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Joint-Ventures in the Soviet Union Under the New Regime—Boom or Bust

Karl William Viehe*

I. INTRODUCTION

Pursuant to the decision of the Presidium of the Supreme Soviet of the Union of Soviet Socialist Republics taken January 13, 1987, the Counsel of Ministers of the Union of Soviet Socialist Republics issued a decree entitled "On the Establishment in the Territory of the USSR an Operation of Joint-Ventures with the Participation of Soviet Organizations and Firms from Capitalist and Developing Countries."[1] The rich potential of the Soviet market, together with the fundamental changes in thinking which seem to be increasingly a real characteristic of the Gorbachev era, has piqued the interest of many western firms. A conference was held this past June in Washington, D.C. at the International Law Institute among a number of U.S. legal authorities on East-West trade, American businessmen and -women, and a delegation of six scholarly lawyers from the Institute for State and Law in Moscow to discuss the current status

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1. Translation by the Institute for State and Law, Civil Division of the Soviet Academy of Sciences for use at the International Law Institute's Conference on the Soviet joint venture law [hereinafter Decree of The USSR Council of Ministers] (although the original document does not have numbered pages, citations in this article refer to them in numerical sequence); *see infra* n. 3.

of the joint-venture law recently promulgated. This article will discuss a number of the findings which arose in the course of this conference.[2]

The law requires that joint-ventures be controlled by the decree of the Presidium of the USSR Supreme Soviet dated January 13, 1987, entitled "On Questions Concerning the Establishment on Territory of the USSR in the Operation of Joint Ventures, International Amalgamations and Organizations with the Participation of Soviet and Foreign Organizations, Firms and Management Bodies," as well as by any additional legislation enacted by the USSR and its constituent union republics, subject to international and/or multilateral or bilateral agreements to which the USSR has subjected itself.[3]

Approval of the proposed joint-ventures emanates from the Council of Ministers and is further controlled and effected by the agreements of the parties to the joint-ventures. Proposals for joint-ventures are to be submitted by the prospective Soviet partner to the appropriate ministries and government agencies which control the organization. In turn, the ministries and agencies in the Union Republics are required to submit proposals to the Council of Ministers of the respective Republics which, in turn, are required to obtain agreement from the USSR State Planning Committee, the USSR Ministry of Finance, and other appropriate ministries. Having obtained all the foregoing approvals, the creation of joint-venture proposal is forwarded to the USSR Council of Ministers for final approval.[4]

All of the foregoing processes seem to have been recognized as too cumbersome and were modified subsequent to the June 1987 Washington Conference to enable individual Soviet Ministries and Departments and the Union Republic Councils of Ministers the right to make decisions with respect to the joint-ventures, international associations, and organizations.

The types of projects for which joint-ventures are sought include those which would result in the output of various types of manufac-

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2. The conference was held June 8th, 9th and 10th, 1987 in Washington, D.C. at the International Law Institute and was ably co-chaired by Don Wallace, Jr., the Director of International Law Institute, and Dr. Viktor Mozolin, Chief of the Sector of Civil Law, Institute of State and Law of the USSR Academy of Sciences.

3. Decree of the USSR Council of Ministers, *supra* note 1, at 1. It should be noted that, subsequent to the decree of January 13, 1987, the USSR Central Committee and the USSR Council of Ministers adopted a resolution intended to address, in part, some of the shortcomings of the enabling decree. On Additional Measures for Improving Foreign Economic Activity Under New Management Conditions, *reprinted in* 41 EKONOMICHESKAYA GAZETA, October 1987 [hereinafter Additional Measures].

4. Decree of the USSR Council of Ministers, *supra* note 1, at 1.

tured products, the production of raw materials and food stuffs, projects which would employ equipment with a "high-tech" component, projects through which the Soviet economy receives the benefit of exposure to foreign managerial expertise, projects which serve to expand the export capabilities of the economy, and, by correlation, those which reduce imports presently placing heavy demands on the USSR's reserves of foreign currency.[5]

While the foregoing "shopping-list" of desired projects is quite extensive, one factor of indispensable concern to the success or failure of the joint-venture initiative will be the attitude of the United States Department of Defense and the Departments (Ministries) of Defense of the fellow COCOM member states with respect to the export licensing process. Since a joint-venture is generally a long-term commitment, such an investment will not appear attractive if a validated, technical data export license is granted for a period not to exceed two years, assuming that DOD will permit the issuance of the technical data license at all. Furthermore, there is the additional difficulty of obtaining the corresponding equipment licenses that will certainly be necessary for many joint-ventures.[6]

II. Legal Characteristics of the Joint-Venture

The law contemplates the joining of Soviet enterprises which are "legal entities" and foreign firms, also required to be legal entities, to form a partnership, which itself is to be recognized as a legal entity under Soviet Law.[7] These joint-venture entities are empowered to contract, to enter into agreements which place them under continuing economic obligations, to bring actions before appropriate courts of justice and arbitral tribunals, and to "acquire proprietary and non-proprietary personal rights." This latter power, as to proprietary and non-proprietary personal rights, is somewhat unique and requires clarification.

Article Five of the decree provides that the Soviet interest in the "authorized fund" of the joint venture is to be not less than fifty-one percent. The notion of the host-nation retaining control over joint-ventures is not unfamiliar to those firms having participated in joint-ventures in less developed countries.

