

# CLIENT UPDATE

## TOP 10 LEGAL DEVELOPMENTS IN RUSSIAN REAL ESTATE AND CONSTRUCTION MARKET IN 2013

### MOSCOW

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International law firm Debevoise & Plimpton LLP presents an overview of ten most significant, in our opinion, developments in the Russian legal regulation (including lawmaking initiatives) and court practice in the real estate, construction and infrastructure sectors in 2013.<sup>1</sup>

### LAWS AND REGULATIONS

#### 1. *Substantial Increase of Tax Burden for Certain Owners of Commercial Real Estate*

The Federal Law adopted in November 2013 permitted the constituent subjects of the Russian Federation to impose property tax on certain commercial property (offices, shopping centres, domestic services facilities, etc.) based on its cadastral rather than balance value (which was used for these purposes previously). The prerequisites for applying the new taxation regime are: (1) a cadastral valuation completed in the respective constituent subject; and (2) a special law adopted by such constituent subject introducing such regime. Given that the cadastral value is typically higher than the balance value, the tax burden will generally increase.

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<sup>1</sup> Please note that this opinion is subjective, and this overview does not attempt to describe all major developments in the legislation and court practice in 2013.

The primary impact, as expected, took place in Moscow. Despite the general reduction of the ultimate tax rate from 2.2% to 2.0% and a milder regime (compared to the federal framework limits) in Moscow (in 2014, the tax rate in Moscow will be 0.9% (rather than 1.5%) increasing 0.3% annually until it reaches 2.0% in 2018 (rather than in 2016)), generally the taxes on Moscow real estate have risen (tenfold or more in certain instances).

Consequently, many owners of such properties intend to contest their cadastral valuation vigorously in court. We note, however, that now and then discussions take place behind the scenes whether contesting of cadastral valuation can be prohibited by law (presently there are no specific draft laws in this respect).

*(See, e.g., Federal Law No. 307-FZ on Amendments to Article 12 of Part One and Chapter 30 of Part Two of the Tax Code of the Russian Federation dated November 2, 2013; Law of Moscow No. 63 dated November 20, 2013 on Amendments to Law of Moscow No. 64 on Corporate Property Tax dated November 5, 2003)*

## 2. *Changes to the Rules of Registration of the Transactions with Real Property and Cadastral Record of Real Property*

First, the state registration of certain transactions with real property (including sale and purchase of residential premises, businesses, gift, long-term lease) was abolished, leaving only the state registration of the title to real property. However, such approach in respect of the long-term lease triggered a strong reaction of the legal and business community, and after a short discussion, the state registration of the long-term leases was re-instated.

But there was a short period (March 2 and 3, 2013) when the original law abolishing the registration was still in force while the new law re-instating it was not yet effective. The long-term leases executed during this period were in fact valid without their state registration. The High Arbitrazh Court later confirmed that such leases were valid with a reservation that the lessees thereunder would not have any preferences in relation to third parties (e.g., they will have no priority right to extend the lease for a new term or continuity right), unless such leases are registered.

*(See Federal Law No. 302-FZ on Amendments to Chapters 1, 2, 3 and 4 of Part One of the Civil Code of the Russian Federation dated December 30, 2012 and Federal Law No. 21-FZ on Amendment of Certain Legal Acts of the Russian Federation and on Deeming Certain Provisions of Legislative Acts of the Russian Federation Inoperative dated March 4, 2013; Federal Law No. 142-FZ on Amendments to Part One, Section I, Subsection 3 and Part Three of the Civil Code of the Russian Federation dated July 2, 2013; Plenary Ruling No. 98 of the Higher Arbitrazh Court dated December 25, 2013 on Supplementing Plenary Ruling No. 73 of the Higher Arbitrazh Court dated November 17, 2011 on Certain Matters of the Practical Application of the Rules of the Civil Code of the Russian Federation in Respect of Lease Agreement)*

Second, a whole range of technical and legal issues related to the state registration or cadastral record of real property was clarified/simplified (e.g., EGRP can now be maintained electronically; shorter period (18 rather than 20 calendar days) of cadastral registration, simplified filing for registration, etc.).

