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Effective Business Development in Arctic Russia: How to Make the Arctic Zone Attractive for Business

*Pavel Tkach**

The Russian Arctic includes millions of square kilometres of land, sea, and ice with a huge amount of mineral resources. For business, the Far North may be considered a vast place for experimentation. However, this region also involves many disadvantages for business, such as its cold temperatures, remoteness, and logistical difficulties. During these difficult times, additional state support for legal entities or

entrepreneurs who intend to start commercial activities in the Arctic can make these regions more attractive and, consequently, more profitable. But what can the Arctic provide businesses, other than profits from mineral resource extraction activities, and how can the region attract business for other commercial activities? This year, the Government and Ministry of Far East and the Arctic of the Russian Federation tried to answer this question, and it issued Federal Law № 193-FZ on State Support of Entrepreneurial Activity in the Arctic Zone of the Russian Federation. We must emphasise that this legal instrument was not issued as a response to the COVID-19 outbreak but was, rather, planned long before the pandemic.



Pic. 1. Arctic Zone of the Russian Federation (from <https://64parallel.ru/obshhestvo/pojmano-v-seti/kostomuksha-teper-v-arkticheskoy-zone/>)

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The state of business in Arctic Russia

To properly begin this section, we must answer the question: What is Arctic Russia? Arctic Russia is four federal subjects of the Russian Federation (namely: Murmansk Oblast, Nenets Autonomous Okrug, Yamal-Nenets Autonomous Okrug, and Chukotka) and five federal subjects, partly represented by municipal formations (the Republic of Karelia, Arkhangelsk Oblast, Krasnoyarsk Krai, Sakha Republic, and Komi Republic) (Pic. 1). A detailed list of the territories belonging to the Arctic Zone of the Russian Federation is set out in the Decree of the President of the Russian Federation № 296 from 2 May 2014 on Land Territories of the Arctic Zone of the Russian Federation.¹

The state of business in the Arctic can be characterised by a strong link between municipalities, small-to-medium businesses, and the mineral extraction industry. This link can be traced in the number of monotowns in Arctic Russia. For the purpose of this research, a *monotown* is a city whose economy is dominated by a single industry or company. A list of monotowns is managed by the Order of the Government of Russia № 1398-r from 29 July 2014, and a monotown may be excluded from the list if its local

economy is sufficiently diversified. However, while the main goal of a link between municipalities and businesses is mutually beneficial to diversify the economy and gain profit, the link between municipalities and the mineral extraction industry aims to provide comfortable conditions for industry and opportunities to enjoy logistics through the Northern Sea Route. Problems in the development of entrepreneurship in Russia have regularly become subjects of discussion at the federal level – in ministries and departments, in the Federation Council and the State Duma, and at meetings with the president of the Russian Federation. Despite these discussions, until 2020, state support for entrepreneurial activity in the Arctic Zone was poor. At the same time, federal subjects looked forward to a diversification of the local economies and developed various projects supporting local entrepreneurs. For example, the educational project ‘You-entrepreneur’ was founded in cooperation with the Russian Federation on the federal level and Arkhangelsk Oblast on the local level to encourage young entrepreneurs to implement business activities in the Arctic. Nevertheless, a lack of state support for local entrepreneurs was not the only difficulty facing entrepreneurship in the

¹ Decree of the President of the Russian Federation № 296 on Land Territories of the Arctic Zone of the Russian Federation (Presidential Executive Office, 2014)
<<http://static.kremlin.ru/media/acts/files/0001201405050030.pdf>> accessed 3 November 2020
(translation by the current author)

Arctic. Local entrepreneurs have highlighted the following difficulties:

