. 3.
405 I.T.D. art. 5(2).
406 I.T.D. art. 6.

earned tax-free has been increased from 70 rubles to 100 rubles. Also, the new legislation retains the reciprocal approach with regard to foreign citizens; it provides that the collection of taxes from foreign individuals may be limited on the basis of reciprocity in cases where the same measures are in effect for Soviet citizens.[407]

[407] I.T.D. art 28(4).