

INTERNATIONAL DATELINE

Russia in Transition

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This is the first of a two-part series that examines the current state of the law of charitable organizations in the Russian Federation "Russia." The second article will discuss specific recommendations for modifying the charitable tax law.

The primary legal framework for nongovernmental organizations (NGOs) is in the form of public organizations, foundations, institutions, partnerships, and other types of noncommercial organizations. Under the general federal law, we find public associations, mass movements, public foundations, and institutions. Foundations, and public institutions can be created under either the Law on Public Associations or the non-commercial organization law. Eighty-nine separate territorial jurisdictions also provide certain benefits and restrictions on NGOs.

Under the existing Russian federal tax laws, which are undergoing revisions, NGOs are exempt from income tax on grants, donations or other funding used to support their activities. However, NGOs must pay an income tax on business activities to the same degree and manner as commercial entities. There are exemptions from the value added tax (VAT) on the transfer of goods and funds to NGOs that support the organizations statutory goals (Article 3a(3)(3)) of the Russian Tax Code (Tax Code). A similar exemption is granted from VAT on the distribution of goods and services that are provided free of charge for charitable purposes and activities undertaken by NGOs. (See Article 149(3) of the Tax Code.)

With respect to contributions, legal entities do not receive the benefit of any tax deductions for contributions to NGOs but individuals may deduct up to 25 percent of their taxable

income for monetary but not in-kind gift contributions. Article 219(1) Tax Code. However, it should be noted that certain restrictions apply to donations. First, the beneficiary organization must be either a state subsidized or state owned organization. Second, the donations do not apply to private schools, museums, or healthcare providers. Third, the donations must be made directly to the beneficiary organization and cannot be passed through a regrating organization.

In 1999, Federal Law No. 95-F2 was enacted to provide exemption from tax for gratuitous assistance provided to the Russian Federation through legal entities conducting humanitarian assistance and technical aid. Foreign contributions to Russian NGOs are allowed under a certification process that confirms the nature of the funds, goods, work, and services provided. Exemption from tax and custom duties for such aid assistance was also granted. The United States has entered into a double-tax treaty with the Russian Federation but there is no provision for recognizing reciprocal cross-border or charitable contribution deductions by donors.

I. Introduction

The Russian Constitution guarantees its citizens a constitutional right of assembly and the right to form associations to affect their political and other goals. Further, the Constitution encourages its citizenry to engage "voluntary social insurance," development of additional forms of social security, and charity.¹ Although the right to engage in voluntary charitable activities, either individually or in the form of associations, is constitutionally guaranteed and encouraged, the current law governing charitable and nonprofit activities in Russia is in a state of flux. Much has been done since the dissolution of the Soviet Union more than 10 years ago to improve the Russian legal system, including the introduction in the mid-1990s of legislation governing nonprofit organizations and charitable activities. However, the charitable sector remains an orphan of Russian legal reform and therefore requires significant revamping in order to make it friendlier for both benefactors and to recipients of charitable aid in Russia.

¹Art. 39(3) of the Constitution of the Russian Federation (as adopted at National Voting on December 12, 1993), available at Lexis, LEXSEE Garant 10003000.

Generally speaking, although Russia had a thriving charitable sector before the 1917 revolution,² a nonprofit sector did not exist in Russia under the Soviet system (or for that matter in the rest of the former Soviet republics forming the Soviet Union) until the Soviet Union's collapse in 1990. Although some nonprofit organizations, (e.g., women's organizations, organizations of veterans of the Great Patriotic War, etc.) existed during the Soviet period, these organizations were state-sponsored and lacked true independence, both financial and political. Some of these organizations, such as the Union of Afghan War Veterans or Blind People Society, were involved in commercial activities to support their memberships and received significant tax and other incentives, including reduced tax rates.

In the post-Soviet period, tax-exempt organizations often served as a shelter for taxable and unrelated commercial activities. Therefore, they were viewed as not truly nonprofit, which resulted in a suspicious attitude toward the nonprofit sector from both the Russian government, which often overreacted and cancelled much of these tax and nontax privileges in the 2001 tax reform, and the Russian people, who perceived the nonprofit sector as a tax shelter for business operations or as a tool of Russian business tycoons pursuing their own political aspirations and agendas.