1. Harsh natural and climatic conditions that affect almost all types of economic and social activities, including the accelerated wearing of fixed industrial assets and a need for these assets' frequent replacement.
2. The risks of environmental accidents and disasters whose elimination in the Arctic – especially on the sea shelf – is an unprecedentedly complex and little-studied matter.
3. Businesses' dependence, in many regions of the Arctic, on northern deliveries (supplies from the central regions of the country during a limited period of Arctic sea and river navigation, including oil, oil products, coal, food, and technical products) and the high cost of these goods' transportation (including by air) to remote Arctic territories.
4. The general underdevelopment of all types of supporting infrastructure for business – such as roads, engineering, and energy.
5. A shortage of many qualified specialists and insufficient motivation for existing workers due to a lack of competition in the local labour market.
6. Arctic businesses' high dependence on large, city-forming corporate structures and state and municipal support, with insufficient bank financing and unfriendly conditions compared to

Russia's central regions (including interest rates on loans).²

All of these factors raised a question about the invention of a distinct package of state support measures for entrepreneurial activity in the Arctic within the federal agenda. A response to this agenda was enacted on 13 July 2020: Federal Law № 193-FZ on State Support of Entrepreneurial Activity in the Arctic Zone of the Russian Federation (hereinafter referred to as 'Federal Law').

Federal Law: From the registration stage to the first profits

Alexander Krutikov, one of the bill's authors, commented on the prerequisites for the law's creation:

This law offers incentives and mechanisms for the economic development of the Arctic. An increase in people's household income is, first of all, the creation of highly paid jobs and the construction of new enterprises. Today, the capital costs of setting up a new enterprise in the Arctic are 2-3 times higher than in central Russia, and no investor will go there. Moreover, the number of operating small businesses is steadily

² Valeriy Lebedevich, *Problems of Small and Medium Business Development in the Arctic Zone of the Russian Federation* (Russian Center for Arctic Development, 2017) <<http://arctic-rf.ru/deyatelnost/issledovaniya/problemyi-razvitiya-malogo-i-srednego-biznesa-v-arkticheskoy-zone-rossijskoj-federaczii.html>> accessed 4 November 2020 (translation by the current author)

declining. We took all the best that works and is in demand by business in the Far East, but it is impossible to completely copy its preferential treatment for the simple reason that the costs and risks are higher in the Arctic. It is proposed to establish reduced tax rates in the Arctic for the entire duration of the investment project. In addition, they will operate not within the support zones and priority development areas but throughout the entire territory of the Arctic Zone of the Russian Federation.³

This statement shows that business practices in the Far East of Russia were used as the case study during the bill's development, and the bill's basic concept is the *priority development area*. The priority development area is where a special legal regime has been established to implement entrepreneurial and other activities in order to attract investments, ensure accelerated socioeconomic development, and create comfortable conditions for the population.⁴ De jure, the Arctic Zone of the Russian Federation is, as a whole, not a priority development area per regulations of the

main legal framework, Federal Law № 473-FZ on Territories of priority rapid socio-economic development. But de facto, the Arctic Zone is perceived by the Government as one large priority development area. As a result, the regulation of state support for entrepreneurial activities in the Arctic Zone is comparable to the regulation of priority development areas in the Russian Federation and adapted, as mentioned in the previous section, to risks and costs in the Arctic.

The Federal Law on State Support of Entrepreneurial Activity in the Arctic Zone of the Russian Federation begins with the most important definition of this legal instrument – the definition of a *resident of the Arctic Zone of the Russian Federation*. A *resident of the Arctic Zone of the Russian Federation* (hereinafter, a *resident*) is an individual entrepreneur or legal entity whose state registration was carried out in the Arctic Zone of the Russian Federation in accordance with the Russian Federation's legislation (except for state and municipal unitary enterprises), which entered into an agreement on the implementation of investment activities in the Arctic Zone of the Russian Federation (hereinafter,

³ Project Office for the Development of the Arctic, *It's Time to Strengthen Support for Small and Medium-Sized Businesses in the Arctic* (porarctic.ru, 30 May 2019) <<https://porarctic.ru/blog/2019/05/30/pora-usilit-podderzhku-malogo-i-srednego-biznesa-v-arktike/>> accessed 5 November 2020 (translation by the current author)