5. Additional Measures, *supra* note 3, at 3.
6. Letter from Thomas L. Shillinglaw, Division Counsel, Legal Department of Corning Glass Works to Karl Viehe (Sept. 16, 1987).
7. Decree of the USSR Council of Ministers, *supra* note 1, at 1.

The joint-venture is required to have what is termed a "statute" approved by its partners. This statute is merely the partnership or joint-venture agreement, and its required content includes the nature and extent of the joint-venture, its objectives, its domiciliary address, the names of the partners, the amount of the "authorized fund" and the share interests therein of the partners, the procedure for raising the capital which comprises the authorized fund (including, specifically, the foreign-currency component of the authorized fund), the organization of the fund's management, the decision-making procedures to be followed, a statement of issues requiring unanimous agreement, and the procedures to be followed in dissolving and winding-up the joint-venture. In addition, the duration of the venture may be stated in the agreement or by a separate agreement among the partners.[8]

Once all of the formal approvals for the joint-venture proposal have been obtained and the partnership agreement has been established, the venture is required to register with the USSR Ministry of Finance, at which time its status as a legal entity is established. The decree states that a notification of the formation of the joint-venture is to be published in the press but does not designate whose responsibility it is to provide for the publication.[9]

The joint-venture is required to establish an "authorized fund," as noted above. This fund is analogous to the capital account of a partnership familiar to Western practitioners. The joint-venture partners provide contributions to the authorized fund, and the fund can be maintained or enlarged through profits from the entity's operations or through additional capital contributions. The capital contributed to the fund by the partners of the joint-venture may be in the form of cash; buildings and/or other structures; equipment; rights to the use of land, water, and/or natural resources; rights to the use of buildings, structures, and/or equipment; convertible and inconvertible currencies, where appropriate; and other intangible property rights such as patents, trademarks, copyrights, etc.[10]

One of the great difficulties with which the parties will be faced arises out of the non-cash contributions of the parties. Article Twelve of the decree provides that the contribution of the Soviet partner is to be evaluated in rubles on the basis of "agreed prices," which give

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8. *Id.*
9. *Id.*
10. *Id.*

due consideration to world market prices. First of all, even assuming the parties could arrive at an agreement on the market value of non-cash contributions, giving due regard to world market prices, there still would remain the question of what exchange rate to employ in making a conversion from foreign currency-agreed prices to rubles. As there are a limited number of reasonably practical exchange rates to use, this latter problem should not be insurmountable. More difficult, however, is the task of arriving at agreed-upon world prices which reflect fair market value. Ultimately, indices based upon the real purchasing power of labor units may have to be established in order that the sticky problem of valuing non-cash contributions may be overcome.

Similar problems may arise with respect to the valuation of the contribution of a foreign partner, particularly with respect to what is to be deemed the official exchange rate to be employed in the conversion to rubles. Valuation of non-cash contributions of the foreign partner may be less difficult for those foreign partners which transact business in convertible currencies; however, for those foreign partners from countries with non-convertible currencies, the valuation problem remains difficult. Article Twelve further provides that the date of conversion of value to ruble terms is the date of the signing of the joint-venture agreement or such date as the parties may agree upon. It is also provided that, where world market prices cannot readily be determined, the parties may determine value by agreement. These latter provisions may prove to be the escape mechanism for the valuation problem. It is not difficult to imagine that, for projects which are deemed important by the appropriate authorities, the issue of valuation can be readily overcome through these latter provisions.

Article Thirteen provides that any equipment, materials, and/or other property required to be imported into the USSR by the foreign partner in a joint-venture as a contribution to capital in the venture will not be subject to customs duties. Furthermore, the western partner in the prospective joint-venture has flexibility in valuing its assets, particularly in the area of transferred technology, although there are limits to the extent that the assets are readily marketable, in which case market values can easily be established, thereby limiting the flexibility in valuation.

The decree requires that the property of the joint-venture be compulsorily insured with insurance agencies of the USSR. It is interesting to note that this requirement for insurance is not part of the founding contract of the joint-venture agreement, but is a legal

requirement. It is unclear, however, whether the joint-venture entity itself, as a property interest, is required to be insured and, furthermore, whether the joint-venture is required to obtain liability insurance, notwithstanding the fact that liability insurance is presently unavailable in the Soviet Union. Given the rather undeveloped state of Soviet law with respect to limited liability, in particular, and, generally, the nascent state of Soviet practice regarding insurability against liability, the prospective joint-venture partner needs to give careful consideration to the entire matter of insurance. Practically speaking, counsel familiar with international insurance practice should be retained to assure that the coverage in place is adequate.

Article Fifteen of the decree of January 13, 1987 states that the joint-venture will be entitled, pursuant to law applicable to it as a juridical entity, to "own, use and dispose of its property" consistent with the purposes for which it was established and the intended purpose of the property. The provision goes on further to state that the property of the joint-venture is not to be requisitioned or confiscated by administrative order. Moreover, the rights and property of the joint-venture are to be protected by legislation which currently provides protection for state-owned Soviet enterprises. Execution, which presumably conveys the notion of a "taking," is enabled by the decision of appropriate bodies empowered under Soviet legislation to resolve disputes arising out of the conduct of the joint-venture.[11] As will become clearer, *infra*, the notions of use and disposition of property by the joint-venture noted in Article Fifteen are similar in some aspects to the treatment of property in a partnership context in western practice, but, nevertheless, differ from the concept of property held in a joint-venture between western commercial entities.