*(See Federal Law No. 250-FZ on Amendment of Certain Legal Acts of the Russian Federation in Respect of the State Registration of Title and State Cadastral Record of Real Property dated July 23, 2013).*

### 3. *The Concept of a Consolidated Real Property Complex*

This is an important rule for a number of commercial entities that allows to register complex and/or separate real properties consolidated by virtue of the same purpose (or location on the same land plot) as a consolidated real property complex (e.g., a pipeline, fuel station, power grid facilities, etc.). It is expected that in practice this new concept will benefit natural monopolies and owners of infrastructure facilities.

*(See Federal Law No. 142-FZ on Amendments to Part One, Section I, Subsection 3 of the Civil Code of the Russian Federation dated July 2, 2013)*

### 4. *The Clarified Procedure for the Termination of Certain Rights to Land Plots*

Certain grounds and procedures were defined and codified for the seizure of land plots that are not being used for their proper purpose (this applies to the right of perpetual use, right of occupancy for life with the right to bequeath and lease). In particular, the land will be first seized by an administrative order that can be contested in court, and then by a court order.

*See Federal Law No. 123-FZ of June 7, 2013 on Amendments to the Land Code of the Russian Federation and Article 3 of the Federal Law on Entry into Force of the Land Code of the Russian Federation; see also the Client Update of August 7, 2013 prepared by our lawyers in this respect)*

### 5. *Substantially Modified Regulation in Respect of the Hazardous Industrial Facilities*

New criteria were developed for the hazard class designations in respect of hazardous industrial facilities. A concept of technical upgrade was adopted,<sup>2</sup> the requirement for the safety assessment was abolished, the requirements for the industrial safety declaration were clarified, etc.

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<sup>2</sup> The technical upgrade is defined to mean an introduction of new technologies, automatic control of a hazardous industrial facility or any of its parts, overhaul or replacement of equipment that modifies the process flow at a hazardous industrial facility.

*(See Federal Law No. 22-FZ dated March 4, 2013 on Amendments to the Federal Law on Industrial Safety at the Hazardous Industrial Facilities, on Amendment of Certain Legal Acts of the Russian Federation and on Deeming Inoperative Article 333.33(1.114) of Part Two of the Tax Code of the Russian Federation)*

## 6. *Other Changes in Legislation*

In 2013, the first bundles of amendments to the Civil Code of the Russian Federation that are part of ongoing reforms of the civil legislation became effective. The most important changes include: express duty of participants in civil law relations to act in good faith in exercising their rights and performing their obligations (and related prohibition to take advantage of their bad faith conduct); definition of the general principles of registration of the title to various types of property (where such registration is mandatory); introduction of general rules for taking decisions by various participants in civil law relations (co-owners, creditors upon bankruptcy, etc.); significant amendments in respect of pledge and assignment of claim, etc.

Other important changes related to the real property and constructions sectors also include a simplified procedure for the registration of title to the real property (in particular, ability to make filing for registration online; shorter period (18 rather than 20 calendar days) of cadastral registration, etc.). In addition, certain special rules were established for the new territories of Moscow: for example, owners and lessees of land plots may purchase adjacent land plots without a tender or preliminary approval of facility location.

*(See Federal Law No. 302-FZ on Amendments to Chapters 1, 2, 3 and 4 of Part One of the Civil Code of the Russian Federation dated December 30, 2012; [see also the Client Update of January 2, 2013 in this respect](#); Federal Law No. 367-FZ on Amendments to Part One of the Civil Code of the Russian Federation and on Deeming Certain Legislative Acts (Provisions of Legislative Acts) of the Russian Federation Inoperative dated December 21, 2013; Federal Law No. 250-FZ on Amendment of Certain Legal Acts of the Russian Federation in Respect of the State Registration of Title and State Cadastral Record of Real Property dated July 23, 2013; Federal Law No. 43-FZ on Special Regulation of Certain Legal Relations in Connection with the Transfer of Territories to the Constituent Subject of the Russian Federation – City of Federal Importance Moscow and on Amendment of Certain Legal Acts of the Russian Federation)*

## **DRAFT BILLS**

### 7. *Fundamental Change of the Framework of the Land Code*

Pursuant to the proposals of the President's Council on Codification and Improvement of the Civil Legislation it is intended to remove all civil law rules and provisions from the Land Code and transfer them to the Civil Code. It is expected that the Land Code will cover only the administrative regulation (provision/seizure of land, protection of land,

etc.). There are plans for a fundamental change of the administrative regulation as well: for example, it is proposed to abolish categories of land and leave the areal zoning only.

