New Sanctions for Russian Currency Control Violations: a Tempest in a Teapot or Pandora’s Box of Liability?

April 2013

In February 2013, changes to the RF Code of Administrative Offenses took effect. They fine Russian citizens and legal entities 75% – 100% of the value of illegal currency operations. They also affect expatriates living in Russia as permanent residents.

With the fall of the Iron Curtain in 1991 and the onset of Russia’s development as a market economy, many Russian citizens started to open foreign bank accounts. This included not only professionals and high-net-worth individuals who landed abroad, but those who remained in Russia to tap its opportunities. With phased liberalization of Russian currency rules over the last decade, the trend of Russians opening foreign accounts continued at an even greater pace.

Today, many Russians (whether living full-time in or out of Russia) hold foreign bank accounts. Although formal restrictions on the use of those accounts always remained ‘on the books’, due to the absence of real ‘teeth’ to enforce such rules, many Russians turned a blind eye to compliance.

Late last year, Russian lawmakers decided to reverse this course by amending the RF Administrative Offences Code (‘AOC’). Federal Law No. 194-FZ, ‘On Amendments to Articles 3.5 and 15.25 of the AOC of 12 November 2012 (the ‘Amendments’) extended the scope of administrative liability for illegal currency operations. The Amendments took effect on 13 February 2013 (the ‘Effective Date’).

Consequently, Russian citizens and companies and foreign expatriates who qualify as ‘currency residents’ of Russia now risk full confiscation of any amounts transferred in violation of the strict procedures established by Federal Law No. 173-FZ, ‘On Currency Regulation and Currency Control of 10 December 2003 as amended (the ‘CCL’).

We outline below some key issues arising as a result of the Amendments causing the need to have a new look at the CCL.

Who Should be Worried?

The Amendments target individuals and companies deemed to qualify as ‘currency residents’ under the CCL. That includes:

- Russian citizens (including, inter alia, those travelling as tourists or temporarily living abroad), save for Russian citizens permanently living abroad for at least a full year;
- foreign nationals or stateless persons continuously living in Russia under a residency permit; and
- legal entities incorporated in Russia and their foreign branches, representative offices and other subdivisions.

Note, ‘residency’ for currency purposes differs from residency for tax purposes in Russia. The latter requires physical presence in Russia for a period longer than 183 calendar days in any consecutive 12-month period, whereas the former is focused on the formalities summarised above and described in more detail below.

Although the CCL sets out relatively clear criteria for determining whether legal entities are residents or non-residents, the question is more complicated for individual Russian citizens. Under the CCL, all Russian citizens are generally treated as residents save for those permanently living abroad for at least a full year. The following categories of Russian citizens may be recognized as lawfully ‘non-resident’ under the CCL:

- Russian citizens permanently living abroad for at least 1 year based on a residency permit issued by the relevant authorities of a foreign state; and
- Russian citizens temporarily staying abroad for at least 1 year based on a work or student visa valid for at least 1 year, or where the periods of validity of several such visas add up to 1 year.

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1 The discussion herein is not an exhaustive list of currency control violations or sanctions.
2 Item 6(a) of article 1(1) of the CCL.
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Conversely, all foreign nationals (and stateless persons) are generally regarded as non-residents, save for foreign nationals or stateless persons issued Russian residency permits. A foreign national continuously staying in Russia under a multi-entry-exit business visa or working under work permit (which is not a ‘residency permit’ per se) therefore does not become resident under the CCL.

The above criteria came into force on 5 June 2012 and intended to expand the group of Russian citizens classifiable as non-residents. However, its provisions raised additional questions as to the status of a Russian citizen with a residency permit issued by a foreign state, where (s)he travels frequently. Unfortunately, neither the RF Central Bank (the ‘CBR’) nor the regulator charged with enforcing the CCL – the RF Federal Service for Financial and Budgetary Supervision (‘Rosfinnadzor’) – has of yet issued clear guidelines.