One of the more interesting aspects of the joint-venture law is found in Article Sixteen, which provides for the assignment of shares in the joint-venture by the venturers in whole or in part to third parties by "common consent." The concept of common consent is somewhat ambiguous. For instance, the most plausible interpretation of the concept would be that unanimous consent is required. However, it may be that, where there are more than two parties to a joint-venture, a majority of the venturers may be willing to approve the assignment, but the requirement of unanimity would bar the result. In western partnership practice, a partnership agreement can

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11. *Id.* at 2.

provide either for the unanimous approval of the partners as to an assignment by one of them or for approval by a majority of the partners. Because of the joint and several liability of the partners arising with respect to the partnership's activities, requirements of unanimity may be prudent even for the mere assignment of a partnership interest and, perhaps, even more strongly recommended in the case where there is to be a transfer of the property of the partnership interest.

Certainly the concept of common consent needs to be satisfactorily clarified in any joint-venture agreement. Notwithstanding common consent, the assignment is not wholly effective until it has been subjected to the endorsement of the State Foreign and Economic Commission of the Soviet Council of Ministers. Furthermore, the provisions of Article Fifteen contemplate the Soviet partners having a "right of first refusal" to acquire the assigned shares.

The provision also seems to contemplate an event analogous to the dissolution of a partnership, in which case the rights and obligations of the joint-venture "pass to the assignees."

From the foregoing, it is clear that the concept of a property right obtained by the joint-venturers falls somewhat short of the notion of a partnership interest obtained by a co-venturer in western practice. In western practice, the concept of an assignment speaks to the transfer of something less than a party's full right, title, and interest (in the current context, a partnership interest). Transfer of the partnership interest, in contrast to an assigment, however, conveys all right, title, and interest which the co-venturer has in the partnership, thereby divesting the co-venturer of not only any right, title, and interest which that venturer may have in the partnership interest but also any right, title, and interest which that venturer may have in the underlying partnership property in the event of a dissolution.[12]

The joint-venture decree provides that all industrial property of the ventures, including patents, are to be protected by Soviet law. The law goes on to state that the joint-venture agreement itself shall specify the procedure by which partners transfer property and/or property rights to the joint-venture.[13]

Article Eighteen provides some seemingly contradictory statements about the liabilities of a joint-venture. It starts out by indicating that the joint-venture is liable for fulfilling its obligations, presumably to

12. *Id.*
13. *Id.*

the extent of its property.[14] The provision then goes on to indicate that the Soviet state is not liable for the obligations of the entity but, then, neither are the partners in the venture. This would seem to provide for the entity the status of a corporation with the shareholders being liable only to the extent of their share of the capital. In this sense, the proposed entity is somewhat different than that normally associated with a joint-venture, since the concept of a venture as a partnership normally implies that the partners shall be jointly and severally liable for the obligations of the entity beyond that of the respective capital contributions of the partners.

The law provides that the joint-venture has no liability for obligations of the Soviet state nor for the liabilities of individual partners in the venture.

Furthermore, should the joint-venture establish affiliates within the USSR, those affiliates are themselves legal entities and do not impose liability as to their obligations on the joint-venture and, likewise, such affiliates are not liable for the obligations of the joint-venture. Thus, the affiliates are quite analogous to subsidiaries of western corporate practice.[15]

The establishment of affiliates and/or representational offices within the territory of the Soviet Union is permitted, but the right to so establish affiliates must be provided for in the joint-venture agreement (foundation documents).[16]

The law goes on to provide a dispute resolution mechanism requiring that, where the joint-venture and a Soviet state-owned entity, cooperative, or other public organization find themselves in a dispute, or where the joint-venturers themselves become embroiled in a dispute with respect to matters arising out of the joint-venture activity, or where two or more joint-ventures find themselves in a dispute, the matter shall be settled consistent with Soviet legislation by the Soviet judicial system or, where third parties consent, by submission to an appropriate arbitration tribunal.

This system of resolution of disputes needs to be very carefully considered by the western partners in the joint-venture. First and foremost would be consideration as to whether or not an agreement to arbitrate would be given effect by the Soviet judicial system in

14. *Id.* The section reads "[a] joint-venture shall be liable on its obligations in all of its property." This would seem to indicate that the venture, as an entity, is liable to the extent of its property.
15. *Id.*
16. *Id.*

the event a significant dispute arose. Second, a prospective venturer should be well apprised of the perils of submitting a dispute to arbitration under Soviet practice. Third, it certainly would seem to be highly desirable to have matters with respect to disputes covered in the joint-venture agreement with the inclusion of, where appropriate, arbitration clauses, choice-of-fora clauses, and choice-of-laws clauses.

The Soviets, in the past, have submitted to international arbitration in Sweden in accordance with the International Chamber of Commerce rules on arbitration, and it would certainly seem that disputes between joint-venture partners would be treated as international disputes and, therefore, proper for submission to international arbitration. Nevertheless, prospective partners are well advised to proceed with caution in formulating contract provisions covering the matter of dispute resolution.