⁴ Federal Law № 473-FZ on Territories of priority rapid socio-economic development (Official Internet Portal of Legal Information, 2014) <<http://static.kremlin.ru/media/acts/files/0001201412290024.pdf>> accessed 5 November 2020 (translation by the current author)

an agreement on the implementation of investment activities) in accordance with the Federal Law, and which is included in the Arctic Zone of the Russian Federation's register of residents.⁵ By this definition, we may conclude that entering into an agreement on the implementation of investment activities grants one status as a resident of the Arctic Zone of the Russian Federation.

Before the administrative procedure of entering into this agreement, a prospective resident must meet all of the following requirements for legal entities or entrepreneurs:

1. The state registration of a legal entity or entrepreneur should be carried out in the Arctic Zone of the Russian Federation (in one of the municipal formations included in the Arctic Zone, or in a federal subject if it is completely located within the Arctic Zone).⁶
2. A legal entity or entrepreneur should intend to implement a new investment project in the Arctic Zone or new to the entity or entrepreneur types of entrepreneurial activities – that is, the entity or entrepreneur must not have conducted these activities before the date of their application. This requirement clarifies that the purpose of this law is not only to attract investment but also to increase the value of the

Russian Arctic as a place for business experiments.⁷

3. The total amount of implemented and planned capital investments cannot be less than 1 million rubles (13,100 USD). This low limit to planned capital investments was declared in order to attract small and medium businesses to entrepreneurial activities in the Arctic.⁸

After meeting these requirements, applicants undergo the procedure for registration as a potential resident of the Arctic Zone. Article 9, Section 4 of the Federal Law declares that the registration procedure may be conducted online. To apply for an agreement on the implementation of investment activities in the Arctic Zone, a prospective resident must follow three simple steps. First, they must visit the Arctic Russia website (<https://arctic-russia.ru/en/>), navigate to the 'Investor' section, and click on the 'User Account' section. Second, they must apply for user account registration. Within a few hours, the application will be approved, and the user will receive their registration data at their email address. Third, to log in to their user account, the user must navigate to the 'Services' section to prepare a required package of documents, upload them electronically, and click the 'Send' button. The required

⁵ Federal Law № 193-FZ on State Support of Entrepreneurial Activity in the Arctic Zone of the Russian Federation (Official Internet Portal of Legal Information, 2020) <<http://kremlin.ru/acts/bank/45677>> accessed 6 November 2020 (translation by the current author)

⁶ Federal Law (no 5) Article 2.1.2

⁷ Federal Law (no 5) Article 9.6.1

⁸ Federal Law (no 5) Article 9.6.3

package of documents includes copies of statutory documents (for legal entities), a business plan, an extract from the Unified State Register of Legal Entities or an extract from the Unified State Register of Entrepreneurs, and a copy of the applicant's certificate of registration with the tax authority. The application will be considered within 10 days, and if a positive response is received, an agreement will be signed within 10 days from the moment response received. The agreement is signed by the legal entity or entrepreneur and the state, represented by a management company.⁹ The *management company* concept derives from the Federal Law on Territories of priority rapid socio-economic development, and it refers to the company appointed by the Government of the Russian Federation to manage priority development areas.¹⁰ The main requirement for such a company is that its controlling stock belongs to the state.