The arrival of foreign charitable assistance in the early '90s did not change this perception much because all the funds were raised overseas and most of the activities of foreign based organizations were localized in Moscow and other major industrial centers. Not surprisingly, the Russian population does not appear to be very supportive of charitable causes. The surveys conducted by international organizations indicate that charitable giving in Russia significantly lags behind that in the developed countries. According to one survey, only 25 percent of Russian households contributed to charity compared to 75 percent in the United States.³ The amount of charitable contributions of the Russian households is also significantly smaller than in the United States. Those households that contribute to charity have donated on average only 0.6 percent of their annual after tax income to charity, compared to almost 3 percent in the United States.⁴

With the fall of the Soviet system, international philanthropy recognizing the needs of the Russian society that could no longer be supported by the government provided significant humanitarian and educational assistance through financial and logistical activities that supported the creation and funding of local charities. Today, as international philan-

thropy finds other objects of its charity, the continued sustainability of the Russian nonprofit sector will depend on charitable giving by domestic Russian sources. The importance of this major shift from the reliance on government and foreign aid to increased contributions from the Russian population is underscored by the reported scaling down of funding by large international charities, many of which, such as George Soros' Open Society Institute in Moscow, became important players in Russian society and influenced and advanced the democratic and legal process. This potential void now needs to be funded and encouraged through increased contributions from Russian businesses and individual donations.

The increase in local charitable giving will depend not only on changing the perception of the Russian nonprofit sector but on the transparency of the noncommercial sector and its activities. It will also depend on the support of the Russian government, which needs to enact incentives for giving and provide assurance to its citizens and foreign grant-makers that the NGO sector meets certain standards of accountability to encourage them to participate and contribute financially and personally to the emerging Russian charities.

II. Basic Legal Framework of the Nonprofit Sector in Russia

The major difference between western and Russian legal traditions when it comes to charities is the difference in understanding what charitable activities are. The common law approach exemplified by the United States or United Kingdom (U.K.) charity law is that it is very flexible and allows the charitable sector and government regulators to adapt to ever changing societal needs in finding certain activities charitable.

In contrast to the very flexible western approach,⁵ the legal meaning of charitable activities in Russia is defined in a number of legislative enactments. The list of charitable activities is enumerated in the Law on the Charitable Activity and Charitable Organizations⁶ and is not open to the broad interpretation used by the western regulatory authorities.

To illustrate, in the United States, the health care facilities and hospitals are usually nonprofit entities exempted from the federal taxation while Russian hospitals, many of which are still owned by the state, are taxed on their business income even if it is expended for healthcare. The second notional problem is the continued inconsistency between various leg-

²The first charitable organization in Russia has been reported to have been founded in 1551. In 1775, the Russian government issued the first decree on regulating private and public charitable organizations. In 1992 there were 11040 charitable organizations including 4762 charitable societies and 6278 charitable institutions. See Abrosimova, *History of the Regulation of the Establishment and Activities of the Russian Charitable Organizations*, 6 JURISPRUDENCE (1992).

³For more information on charitable giving in Russia, see Arthur Brooks, *Charitable Giving in Transition Economies: Evidence from Russia*, 55 NATIONAL TAX JOURNAL 743 (December 2002).

⁴*Ibid.*

⁵The legal definition of charitable activities generally adopted in the common law jurisdictions throughout the world has been derived from the seminal English case *Income Tax Special Purposes Commissioners v. Pemsel* (1891) AC 531 which defined charitable activity purposes as activities aimed at (i) the relief of poverty; (ii) the advancement of education, or increase of knowledge; (iii) the advancement of religion; and (iv) other purposes beneficial to the community.

⁶Federal Law No. 135-FZ of August 11, 1995 on the Charitable Activity and Charitable Organizations (with the Amendments and Additions of March 21, July 25, 2002), available at Lexis, Economic Laws of Russia, GARANT 4232 (Charities Law).

islative enactments that may interpret similar terms differently for purposes of tax and nonprofit law. The problem may in some cases be exacerbated by conflicting regional law or local practice. Although many of these problems can usually be overcome by large foreign and Russian charities, they still may pose a significant threat to smaller local charities and foreign donors.

Nonprofit organizations can be created under the registration process generally applicable to all other organizations. Since July 2002, the registration of all legal entities, including nonprofit entities, is processed by a local office of the Russian Ministry of Taxation under a newly implemented "one window" policy. However, in addition to the Ministry of Taxation, regulatory functions over the charities are retained by both local authorities (i.e., the Charities Council in Moscow) and various federal bodies such as the Ministry of Justice.

Although the concentration of the regulatory power in the hands of the revenue authorities is similar to the U.S. approach, the retention of broad administrative and regulatory powers also resides with other federal and regional authorities, which complicates compliance.⁷ This is especially true at the level of grass-root local organizations that are not as sophisticated and often may not have access to legal services to maintain their exempt status. The problem is exacerbated by the lack of legal information and plain language instructions explaining the regulatory requirements for setting up and maintaining a nonprofit organization.

Many observers of the Russian scene believe that centralizing the regulatory process and concentrating powers in one centralized body, along with more active dissemination of information and advisory materials related to all aspects of the nonprofit law is required for the successful revival of the Russian charitable sector.