III. Procedures and Practices for Operating Joint-Ventures

The law provides that the equivalent of the board of directors of the joint-venture, which is termed the "governing body," is constituted by an appointment by the partners. The chairman of the governing body and the director general of the joint-venture, *i.e.*, the operating manager, are required to be Soviet citizens.

It is anticipated that the operational management of the joint-venture will consist of both Soviet citizens and foreign nationals.

The procedures for the board to follow in its decision-making are to be specified in the joint-venture agreement.[17]

The law requires that the joint-venture entity establish relations with the appropriate central authorities of the Soviet government and the respective governments of the Union Republics by intermediate authorities superior to the Soviet venture partner, which, presumably, means through the ministry to which the Soviet partner is responsible. On the other hand, the entity is empowered to contact local governmental authorities directly.

The law provides that the joint-venture entity is to have full freedom in establishing its plan of operations and that no Soviet state planning organization shall establish a mandatory plan in limitation of the joint-venture's freedom of operation. On the other hand, the law provides that no state-planning organization shall

17. *Id.*

provide a guaranteed market for the joint-venture's products.[18] Furthermore, in accordance with the decree, the joint-venture has full freedom with respect to entering into contracts for export and import activities necessary to its business operations, including the authority to conduct export and import operations in furtherance of its business with members of the Council of Mutual Economic Assistance. These provisions seem to permit the direct contracting for the requisite export and import operations. The law goes on to state that export and import operations may also be conducted with the assistance of Soviet foreign trade organizations or through contracting with marketing networks of foreign partners.

The shipment of the output of the joint-venture is to be done pursuant to a license issued by the government in accord with appropriate legislation.

The law entitles the joint-venture to correspond freely with organizations in other countries as well as to maintain telegraph, teletype, and telephone communications.[19]

One aspect of the joint-venture law that is of particular importance to prospective venturers is that provided in Article Twenty-five. Because of its importance, Article Twenty-five is quoted in full: "25. All foreign currency expenditures of a joint-venture, including transfer of profits and other funds due to foreign partners and specialists, shall be covered by *proceeds* from the sales of the joint-venture's products on foreign markets."[20]

The first point to be made in connection with this article is that the repatriation of profits is enabled only to the extent that "proceeds" are available from the sales of the joint-venture's products on foreign markets.

The second point to be noted is that, if the products to be manufactured require a substantial component of imported materials or subassemblies, payment for said subassemblies must also be covered by proceeds from the sales of the joint-venture's products on *foreign* markets.[21]

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18. *Id.*
19. *Id.*
20. *Id.* (emphasis added).
21. The foreign exchange needs covered by this article can be substantial, including machinery, spare parts, foreign employees' salaries, debt service, royalty payments to the foreign partner for its technology, and, alternatively, dividend repatriation. The time for the venture to make inroads into western markets sufficient to provide foreign exchange needs may be of too long a duration for it to cover effectively its foreign exchange operational needs in the start-up phase.

Article Twenty-five does not contemplate the possibility of a joint-venture generating exchange by selling domestically to foreign trade organizations for foreign exchange. This latter point envisions the joint-venture selling its product to foreign trade organizations and receiving foreign exchange in payment. Furthermore, certainly most ventures would like to be able to sell directly to the Soviet market for rubles and convert those rubles to foreign exchange upon the theory that these latter direct sales were import substitutions; that is, a sale that the Soviet buyer otherwise would have had to have made abroad in exchange for convertible currency.

The joint-ventures also seem not to have the ability to trade foreign exchange among themselves upon agreed-upon bases. That is, for instance, a foreign exchange-rich venture might wish to sell some of its foreign exchange to a joint venture lacking sufficient foreign currency. Therefore, it is quite possible that, under the latter circumstances noted above, proceeds may not be available to provide for the repatriation of profits. Furthermore, as will be noted below, there is also a remittance tax on repatriated profits.

The net effect of this provision should be to cause venturers to focus on production of products for sale in foreign markets and, at the same time, to minimize the use of foreign resources and materials and subassemblies in order to maximize the dollars available to be deemed "proceeds from foreign sales" to provide for the repatriation of profits.[22]

Article Twenty-six may be a source of disappointment for many prospective partners in that it requires sales of products resulting from the joint-venture to be channeled to the Soviet market through the appropriate foreign trade organization. Certainly, one of the magnets for any prospective partner in the Soviet Union is the magnitude of its market, with reasonably widespread mass media available in furtherance of marketing prospects. However, this inability to participate directly in the marketing of the venture's products will prove unattractive for many types of enterprise. Certainly, this will be true in terms of production in the consumer sector, although it may be less a problem in the raw materials and industrial sectors of the economy. While subject to the limitations noted above, the joint-venture entity has the freedom to purchase raw materials and other subassemblies from international markets. However, supplies

22. Decree of the USSR Council of Ministers, *supra* note 1, at 2.

of such from the domestic market are required to be channeled through the appropriate Soviet foreign trade organization. This may create problems for the venture.

Moreover, materials purchased through the Soviet foreign trade organizations must be paid for in rubles pursuant to prices established by contract, but these prices are required to be established with "due regard to world market prices."[23] Requiring the contractual prices to be established with "due regard" to world market prices may necessitate a price structure which results in the price of the final product not being competitive internationally.

Clearly, one of the reasons for a western firm considering a joint-venture would be to take advantage of attractive wage differentials. If raw materials and subassemblies are arbitrarily increased in price to world market levels, the advantages quickly diminish.