The commercial activity of a resident of the Arctic Zone is accompanied by preferences which fall into two categories: tax preferences and administrative preferences. Tax preferences include a 0% tax rate for:

VAT when selling goods placed under the customs procedure of the Free Customs Zone (FCZ); income tax from the moment the resident's first profit is received; land tax from the moment resident status is obtained or the ownership of each land plot commenced; corporate property tax from the tax period in which the organisation is included in the Arctic Zone of the Russian Federation's register of residents.¹¹ However, these preferences do not apply to projects in solid mineral extraction, to representative offices (branches) of foreign entities registered in the Arctic Zone of Russia in order to implement investment projects, or to entities with branches outside the Arctic Zone, which would contradict to articles 284.4.1.2 and 284.4.1 of the Tax Code of Russian Federation, with amendments that will be enacted on 1 January 2021.¹² Importantly, the tax preferences mentioned above apply only to taxes paid into the federal budget; tax rates for taxes paid into the budgets of federal subjects are set annually by local tax authorities. Moreover, the Tax Code does not specify the maximum tax rates

⁹ Federal Law (no 5) Article 10.1

¹⁰ Federal Law (no 4) Article 2.5

¹¹ Tax Code of the Russian Federation № 117-FZ with amendments on 15 October 2020 (Official Internet Portal of Legal Information, 2020)

<http://www.consultant.ru/document/cons_doc_LAW_28165/> accessed 7 November 2020

(translation by the current author)

¹² Rules of the Tax Preferences to the Residents to the Arctic Zone of the Russian Federation Will Enter into Force on 1 January 2021, with Amendments (15 October 2020) to Tax Code of the Russian Federation

for taxes paid into the budgets of federal subjects, and it only declares the possibility of reduced tax rates.¹³ This rule enables local tax authorities to reduce tax rates for residents of the Arctic Zone by only 1%, and tax rates will thus remain high. On the other hand, article 284.4.5 (2021) declares that the tax rates for taxes paid to the budgets of federal subjects by the residents of priority development zones and residents of the Free Port of Vladivostok cannot exceed 5%. We suggest that adding residents of the Arctic Zone of the Russian Federation to the ruling of this article would make tax preferences more dependable for entrepreneurs and legal entities implementing commercial activities. Administrative preferences include: no quota on the recruitment of foreign employees; shortened inspection times (the term for scheduled inspections cannot exceed 15 business days); a possibility to apply the free customs zone procedure to residents' developed and equipped land plots; court representation of residents by the management company; and a possibility to conclude concession agreements without tender procedures.¹⁴

In addition to preferences, residents also have obligations. Residents' primary obligations are to carry out the activities provided for by the agreement and to

make investments, including capital investments, in the declared amounts and terms.¹⁵ A violation of these obligations constitutes a repudiatory breach of their agreement, and it may result in termination of the agreement and revocation of resident status. Regarding non-contractual obligations, notably, article 28 of the Federal Law establishes an obligation for residents of the Arctic Zone to support and cooperate with Indigenous communities in their places of residence or their traditional activities, following the principles approved by the authorised federal body. The authorised federal body monitors compliance by residents of the Arctic Zone with these principles and publishes a report on this compliance on its official website annually, no later than July 1.¹⁶ Nevertheless, a violation of the obligation for cooperation with Indigenous communities will not lead to termination of the agreement, though it may cause fines for the resident.

In concluding this section, we reiterate that tax and administrative preferences are very attractive and able to make entrepreneurial activities in the Arctic financially comfortable. However, tax preferences also entail certain drawbacks, such as the inability to use these preferences in mining projects and by entities with branches outside the

¹³ Tax Code (no 12) Article 284.1.8

¹⁴ Federal Law (no 5) Chapter 4

¹⁵ Federal Law (n 5) Article 11.3

¹⁶ Federal Law (no 5) Article 28.4

Arctic Zone. On the positive side, we emphasise that the application procedure may be completed online, without any additional administrative burden, and the requirements for the total amount of implemented and planned capital investments enables small and medium businesses to participate. Despite these advantages, a foreign company that wishes to register a representative office or branch for commercial activities in the Arctic will be unable to avoid an administrative burden. Before a representative office or branch of a foreign company applies for status as a resident of the Arctic Zone, they must first undergo the state registration process as a legal entity within the Arctic Zone of Russia. For the other Arctic States, we have emphasised the legal definition of a *resident of the Arctic Zone* as an example of how to divide business conditions on the grounds of a location.