Russian charities, similar to western nonprofit organizations, enjoy significant tax benefits. Under Russian federal tax laws, NGOs are exempt from income tax on grants, donations, or other funding used to support their activities. However, NGOs must pay an income tax on business activities to the same degree and manner as commercial entities even though their profits are used to support charitable activities. In addition to exemption from income tax, Russian NGOs benefit from exemption from the value added tax (VAT) on the transfer of goods and funds to NGOs that support the organizations' statutory goals. A similar exemption is granted from VAT on the distribution of goods and services that are provided free of charge and for charitable purposes and activities undertaken by the NGO. These fiscal benefits are extended to the Russian NGOs by federal legislation. However, further fiscal and other incentives, such as local or property tax exemptions, may be extended by regional and local legislation.

With respect to the deductibility of contributions, legal entities, including commercial organizations, do not receive the benefit of any tax deductions for contributions to NGOs. However, individuals may deduct up to 25 percent of their taxable income for monetary but not-in-kind gift contributions, but it should be noted that certain restrictions apply to these donations. First, the beneficiary organization must be either a state subsidized or state owned organization. Second, the donations do not apply to private schools, museums, or healthcare providers. Third, the donations must be made directly to the beneficiary organization and cannot be passed through a regrantee organization. Contributions from foreign individuals and organizations may receive additional tax benefits.

In 1999, the Law on Gratuities Assistance exempted from the VAT, customs, and other duties certain humanitarian assistance and technical aid certified by the Russian government and provided free of charge through foreign governments and foreign charitable organizations to Russian NGOs and individuals.

U.S. citizens and entities that wish to make tax deductible contributions to Russian charities for federal income tax purposes must make such donations through a recognized tax-exempt U.S. charity. Although a donation can be made directly to a Russian charity and such contribution will be fully recognized under the Russian law, it will not receive the tax deductible benefits provided under U.S. law because there is no provision for recognizing reciprocal cross-border deductibility by donors under the double tax treaty entered into between the United States and Russia.

III. Charitable Giving in the Russian Federation

A. Legal Environment for Russian Tax-Exempt and Charitable Organizations

The legal environment for charitable and other tax-exempt organizations in Russia is based on the Russian Constitution, the Civil Code, and a number of recently adopted laws regulating various aspects of activities of nongovernmental organizations in the Russian Federation.

Although activities of charitable organizations are significantly affected by the relevant provisions of other legislative enactments, such as the Law on Nonprofit Organizations⁸ or the Law on Religious Associations,⁹ the Charities Law is a fundamental federal law directly regulating activities of charitable organizations in Russia. Any other legislation pertaining to the regulation of charitable activities, implemented at the federal or local level, has to comply with the provisions of the Charities Law. With the notable exception of the international obligations of the Russian Federation that would ordinarily prevail over the domestic law, any inconsistent law, including the law and regulations issued by the branches of

⁷See for instance, the City of Moscow Law N11-46 on Charitable Activities, of July 5, 1995 (as amended on June 10, 1998 and December 14, 2002).

⁸Federal Law No. 82-FZ (May 19, 1995).

⁹Federal Law No. 125-FC (Sept. 26, 1997).

the federal government or the subjects of the Russian Federation, is invalid to the extent of the inconsistency.¹⁰

Individuals and legal persons have a constitutionally guaranteed right to conduct charitable activities and pursue their charitable goals either solely or in the form of voluntary associations. Because constitutionally guaranteed rights are extended only to Russian citizens and residents, this issue was specifically addressed in a separate legal enactment, the Charities Law. The right to carry on charitable activities is now guaranteed to foreign citizens and organizations¹¹ who may carry on such activities directly, i.e., in their personal capacity, or indirectly via local subsidiaries organized under the applicable Russian law. The Charities Law expressly prohibits the state and its officials from interfering in or otherwise affecting the selection of goals and methods of carrying out the charitable activities, although the state may indeed regulate these activities.

1. Concept of Charitable Activities in Russia

As was discussed above, the concept of charity was legislatively introduced in Russia in the 18th century. However, the years of Soviet control and state domination over all aspects of the private and public life and the abuses of the transition period resulting from the centralized planning to a free market economy resulted in the re-inventing of "charity." This posed a dilemma for Russian lawmakers in the mid-'90s. This uneasy task had to be approached by encouraging private charitable activities and preventing potential abuses with a limited arsenal of legal tools in place at the time.

The first and most fundamental characteristic of "charity" under Russian law is its "gratuitous" character — a charity cannot be engaged in commercial activity. The receipt of any pre-negotiated private consideration would also result in the disqualification of the charitable activity. Although, as discussed below, an individual donor or contributor may retain certain limited control over the expenditure of the charitable donation. Any receipt of consideration, including public acknowledgment of the donor stipulated as a condition of the gift, could render the gift noncharitable to both the donor and the recipient.