Article Twenty-seven provides that the joint-venture may obtain credits on what is termed "commercial terms." Foreign exchange may be obtained from the Soviet Bank for Foreign Trade or, upon obtaining the consent of this latter bank, from foreign banks and other institutions. Capital needs, in ruble terms, may be obtained on credit from the USSR State Bank or the USSR Bank for Foreign Trade.

Both the USSR State Bank and the USSR Bank for Foreign Trade have the authority to monitor the use of funds provided under the credit agreement, to require appropriate security, and to require timely repayment of the monies loaned.[24] Cash assets of the joint-venture denominated in rubles must be deposited in a ruble account with the USSR State Bank, while cash assets denominated in foreign currency must be deposited with the USSR Bank for Foreign Trade.

Article Twenty-nine provides that the foreign currency accounts shall be interest-bearing with reference to international monetary rates, while the ruble accounts are to bear interest on terms to be specified by the USSR State Bank. The gains or losses which arise on the foreign currency accounts of the joint-ventures are required to be reflected currently on the entity's operating statement ("profit and loss accounts").[25]

One provision which is apt to cause some concern is Article Thirty, which requires the joint-venture to set aside from its operating profits,

23. *Id.*
24. *Id.*
25. *Id.* at 2-3.

monies which are to form a "reserve fund" and additional funds, presumably denoted as segregated accounts, sufficient to provide for its costs of operation and for the "social needs of its personnel." Thus, the provision seems to require the establishment of three separate line item accounts which might be termed the "reserve fund;" the "operating account," and the "social fund." While the annual contributions to these funds are to be agreed-upon and incorporated in the joint-venture agreement, the amount required to be channeled into the reserve fund must amount to a total of twenty-five percent of the authorized capital of the joint-venture.[26]

Several observations are in order. First of all, the decree seems to provide no indication of what is to become of amounts contained in the funds upon liquidation of the venture. Second, it might have been advantageous to have the required amounts be structured as taxes in order that, where appropriate, they be creditable as foreign taxes paid in the foreign partner's home jurisdiction.

The law provides that the profits of the joint-venture are to be distributed among the venture partners in proportion to each partner's share in the venture's capital account (authorized fund) after deduction from profits of amounts to be paid into the USSR National Treasury as taxes and payment of sums necessary to establish the joint-venture's capital account or, where appropriate, to replenish said account.[27]

In regard to this provision, it might have been better if the drafters had provided some flexibility by permitting an incentive preferential return to appropriate parties under certain circumstances. Certainly, such a result could have been rather easily included by adding to the words "funds shall be distributed among the partners in proportion to each partner's share in the authorized fund" or the phrase "or in such manner as the partners shall agree."

Article Thirty-two of the decree seems to be somewhat contradictory, certainly in spirit if not in fact, to the provisions of Article Twenty-five. Simply stated, Article Thirty-two guarantees that the foreign partners may repatriate their share in the distributive profits of the venture without restriction. However, as noted above, Article Twenty-five seems to permit the transfer of profit only to the extent that proceeds are available from the sales of products on foreign

26. *Id.* at 3.
27. *Id.*

markets. Certainly, any prospective partner will want to have this point clarified.

An interesting provision arises under Article Thirty-three, wherein it is stated that joint-ventures shall make depreciation payments in a manner similar to that of state-owned organizations. This provision seems to require a payment into an account pro rata to the extent of depreciation of the venture's capital assets. Western firms, however, normally consider depreciation to be a cost of business from which they obtain a tax savings and the idea of paying into a depreciation account will not be appealing.

However, it must be noted that the law does provide that the joint-venture agreement can provide for a different method of accounting for depreciation, and certainly western partners will want to reflect generally accepted accounting principles.[28]

The law provides that design and construction of the facilities, both for operating and social purposes, are to be paid for by the venture itself either out of its own capital or with borrowed funds. The USSR State Building Committee is to establish a procedure for the approval of building designs in connection with the joint-venture, and the needs of the joint-venture in connection with this construction, both as to labor and materials, are to be given priority.[29] The law also provides that the transportation of products of the joint-venture will be in accord with the procedures followed by Soviet domestic enterprises.

IV. Tax Treatment of the Joint-Venture Entity

Unlike the U.S. practice of taxation of joint-ventures, where the venture partnership generally is a "conduit," Article Thirty-six of the decree of January 13, 1987 provides for "entity" treatment of the joint-venture.

Although the article provides no definitive statement of how the concept of profit is to be arrived at nor any accounting guidelines to determine profit, the tax rate applied to profits of the joint-venture is thirty percent of the profits which remain after allowance for the required contribution to the reserve and the provision for funds to be used for capital construction ("development of production") and research and development ("science and technology"). The aforementioned tax is paid at the national level.