The Russian Government's opinion – reflecting the relation of the state to the Federal Law – can be found a statement by Yuri Trutnev, Deputy Prime Minister of the Russian Federation:

Significant steps have been taken to improve the system of public administration for the development of the Arctic region. Almost the entire Russian Arctic is becoming a

special economic zone with a set of tax preferences. The most important thing is that the principle is changing: if at the previous stage the State itself invested in the Arctic, and in not very large amounts, now we are talking about supporting investors and providing assistance to projects in the economic sphere. We will continue to improve the conditions for commercial activities, develop the economy of the Arctic territories because this will help improve the living conditions of people in the future.¹⁷

The Government supports this legal instrument, but how it will apply practically remains to be seen.

Conclusion

In conclusion to our research, we would like to link the Federal Law on State Support of Entrepreneurial Activity in the Arctic Zone of the Russian Federation and entered into force on 26 October 2020 the Strategy on the Development of the Arctic Zone of the Russian Federation for the period up to 2035 (hereinafter, *Strategy*) and to address how the Federal Law will help achieve the Strategy's goals.

First, Paragraph 4, Subparagraph D of the Strategy recognises that a major

¹⁷ Ministry for the Development of the Russian Far East, *The Arctic Zone of the Russian Federation Accepts Its First Residents* (minvr.gov.ru, 5 October 2020) <<https://minvr.gov.ru/press-center/news/28229/>> accessed 9 November 2020 (translation by the current author)

problem in the economic development of Arctic Russia is the uneven industrial and economic development of certain territories in the Arctic Zone and the economic focus on extracting natural resources, with further exports to the industrialised regions of the Russian Federation and abroad.¹⁸ Unequal tax preferences for mining projects in the Federal Law clarify that the law's foremost goal is diversifying the economy since, firstly, the mining industry in Russia is well divided between Gazprom and Rosneft and, secondly, the Arctic Zone of the Russian Federation is, as a whole, a well-developed "mining hub" which lacks serious problems. Moreover, a focus on mining and a lack of economic diversification may lead to an increased number of monotowns and shrinking Arctic cities, such as Vorkuta, where – after the collapse of the city's dominant coal mining industry – the population decreased dramatically, from 218,467 people in 1989 to 73,123 people in 2020.

Another achievement of the Federal Law is its introduction of a special economic regime in the Arctic Zone. According to Paragraph 12, Subparagraph A of the Strategy, the introduction of a special economic regime in the Arctic Zone may

promote the area's transition to a circular economy. Paragraph 12 of the Strategy declares a list of necessary measures to achieve economic development in the Arctic. We think the Federal Law can be considered a general legal framework for these measures' implementation. For example, Subparagraph G declares the necessity of simplifying the procedure of granting land plots for the purpose of carrying out economic and other activities not prohibited by law, which is implied from Article 15 of the Federal Law. Furthermore, based on Paragraph 17, Subparagraph M of the Strategy, we can suggest that the preferences declared by the Federal Law be considered as measures to attract not only different projects but also foreign investments to the Arctic Zone.

So, can we consider this Federal Law to be promising? We can find the answer to this question in statistics. As of 14 November 2020, the Arctic Zone of the Russian Federation includes 14 registered residents, 55 billion rubles (719 million USD) in investments, and 2,855 announced new jobs.¹⁹ These figures offer hope that the economy of the Russian Arctic will diversify and that Arctic entrepreneurship will rise.

¹⁸ Strategy of the Development of the Arctic Zone of the Russian Federation for the Period Up to 2035 (Official Internet Portal of Legal Information, 2020)

<<http://static.kremlin.ru/media/events/files/ru/f8FhckYOPAQQfxN6Xlt6ti6XzpTVAvOy.pdf>>
accessed 10 November 2020 (translation by the current author)

¹⁹ <https://investarctic.com/en/>