The second fundamental legal characteristic of "charity" is the definition of "participants" in the charitable activities. Without defining the participants, it would be very difficult to define the relationships, the subject, and the obligations of the parties to these relationships. The Charities Law provides that both donors and recipients are participants of the charitable activities. In the traditional Russian civil law approach, the law specifies that only an individual "citizen" can be recognized as the participant of charitable activities, stipulating that foreign citizens and residents "may have the right to become participants of the charitable activities." As a result of this peculiar distinction, close attention must be paid to which rights are accorded to "citizens" and which only apply to "participants." This particular inconsistency may be over-

come by establishing a legal entity under the Russian law. In addition to revising the concept of charity, the Charities Law created a new Russian law concept of a "volunteer" that included gratuitous labor in the definition of charitable activities in addition to monetary and in-kind contributions.

Unlike the traditional common law concept of charitable purposes adopted in most western common law countries, the Charities Law enumerates activities recognized as charitable.¹² Generally speaking, the following activities are recognized as charitable: social support and protection of underprivileged and impoverished citizens; assistance aimed at alleviating of natural and ecological disasters; strengthening of peace and prevention of social, religious, and national conflicts and protection of the family, maternity, and childhood; support of education, science, culture, art, and generally intellectual development of personality; the prevention of diseases and protecting the health of citizens; support of sports; protection of environment and wildlife; and finally, protection of objects of historical and cultural value, and burial places.

The Russian statutory history indicates that the legal definition of charitable activities should be given as broad interpretation as possible. It is also clear that, as drafted, the definition of charitable activities is broad enough to include the major charitable activities aimed at social welfare, health, and education. However, the listed charitable activities cannot be interpreted or broadened to include other activities not expressly listed in the Charities Law. For instance, to qualify as a charitable organization, a religious organization needs to rely on purposes stated in the law, i.e., protection and maintenance of religious objects or support of education, rather than rely on its status as a religious organization as it would in other countries.¹³

Having provided for rather broad boundaries for charitable activities, the law is very specific as to what activities are not considered charitable. The Charities Law expressly excludes from the definition of charitable activities financial and other aid to commercial organizations, or the support of political activities.¹⁴

Even a cursory reading of the definition of a charitable activity indicates a potential conflict between charitable and commercial activities. The broad and seemingly permissive definition of "charitable activities" under the Charities Law is rather deceptive in that some of the activities that appear charitable may not necessarily qualify under the Russian law. *In addition to the previously discussed example of contributions to healthcare facilities, another example provided by commentators commenting on the Charities Law involves*

¹⁰Art. 3 of the Charities Law.

¹¹ Art. 22 of the Charities Law.

¹²Art. 2(1) of the Charities Law.

¹³In the case of religious organizations, this phenomenon may be explained by the expressly stated principle of separation of the state and religion. The express provision of charitable status to the religious organizations would implicitly amount to state support of religion. See Art. 4 of the Law on Religious Association, which states that "religious associations are separated from the state and are equal before the law."

¹⁴Art. 2(2) of the Charities Law.

donations to a nonprofit theatre that would ordinarily be considered charitable because it supports culture. However, according to Russian commentators, this is not a charitable contribution. Nor would a donation be deductible for the restoration or maintenance of a theatre building belonging to the theatre. The line between charitable and commercial activities is not well defined and is subject to conflicting interpretations. This is an extremely troubling situation for nonprofit organizations given the lack of regulatory guidance provided by governmental authorities that, in turn, creates a potential for abuse from local authorities who may interpret the law either way and, indirectly, influence the activities of the charities. The very broad nature of the definition of charitable activity under a transitory legal environment creates a weak link in the law making such broad definitions antiproductive and legally ambiguous and results in a deterrent rather than a supportive factor.

2. Establishing and Dissolving a Charity in Russia

Russian law does not prescribe a specific form of organization that may carry on charitable activities, instead stipulating that any person, either an individual or a legal entity, has a right to carry on such activities. Charitable organizations may be created in a variety of legal forms offered by Russian law. Importantly, under Russian law, the nonprofit organizations, including charities, acquire a legal status and with it all other rights accorded to a legal person under the Russian Civil Code and other legislation, including the rights to deal with property, enter into a contract, and represent and be represented in its own name.¹⁵

Under the law, nonprofit organizations may be created in the form of social or religious associations, nonprofit partnerships, institutions, autonomous nonprofit organizations, social, charitable and any other funds, associations and unions, and also in any other forms stipulated by federal laws.¹⁶ The selection of the specific legal entity may depend on the status of the founder (i.e., institutions may only be created by the state and not by a private person) and the specific goals pursued by the proposed charitable organization. Russian law does not restrict foreign individuals or legal entities from establishing a nonprofit organization in Russia. The only notable exception is the establishment of political public associations under the Law on Political Associations that expressly prohibits foreign participation, either individual or of foreign organizations, in Russian political associations.¹⁷

The law recognizes the following forms of nonprofit organizations, including social and religious associations;¹⁸ funds;¹⁹ state corporations established by a separate decree

for effecting specific state purposes;²⁰ non-commercial partnerships; institutions;²¹ autonomous nonprofit organizations;²² and associations (or unions) of commercial organizations pursuing their noncommercial interests. The Charities Law specifically permits public associations, funds, and institutions to serve as legal vehicles for charitable activities, indicating that other legal forms may be used as well if permitted by other federal enactments. Foreign donors conducting activities in Russia are well advised to carefully analyze the legal entity chosen as a legal vehicle for their operations because the federal and regional laws under which they operate set important limitations as to which activities can or cannot be conducted by certain types of nonprofit organizations.