28. *Id.*
29. *Id.*

Initially, the law provided a tax holiday for the joint-venture, exempting it from the aforementioned tax on profits for the first two years of operation. Practically speaking, however, very few ventures, particularly those involving large start-up costs, will have any profits to exempt in the first two years. The provision for the tax relief would have been far more attractive if, consistent with incentive tax holiday programs employed in western practice, the period of forbearance from taxation encompassed a span of time of from four to ten years, depending on the nature of the venture.[30]

Article Thirty-six does provide for some flexibility in that the USSR Ministry of Finance is empowered to levy a reduced rate or to eliminate the tax on the joint-venture. Although the intent of the provision is somewhat unclear, it appears also that the Ministry of Finance has the power selectively to eliminate the tax on joint-venture partners.[31] The decree of January 13, 1987 provides that the joint-venture itself is responsible for the determination of the tax due on profits. The law requires that the entity determine an "advance tax payment" for its current operating year based upon its best estimate of its financial plan for that year. Furthermore, the joint-venture is required to make a determination of the total tax payable no later than the fifteenth of March of the year following the current fiscal year. Appropriate financial authorities within the Soviet government are authorized to review the determination made by the entity. The tax for the current year is required to be paid to the government in equal installments, similar to the estimated quarterly tax payments required of an American business, not later than fifteen days prior to the end of the quarter. The balance, if any, is to be paid on or before the first of April of the year following the then-current year. In the event the predetermined tax results in an overpayment for the year, the amount overpaid can be refunded or credited against taxes payable for the following year.

In the event there is a delay in transferring payment to the government for the taxes due, a penalty is assessed at the rate of five one-hundredths of one percent for each and every day of delay, which compounds to an annual penalty of twenty-five percent.[32] A

30. Additional Measures, *supra* note 3, at 3, alters the parallel provisions in the Decree of the Council of Ministers, *supra* note 1, at 2, stating, "In order to increase involvement on the part of foreign partners in the creation of joint-ventures on Soviet territory, it is deemed practicable to exempt these enterprises from payment of taxes on profits over a period of two years from the time they receive their *first* declared profits." (emphasis added).

31. *See generally*, Decree of the USSR Council of Ministers, *supra* note 1, at 3.

32. *Id.*

procedure is stated for the collection of taxes not timely transferred, which presumably applies to the foreign partners of the venture.[33]

Article Forty provides a right of appeal on the part of the joint-venture to actions of the financial authorities concerning any matter of tax collection. The appeal is required to be filed with the authority charged with verification of the tax computation. The law provides that the appeal shall be decided within thirty days of its filing. In the event of an adverse determination at the level of the first appeal, the entity is entitled to a further appeal to an appropriate superior financial authority, assuming the appeal is filed within one month from the day of the adverse ruling. Notwithstanding the fact that an appeal is filed or to be filed, the entity must pay the tax due.[34]

The foreign partner in the joint-venture faces a repatriation of profits tax in the amount of twenty percent unless there is a tax treaty in effect between its domiciliary state and the USSR. Recall that profits cannot be transferred unless and until there are sufficient proceeds from the sales of the joint-venture's product on foreign markets. [35]

Two interesting questions arise with regard to the provisions of Article Forty-one. The first is, in which currency must the repatriation of profits tax be paid? For instance, there may be sufficient proceeds for the payment of the eighty percent of the profits which a foreign partner desires to repatriate but not for the additional twenty percent due as tax. So, the question arises as to whether that twenty percent can be paid in rubles. The second question concerns whether the portion of profits desired to be repatriated by a foreign partner are profits stated in ruble terms or in hard currency. Furthermore, there is a question as to whether the hard currency has to be that of the repatriating partner or whether it might be a hard currency profit resulting from a sale in other markets.

The tax regimen outlined above is effective for joint-ventures which are established in the territory of the USSR and also for affiliates of joint-ventures which are located in the USSR, where such affiliates are established with the participation of Soviet enterprises and/or other organizations. For these latter entities the reach of the tax

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33. Rules on Collection of Delayed Taxes and Non-Tax Payments, Ved. Verkh. Sov. SSSR, 1981, No. 5, art. 122 (Decree of the Presidium of the Supreme Soviet of the USSR, dated January 26, 1981, establishing a procedure for the collection of taxes from foreign legal persons).

34. Decree of the USSR Council of Ministers, *supra* note 1, at 3.

35. *Id.*

statutes is both to profits produced within the Soviet Union including its continental shelf and to profits arising from operations in other countries. Thus, the thrust of the tax scheme is to provide for the taxation of world-wide profits (income).[36] It is interesting to note that nothing in the general policy statement of the decree of January 13 explicitly or implicitly indicates the aim to encourage active manufacturing operations such as is found in the U.S. provisions for taxing foreign source income of corporations, but this may merely be a reflection of the fact that there will not be relatively free entry into the marketplace. Nevertheless, it might seem worthwhile for the USSR Ministry of Finance, in developing its implementing regulations,[37] to give some thought to structuring the taxation of ventures in such a way as to provide incentives for the entry of partners in the lines of activity for which there is particular interest.

V. Administrative Procedures for Supervising Joint-Venture Operations

The law requires that the joint-venture agreement provide for a flow of information to the partners in order to provide them with the facts necessary for decision-making with respect to all aspects of its operations and the status of its balance sheet and operating statements. The joint-venture agreement may provide for the institution of an auditing procedure for the continuous monitoring of the venture's accounts.[38]

A problem which looms on the horizon is the requirement that the joint-venture maintain its business, bookkeeping, and statistical records of account in a manner consistent with that for Soviet state-owned enterprises. This is quite likely to result in a necessity for the foreign partner to maintain two sets of books. Furthermore, this is particularly true for publicly-held foreign partners. No clear procedures are provided for dealing with any domestic requirements imposed on the foreign partner for certified statements prepared by independent auditors nor for the filing requirements necessary in connection with the securities regulations of foreign jurisdictions. Also, it is unclear whether the foreign partner would be able to

36. *Id.* While Article 42 provides that the tax procedure applies to "income," it seems fairly clear that the intention is to tax profits as noted in Article 36. *See supra* text accompanying note 33.