Discussions to this effect were under way within the expert community for a fairly long time, but it was only in 2013 that the work on the respective draft law recommenced with renewed vigour.

*(See, e.g., Draft Bill No. 50654-6 on Amendment of the Land Code of the Russian Federation and Certain Legal Acts of the Russian Federation in Respect of Abolishing Land Categories and on Deeming the Federal Law on Transfer of the Land and Land Plots from One Category to Another Inoperative Subject to Proposals of the Ministry of Economic Development available at [http://regulation.gov.ru/project/6036.html?point=view\\_project&stage=3&stage\\_id=2461](http://regulation.gov.ru/project/6036.html?point=view_project&stage=3&stage_id=2461))*

The Government developed a bundle of amendments to the Land Code that significantly modify the rules for the provision of land plots, determination of their permitted use, execution and performance of integrated urban development contracts. The procedure for the sale and lease of land plots that is in the state or municipal ownership will change significantly. The draft law primarily will impact the interests of lessees carrying out development projects on the land plots that are in the state or municipal ownership.

*(See Draft Bill No. 444365-6 on Amendment of the Land Code of the Russian Federation and Certain Legal Acts of the Russian Federation in Respect of Improvement of the Procedure for the Provision of Land Plots that Are in the State or Municipal Ownership)*

## 8. *Federal Law on Public-Private Partnership*

The framework of this draft law was discussed by the professional community for a few years. In 2013 the draft bill was at last submitted to the State Duma reviving its consideration. By its second reading, a significant bundle of amendments was prepared. However, the second reading has not taken place yet.

*(See Draft Bill No. 238827-6 on the Principles of the Public-Private Partnership in the Russian Federation)*

## 9. *Limited Rights of Foreigners to Acquire Immovable Property in Russia*

The investment community was taken aback by this draft bill in late 2013. Despite the fact that the key purpose of the draft law was to create control mechanisms in respect of illegal migrants, the provisions of this draft law implied that foreigners (including respective foreign and controlled Russian legal entities) would be required to obtain a prior consent of the competent governmental authorities for the acquisition or lease of almost any

immovable property. The adoption of this law as currently drafted would create a significant hurdle for foreign investment in the Russian real property.

According to the consensus forecast of the expert community, this law will not be adopted as currently drafted: the draft bill will most likely be substantially redrafted or withdrawn.

*(See Draft Bill on the Special Regulation of Transactions with the Immovable Property Made by Foreign Persons and on Amendment of Federal Law No. 122-FZ on the State Registration of Title to Immovable Property and Transactions Therewith dated July 21, 1997)*

## COURT PRACTICE

### 10. *Clarifications by VAS in Respect of Lease*

Long-awaited clarifications were provided on a number of key issues regarding the lease. E.g., the ability to lease incomplete real property or a part of such property. It is clarified that the lack of the operation certificate for the facility does not prevent the lease of such facility (for example, for fit-out works); however, the parties to such lease must consider whether the operation of such facility may lead to administrative liability (for example, if incomplete office premises are used as office space for the lessee's employees).

*(See Plenary Ruling No. 13 of the Higher Arbitrazh Court dated January 25, 2013 on Supplementing Plenary Ruling No. 73 of the Higher Arbitrazh Court dated November 17, 2011 on Certain Matters of the Practical Application of the Rules of the Civil Code of the Russian Federation in Respect of Lease Agreement; [see also the Client Update of June 18, 2013 prepared by our lawyers in this respect](#))*

### 11. *Development of “Anti-Offshore” Court Practice in Real Estate (Skakovaya 5 Case)*

This case is a good example of the civil law relations in general becoming ever more complicated (and in the real estate sector, in particular). The Higher Arbitrazh Court developed a number of important rules in this case in respect of the ownership structure common in Russia involving a chain of foreign companies (including in offshore jurisdictions), in particular, that: (1) owning Russian immovable property through an offshore company does not per se prejudice the rights of such owner, however, (2) if proof is required in a dispute that an offshore company acts in good faith, the burden of such proof will be borne by such company and it will have to disclose its ultimate beneficiary to the court; (3) in addition, the transfer of real estate to an offshore owner may show an intent to create an appearance of acting in good faith: if proved, it will qualify as an abuse of right, and the respective person will be denied judicial protection.

*(See Ruling No. 14828/12 of the Presidium of the Higher Arbitrazh Court dated March 26, 2013)*

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Please do not hesitate to contact us with any questions.

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