Under Russian law, a nonprofit or charitable organization must be a legal entity. Procedurally, the registration of a Russian nonprofit or charitable organization is conducted in accordance with the procedures set out in the Law on Registration of Legal Entities.²³ Registration was significantly simplified in July 2002 when the Russian government implemented a "one window" policy for the registration of Russian legal entities. The registration is processed by the Russian Ministry of Taxation. Similar to the North American regulatory practice, the Russian revenue authorities supervise and control the charitable organizations. Under the Russian Charities Law, the regulation of the charity is under the control of the "body that registered the organization," in this particular case the Russian Ministry of Taxation.²⁴

A charitable organization must annually furnish to the Russian revenue authorities complete information about its members, the board of directors, and a detailed financial account of its expenditures and sources of its income and gifts. Importantly, the Charities Law requires that this information, including the sources of gifts and charitable donations, furnished by the charity to the revenue authorities become publicly accessible. The failure to pursue stated charitable goals and to comply with the requirements of the Charities Law and other federal enactments may result in the forced liquidation of the company, with the proceeds directed toward the needs of the local charitable causes.

It is important to note that unlike the common law jurisdictions, the status of the charitable organization is not defining. Once the organization has been found to be charitable, it cannot change its status unless it is dissolved in accordance with the applicable Russian law.

The dissolution or reorganization of a charitable organization is conducted in accordance with the applicable provisions of the Civil Code²⁵ and certain requirements imposed

¹⁵Art. 3 of the Charities Law.

¹⁶Art. 2(3) of the Law on Nonprofit Organizations.

¹⁷Art. 12.1 of Federal Law No. 82-FZ of May 19, 1995 on Public Associations (with the Amendments and Additions of May 17, 1997, July 19, 1998, March 12, 21, July 25, 2002), available at Lexis, LEXSEE Garant 10064186.

¹⁸Art. 6, *ibid.*

¹⁹Art. 7, *ibid.*

²⁰Art. 7.1, *ibid.*

²¹Art. 8.

²²Art. 9, *ibid.*

²³Federal Law No. 129-FZ of August 8, 2001 on the State Registration of Legal Entities.

²⁴Art. 19 of the Charities Law.

²⁵Art. 57-64 of the Civil Code.

by the Charities Law. The Russian law requires that the property of the liquidated charitable organization is to be first directed toward the satisfaction of the debtors' claims. Any remaining property can be used only for the charitable purposes that are described in the organization's charter or by the liquidation committee. The return or transfer of property to the founders of the charitable organization is not expressly prohibited and can be affected at fair market value,²⁶ but this transfer will presumably be a taxable event to both the organization and to the recipient.

3. Maintaining Charitable Status and Conducting Charitable Activities

Regardless of the selected form, a nonprofit organization may be created only for noncommercial purposes and cannot distribute its profits among its participants. Any financial dealings between the charity and its officers and founder are prohibited. To effect its charitable activities and collection of charitable donations, a charity may establish its branches in Russia and representative offices abroad. Further, charities may also establish noncommercial unions and associations for pooling their resources to achieve their common charitable goals.²⁷

As a legal entity created under Russian law, the charity may possess all forms of property, including realty, intellectual, and other immovable property.²⁸ It may also acquire, dispose of, or enter into any other contracts regarding the property it owns, unless the purpose of these contracts may contradict other provisions of the Charity Law or other federal enactments. For example, if a charity enters into contractual relations with a related party characterized as self-dealing under the Charities Law, such contract would be illegal and supposedly can be annulled under the provisions of the Russian Civil Code.

Contributions to a charity made by either members or donors become the property of the charitable organization and must be used to pursue the charity's stated charitable goals.²⁹ The organization has the right to solicit charitable contributions from private citizens and legal persons or pursue other activities to acquire financial means, including organizing charitable and sports events, conducting lotteries or auctions, etc.³⁰

The Charities Law provides important guidelines as to how charitable gifts and other property of charitable organizations can be expended. First, in addition to the State's control over the charities' expenditures, the contributors have a legal right to direct the use of their donations for specific purposes. The Russian Civil Code expressly allows the contributors to attach conditions to the gifts and recall them if the conditions are not satisfied or the gift is being misused by the charity. The "conditioned gift" appears to be the

furthest extent of control that can be exercised by the donor over the contributed property or over the ways it is being used by the charity.