37. *Id.* at 3.

38. *Id.*

provide information on the venture pursuant to a court order (or, for that matter, arising in the course of ordinary discovery proceedings) from a court outside the Soviet Union.

The USSR Ministry of Finance and the Central Board of Statistics are charged with the responsibility of developing accounting and bookkeeping requirements and, clearly, it will be worthwhile for them to focus on the aforementioned issues.

The need for clarification of these issues is particularly apparent in light of the provision that a "joint-venture shall not submit any accounting or business information to the state or other authorities of foreign countries."[39] On the face of it, the foregoing provision would render participation by any American firm untenable in that even non-public firms would have the requirement to provide accounting information to state and federal tax authorities. Superficially, at least, the "out" for the Ministry of Finance might be that the provisions of Article Forty-five prohibit the direct submission of information by the joint-venture, but do not prohibit the submission of appropriate information by the joint-venture to the foreign partner with the foreign partner then able to transmit that information in accord with its domestic filing requirements. However, even accepting such a tenuous interpretation of the wording, it is not difficult to conceive of a situation in which, under a tax audit of the foreign partner by the foreign partner's domiciliary government, the need would arise for the submission of verifying information directly from the joint-venture entity. Some clarification with regard to the foregoing issues is necessary.

The joint-venture itself is charged with the responsibility for maintaining its accounting records and for having bookkeeping procedures in place which result in true and accurate records. However, the law provides for audit of the joint-venture's activities by an appropriate Soviet auditing organization with appropriate fees to be paid to the auditing organization.[40] If this provision becomes mandatory, it may lead to a duplication of effort which may prove burdensome to the venture in general and, more particularly, to the foreign partner which, in any event, will want to provide for its own audit in fulfillment of its domestic reporting requirements.

39. *Id.*
40. *Id.*

VI. Personnel Issues for the Joint-Venture

Certainly one of the key areas of uncertainty to be faced by the foreign partner is its ability to deal with the Soviet labor force. Assuming that appropriate relationships can be established in the context of the joint-venture agreement and that agreements can be reached with the appropriate trade union organizations, the experience with Soviet labor may not prove to be too unfavorable if it follows the pattern occurring in ventures employing host country nationals in Poland and Hungary. However, practically speaking, it is certainly far from clear at the outset that the trade union organizations will be willing to accommodate the realities of operating a business enterprise in a commercially feasible manner.

Article Forty-seven of the decree provides that there is to be a predominance of Soviet labor employed by the joint-venture. The joint-venture agreement together with the provisions of Soviet social legislation will have a profound impact on the content of the agreements reached with the appropriate trade union organizations.[41] At the outset, the process will be somewhat tenuous until sufficient precedent has accumulated to provide guidance for negotiating such agreements.

The terms and conditions of employment of the workforce, not surprisingly, are to be controlled by regulations issued pursuant to Soviet legislation. These regulations will encompass the pay scales, scheduling of work, the provision for recreation, the provision of social security, and social insurance for the Soviet citizens employed by the joint-venture. The law also provides that various aspects of the terms and conditions of work for foreign citizens employed by the joint-venture shall be controlled by regulations issued pursuant to Soviet legislation. Matters of pay schedules, leaves, and pensions are to be established on a case-by-case basis as reflected in contracts signed with each of the foreign employees.[42] The decree, however, is unclear as to which parties are to be signatories to the contracts with the foreign employees.

The law states that the USSR State Committee for Labor and Social Affairs and the All-Union Central Council of Trade Unions are empowered to provide the rules and are to develop regulations

41. *Id.* at 4.
42. *Id.*

to provide social insurance coverage for the joint-venture's foreign employees.[43]

Article Forty-nine requires the joint-venture to make contributions to the national budget in amounts sufficient to pay both the costs of state-sponsored social insurance for both the Soviet and foreign employees and the costs of pensions for Soviet employees as determined by the appropriate state organizations.[44] It is quite unclear at this time whether these amounts bear any relationship to the reserve fund requirements stated in Article Thirty of the decree of January 13, 1987.

One very specific provision of Article Forty-nine is that contributions made by the joint-venture to the foreign employees' pension plans are required to be transferred to the employees' domiciliary country, with the transfer to be in the currency of that country.[45]

The joint-venture's foreign employees are subject to an income tax as provided under Soviet law.[46] The part of the foreign employee's pay which is saved may be repatriated in foreign currency and, in fact, the law seems to permit it to be transferred anywhere abroad.[47]

VII. Liquidation of the Joint-Venture Entity

The decree provides that there are several procedures by which the joint-venture can be terminated. First of all, the joint-venture agreement may provide the types of events which result in termination and the procedures to be followed to terminate. In addition, the Council of Ministers may order a termination if the activities of the joint-venture are not consistent with its objectives as defined in the joint-venture agreement. Public disclosure of the liquidation of the joint-venture is required; however, it is not clear whether such publication is to be made prior to the liquidation or ex post facto.[48]