Second, the law imposes important quantitative requirements on how much charities can expend for their maintenance and charitable programs. Under the Charities Law, a charity cannot spend more than 20 percent of its annual expenditure for administrative and other expenditures, including salaries.³¹ Further, unless conditioned otherwise by the donor, the charity has to spend at least 80 percent of the monetary gift within one calendar year after the receipt.³² In-kind gifts should be fully applied for the charitable purposes within one year after their receipt.³³ It is important, however, to note that this timing may be significantly circumvented by the requirements of the Russian Tax Code that require charitable organizations to expend the contributions within a fiscal year of their receipt to maintain the gifts' tax-free character. Although these expenditure provisions provide donors with additional safeguards and prevent potential abuse and misuse of the contributed funds, the combined effect of the requirements of the Charity Law and Tax Code may be counterproductive in the long run. One potential effect is the charity's inability to build reserves or provide for long-term programs or capital expenditures out of tax-free contributions.

B. Commercial Activities of Nonprofit Organizations

Nonprofit and charitable organizations are generally restricted from engaging in commercial activities as their primary purpose on their own behalf or on behalf of their members. The Russian Civil Code³⁴ limits the allowable commercial activities to those that "help" nonprofit organizations achieve their stated goals.³⁵ The extent of permissible business activities depends on the status of the organizations. Generally, a nonprofit entity may engage in a broad array of business activities, including "production of goods and services for profit," as long as these activities "serve the goals for which the organization was created."³⁶ Additionally, a nonprofit may acquire and sell marketable securities, property, and nonproperty rights and participate in business associations as an investor either directly or indirectly, via its subsidiaries.³⁷

The right to engage in business activities has been significantly curtailed for charities. Specifically, the Charities Law restricts business activities of charitable organizations to *only*

²⁶Art. 16(5) of the Charities Law.

²⁷Art. 14 of the Charities Law.

²⁸Art. 16 of the Charities Law.

²⁹Art. 12 of the Charities Law.

³⁰Art. 15 of the Charities Law.

³¹Art. 16(3) of the Charities Law.

³²Art. 16(4) of the Charities Law.

³³*Ibid.*

³⁴The Civil Code of the Russian Federation (Parts One, Two and Three) (with the Additions and Amendments of February 20, August 12, 1996, October 24, 1997, July 8, December 17, 1999, April 16, May 15, November 26, 2001, March 21, November 14, November 26, 2002, January 10, 2003), available at Lexis, Russian Economic Law Library, GARANT 10064072.

³⁵Art. 50(3) of the Civil Code, *ibid.*

³⁶Art. 24(2) of the Law on Nonprofit Organizations.

³⁷Art. 24(2) of the Law on Nonprofit Organizations.

those required for achievement of charitable goals.³⁸ Failure to comply with this provision will result in the confiscation of the received income, which then will be used for charitable purposes as determined by the local social assistance authorities.³⁹ To avoid potential violation of the law stemming from charities' attempt to be self-supported through various business related ventures, the law allows charities to organize and presumably conduct such business activities via their subsidiaries, which will be engaged in business activities on behalf of the charitable organization.⁴⁰ Although these activities will be taxed at the regular applicable corporate tax rates, the importance of this provision is rather significant because it allows the charities to maintain financial independence without endangering their charitable status.

Further, the law provides a very strict limitation on the ability of charities to enter into business-oriented associations. Although the law does not restrict the abilities of nonprofit organizations to associate and pursue their business or nonbusiness interests jointly, charitable organizations cannot form or join business associations with other organizations.⁴¹ Although commentators suggest that the primary goal of this provision is to prevent business operations disguised as charities, there are indeed unintended repercussions. For example, given the comparably poor financial health of the Russian charity sector, this provision effectively prevents small charities from pulling their profit-producing resources together without potentially losing their charitable status.

C. Russian Charities and International Activities

A Russian charitable organization may receive charitable donations from foreign individuals, legal persons, and international organizations and use these funds in accordance with its charitable purposes.⁴² Importantly, under Russian law, charitable organizations may be engaged in charitable activities within and without the borders of Russia. Russian law expressly permits Russian charities to participate in international charitable projects and cooperate with foreign charitable organizations in their international charitable efforts.⁴³ Importantly, a charitable organization can open and maintain banking accounts in foreign countries, although presumably permission from the Russian Federal Bank and tax authorities might be required. At this time, there is no internal Russian law providing guidance with regard to other extraterritorial charitable activities, so it is not clear how a charitable organization may effect its other charitable activities outside Russia. Moreover, it is not clear whether and how a Russian charitable organization may operate extraterritorially without participation in an "international project."

³⁸Art. 12(3) of the Charities Law.

³⁹Art. 20(4).

⁴⁰Art. 12(4) of the Charities Law.

⁴¹*Ibid.*

⁴²Art. 21(4) the Charities Law.

⁴³Art. 21(1)-(3) of the Charities Law.

D. Taxation of Charitable Organizations and Charitable Donations in Russia

1. Taxation of Charitable and Nonprofit Organizations

To obtain tax-exempt status, a charity has to be a nonprofit organization created and existing under the Law on Nonprofit Organizations. Not all income of the nonprofit organizations is exempt; the exemption is available only to certain donations and other contributions expressly enumerated in the tax law and to charitable expenses by the nonprofit organization during the tax year.

A charitable organization may receive gifts and donations from any individual or legal person, including foreign persons and international organizations. On the recipient side, under the tax law, charities are exempt from the income tax on all membership fees, governmental grants, donations, bequests, and other contributions used by a nonprofit organization in pursuit of its chartered activities.⁴⁴ Further, all donations, gifts, or any other contributions to nonprofit organizations used for charitable activities are not included in the tax base of the charitable organization and therefore are not subject to income taxation.⁴⁵

The law expressly provides that to retain tax-exempt status, gifts and other contributions have to be used (or expended) within the fiscal year. This provision is clearly inconsistent with the Charities Law requirement to expend 80 percent of the gifts within one year of receipt.⁴⁶ Further, the current expenditure requirement of the Tax Code is a strong deterrent against the charitable organization setting aside reserve funds. A charity wishing to set aside reserve funds for specific programs can raise contributions in the year of expenditure or, should the contributions be made earlier, pay the applicable tax on the unexpended gifts. To illustrate, a gift from an individual of 100 rubles of pre-tax income to a qualifying charity will translate into 100 rubles received by the charity in the year of the receipt and only 76 rubles (100 less 24 rubles paid in federal taxes) next year.⁴⁷ A gift of pretax 100 rubles from a business entity will result in 76 rubles donated to the charity in the year of the receipt and approximately 57 rubles in the next fiscal year.

Russian tax law also excludes from the tax base the realization of income from grants received by Russian citizens and legal entities, including charitable and nonprofit organizations, from foreign donors under a list approved by the Russian government. The grants are tax free if they are received from donors and approved by the Russian govern-

⁴⁴Art. 251(2)(1)-(3) of the Russian Tax Code.

⁴⁵Art. 251(2)(4), *ibid.*

⁴¹Art. 16 of the Charities Law.

⁴⁷Profits of the organization taxed in accordance with Chapter 25 of the Russian Tax Code. The applicable rate may vary depending on the type of the income. The prevailing rate applicable to most kinds of business profits is 24 percent. Individual income is taxed at the rate of 13 percent.

ment for specific educational, environmental, scientific, or other projects specified in the grant.⁴⁸

In addition to the income tax benefits available to nonprofit organizations, charitable organizations generally are not subject to the Russian Value Added Tax (VAT). Given that charitable organizations are usually the end users of the goods and services and cannot transfer the VAT burden to the purchasers of their services, it is important that the charity qualify for the VAT exemption, the burden of which actually may be more significant than the income tax.⁴⁹ A donor has to check whether the contribution is entitled to exempt status. Generally, under Chapter 21 of the Russian Tax Code, the transfer of goods and services in the course of the charitable activities conducted in accordance with the Charities Law is not subject to the 20 percent VAT imposed on most goods and services. However, it is not entirely clear if this provision exempts only the nonprofit organizations conducting their charitable activities or any organization, including foreign charities, conducting charitable activities stipulated in the Charities Law. Chapter 21 of the Profits Tax also contains special provisions applicable to specific nonprofit organizations (i.e., organizations of disabled people enjoy significant VAT exemptions) or specific activities (i.e., contributions of capital or membership fees are exempt from VAT).

Foreign donors considering the contribution of property should check applicable customs legislation. Generally, property contributed to a Russian nonprofit organization is subject to customs duties and tariffs, with the exception of property donated as part of humanitarian assistance in accordance with the Law on Gratuitous Assistance to the Russian Federation.⁵⁰ The definition of gratuitous assistance includes humanitarian assistance and technical aid and is broad enough to cover many activities traditionally conducted by the foreign charities in Russia. For example, goods and services imported by foreign donors and transferred to Russian recipients, including juridical and natural persons, in the course of "providing medical and social aid to low-income, socially unprotected groups of the populace as well as those subjected to natural disasters" are free of any taxes, including custom duties and VAT.⁵¹

The local and regional authorities may provide charities with additional economic and fiscal benefits. These benefits

may be in the form of reduced rent and property taxes,⁵² etc. Further, the regional authorities may provide charities with a small reduction of the income tax imposed on their business activities. Under Chapter 25 of the Russian Tax Code, the regional authorities have discretion to reduce the income tax rate from 24 percent to 20 percent. Importantly, these tax benefits can be provided only to selected taxpayers and be extended, at the regional government's discretion, to business income of local charitable organizations. Under the Tax Code, the reduced tax rate is provided to "selected categories" of taxpayers, thus reducing the potential for corruption and indirect influence of charitable organizations by local bureaucrats. As an illustration, a single charity with limited business activities may apply to the regional government to reduce the applicable tax rate. This rate will then be available to all charitable organizations located in that region.