One of the areas of greatest uncertainty in connection with the decree is the distribution of monies upon liquidation. The provision is that: "The foreign partner shall have the right to return his contribution in money or in kind pro rata to the residual balance of

43. *Id.*
44. *Id. See supra* text accompanying note 28.
45. Decree of the USSR Council of Ministers, *supra* note 1, at 4.
46. *See* On the Income Tax Levied on Foreign Legal and Physical Persons, Ved. Verkh. Sov. SSSR, 1978, No. 20, art. 313 (Decree of the Presidium of the Supreme Soviet of the USSR dated May 12, 1978).
47. Decree of USSR Council of Ministers, *supra* note 1, at 4.
48. *Id.*

his contribution at the moment of liquidation of the joint-venture, after discharging his obligations to the Soviet partners and third parties."[49]

The first question which arises concerns the concept of the "residual balance." Presumably, what should happen in the liquidation is that the joint-venture discharges all of its obligations incurred as an entity, providing some amount which might be termed a "residual balance" against which there may be required offsets to adjust the accounts for any obligations which may exist between or among the parties. Another question arises, as noted above, with respect to what part the reserve fund plays in arriving at the value of a residual balance. Another issue which might also be considered is, in the event the joint-venture is unsuccessful and the remaining obligations are such that the residual balance is negative, what are the responsibilities of a foreign partner, and how would the responsible Soviet authorities deal with the situation if a bankruptcy of the foreign partner were to be precipitated by that partner's obligation on the negative residual balance?

As a final matter, the decree requires that the liquidation is to be registered with the USSR Ministry of Finance upon its completion. This, of course, is not unfamiliar to western practice, since most corporate entities are required to file a notice of dissolution upon the termination of the corporate entity.

VIII. Summary

First, the venture in which the foreign partner would be entering is, in many respects, like a partnership interest in that, on the whole, it appears to be relatively illiquid. No real safeguards exist in the way of a limitation on liability, and the partner's interest is subject to limitations on transferability and to rights of first refusal. Additionally, the obligations of the joint-venture partners in a liquidation seem to parallel those of partners in the liquidation of a partnership.

On the other hand, from the point of view of its taxation, the joint-venture entity seems to be more corporate in form, in that it is given entity rather than conduit treatment; that is, a tax is levied against the entity rather than the pro-rata share of profits passing through to the respective partners to be taxed only at the partner's personal (corporate) rate of taxation. While restrictions on share-

49. *Id.*

holders such as those found in the joint-venture law are not uncommon, the shares received by a foreign partner in a joint-venture seem to have few of the characteristics required by the western notion of title. Perhaps one of the more useful ways to characterize the interest that the western partner receives is as a leasehold interest in the shares of the enterprise subject to a requirement for capital contributions under appropriate terms and conditions.

A second point to be considered is that the thrust of the joint-venture law as it is now structured seems inevitably to focus the productive efforts of the joint-venture on goods and services which will be exported from the Soviet Union, ultimately resulting in the earning of hard currency which can then be repatriated, subject to stated limitations.

A third factor to be considered is the inability of the joint-venture entity to sell directly to the Soviet market. Unless implementing regulations issued pursuant to the decree provide a rather creative way of overcoming this problem, this provision is apt to be the single most dissuasive element in the joint-venture package. Certainly, many western firms look at the Soviet market as one which holds a great deal of potential.

A fourth point is that the decree of January 13, 1987 provides only the skeleton of the law by which the joint-venture program will be controlled. There is a fair amount of flexibility built into the decree, and the implementing rules and regulations as they are formulated may shed some light on a few of the areas of uncertainty identified in the analysis above. Furthermore, as some of the larger and better connected western firms enter into joint-ventures requiring political solutions to practical problems arising under the decree, precedents will be established which will be useful in formulating subsequent ventures.

IX. Concluding Remarks

It is the opinion of this author that the joint-venture reforms, as instituted, are an interesting first step. It is clear that the law reflects the remaining distrust of the private holding of productive capital. This author believes that the fear of placing productive capital in private hands does not reflect a shrewd assessment of the dynamics of political economy of recent western experience. A noteworthy example is the ability of the political processes to disembody the single largest industrial corporation in the Western world, *i.e.*, American Telephone and Telegraph, and to dismantle the $149 billion

entity into six separate companies (whether that was a wise result will be left for the reader to decide). The very fact that such was accomplished when the political will deemed it appropriate ought to shed some light on the putative "indominability" of corporate capital in the political process.

A simple and far less bureaucratic approach to attracting foreign capital and skill might involve a multi-pronged policy including:

1. The creation of foreign enterprise zones;
2. the authorization of long-term leases of real property, both within and without such enterprise zones;
3. the authorization of leases of appropriate terms on the tools and equipment necessary for operating businesses;
4. the establishment of appropriate "domestic content" provisions;
5. the requirement for the training and employment of Soviet citizens in appropriate proportions; and,
6. the authorization of entities to employ personnel up to some appropriate numerical level.

None of the foregoing suggestions would violate the basic tenets of the social system vis-à-vis individual and property rights and all of the foregoing would have been much simpler to implement from a regulatory point of view. Furthermore, it is the belief of this author that many more western enterprises would find the Soviet market attractive with such a scheme, particularly since the start-up capital costs for ventures would be far less than under the joint-venture law as now contemplated.