2. Taxation of Charitable Donations and Contributions

The Russian Tax Code, amended in 2002, eliminated most of the deductions for contributions to charitable organizations that had been available to Russian corporate and individual donors. Under current law, business entities do not receive any tax deductions or tax credits for their charitable contributions and gifts. Under the prior law, corporations could deduct the amount of the contributions to charitable organizations (including youth, religious organizations, etc.) not exceeding 3 percent of their taxable income.⁵³

The same prohibitive limitations have been introduced with regard to individual charitable giving. Under the prior tax law, an individual could deduct up to 100 percent of his or her charitable contributions to certain charitable organizations.⁵⁴ The amount of deductible charitable gifts and contributions was limited to 25 percent of the individual donor's taxable income.⁵⁵ Even more important, the current law imposes a number of important limitations that are likely to reduce significantly the amount of charitable giving. First, the law limits contributions only to monetary gifts and does not recognize in-kind contributions. Second, the list of eligible recipients is very limited and does not correspond to the list of charitable activities allowed by the Charities Law. Third, charitable contributions are permitted under the Tax Code and are deductible by the donor only if made directly to "cultural, educational, health, and social security establishments partially or fully financed from the state budget." This list of eligible recipients also includes sports organizations, preschool education establishments, and religious organizations. The latter is even more surprising given that religious activities are not recognized as accepted charitable activity permitted by the Charities Law (although the maintenance of the churches and other religious premises is).

⁴⁸Art. 215(2)(14).

⁴⁹VAT imposed and collected under Chapter 21 of the Russian Tax Code is the largest source of revenue for the Russian government, accounting for slightly less than one-half of the Russian national budget.

⁵⁰Federal Law No. 95-FZ of May 4, 1999 on Gratuitous Aid (Assistance) to the Russian Federation and on Amending Specific Legislative Acts of the Russian Federation on Taxes and on the Establishment of Exemptions from Payments to the State Non-Budget Funds in Connection with Granting Gratuitous Aid (Assistance) to the Russian Federation (with the Amendments and Additions of August 5, 2000, March 24, August 6, 2001, November 27, November 27, 2002, January 10, 2003), available at Lexis, LEXSEE Garant 12015538.

⁵¹Art. 1 of the Law on Gratuitous Assistance.

⁵²For example, under the Law on Property Tax, regional authorities may collect property tax at a rate up to 2 percent of the book value of an organization's assets.

⁵³Art. 6 of the Law on Profits Tax (abolished).

⁵⁴1991 Law on Income of Tax Payable by Individuals (abolished).

⁵⁵Art. 212(1)(1).

IV. Conclusions

Russian tax law governing charitable organizations is a result of the legislative effort undertaken by the Russian government in the mid-'90s. That law initially addressed the major needs of Russian society. However, major economic, social, and legal changes in the years since require revision to some parts of the legislation governing charitable activities. The main effort should be directed at eliminating numerous inconsistencies between the nonprofit regime and other federal and regional enactments. Specifically, inconsistencies between the Charities Law and the Tax Code impose on both charities and donors very stringent timing requirements that were not intended by the drafters of the original Charities Law and prevent charities from gaining financial (and political) independence. Second, although the "one window" approach is a significant improvement toward the more efficient administration of charitable activities, the law remains rather complex and, given the paucity of regulatory guidance, not entirely "user-friendly."

The increase of charitable activities will also require official guidance on permissible charitable activities of Russian

charities and assurances to donors that their contributions are tax deductible. The tax authorities should explain in simple and understandable terms the main provisions and benefits of the charitable law. Finally, the increase in charitable activities will greatly depend on the provision of tax incentives to donors and recipients. The current tax system does not encourage charitable contributions by donors. The restriction of the deductible donation to a limited number of organizations discourages contributions by citizens who may not be inclined to contribute to a state organization. It is also important to encourage Russian business entities to participate in the charitable sector by offering them deductions and tax credits.

The law needs clarification to permit organizations to engage in related business activities to support the carrying out of their charitable purposes. Similarly, the law should include a provision for taxing commercial activities that are conducted only for the production of income. Allowing charitable organizations to conduct very limited income producing activities to support charitable purposes will further strengthen the growth of the Russian charitable sector.