Under a common-sense approach, the qualification of a Russian citizen as a resident of a foreign state is subject to formal acknowledgment of such status by a foreign state. A residency permit or work/student visa with a term exceeding 1 year could evidence that acknowledgement. Logically, the actual duration of physical presence of a person in a foreign state should not be the deciding factor. Otherwise, an individual would have to stay put in a particular foreign state with a limited right of movement. If the regulator follows a more conservative interpretation, it may be difficult for Russian citizens living abroad to escape Russian currency residency unless they stay out of Russia completely.

From a practical standpoint, taking the conservative approach would not be viable for the regulator and could create major problems for it and Russia’s citizenry. On the other hand, we understand that certain Rosfinnadzor representatives confirm that a more formalistic, conservative interpretation of the CCL may well be in the cards. Russians now carrying out currency operations on the assumption that they are non-resident must bear in mind the risk of potential re-classification (solely for the currency control purposes) with consequent re-classification of operations with their foreign accounts.

This is worrisome. Many Russians permanently living, working or pursuing their educations abroad do not cut off relations with their motherland. They come to Russia frequently to visit their friends and families. They travel to Russia often on business. If they wish to mitigate the risks, in the absence of further clarification from Rosfinnadzor they may need to change those habits or restructure their accounts so these are not held directly.

New Brimstone for Old Sins

So what if someone does qualify as a ‘resident’?

Any violation of Russian currency controls by a resident may give rise to administrative or even (for CEOs of legal entities) criminal liability. Whereas before a formal violation may not have led to a penalty for that resident (given the absence of teeth), under the Amendments this has now changed.

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2 International treaties may create special rules for certain foreigners in Russia. For example, article 52(1) of the Agreement Establishing the European Bank for Reconstruction and Development (‘EBRD’), to which Russia is a member, provides, ‘All Governors, Directors, Alternates, officers and employees of the Bank and experts of the Bank performing missions of the Bank…not being local nationals shall be accorded… the same facilities as regards exchange regulations…as are accorded by members to the representatives, officials and employees of comparable rank of other members.’ However, it seems clearly to recognise Russian citizens are not exempted from Russian currency controls (and hence the Amendments) solely by virtue of their employment with the EBRD. That said, if they meet the formal requirement for non-residency as discussed herein (e.g., if they live outside Russia continually for a 1 year under a residency permit from a foreign government) they may be exempt.


5 Although the CCL and Amendments do not address the case of Russians holding dual citizenship (i.e. also holding a foreign passport), nonetheless one would expect that the foreign passport would be deemed to be equivalent to a residency permit issued by a foreign state. Nonetheless, this may not be sufficient insurance against sanctions under the Amendments, given that travel to Russia may be sufficient to create residency under Federal Law No. 406-FZ.

6 It will be recalled, in Russia’s legal system three main types of liability exist: (a) civil liability (e.g., for breach of contract or tort), (b) administrative liability (for violations of law by individuals or legal entities not rising to the seriousness of criminality – this usually results in monetary fines and for individuals can include short custodial restraint), and (c) criminal liability (for more egregious violations of law and order, e.g., murder, etc., but in the context of white-collar crime includes tax evasion and money-laundering – criminal liability usually results in far more extensive imprisonment and/or forced labor). Criminal liability may only be applied to individuals. The Amendments impose administrative liability for individuals and legal entities.

7 Criminal liability for a violation of currency controls in and of themselves only arises for CEOs of Russian resident companies (irrespective of the CEO’s nationality) in respect of the violation of the repatriation requirements for Russian resident-companies for amounts over 30 million RUR. See RF Criminal Code, article 193.
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As from the Effective Date this includes a potential fine of 75% to 100% of the amount of any illegal currency operation, i.e., if such operation is either:

(i) expressly prohibited by the CCL, 8 or
(ii) carried out in a manner inconsistent with the CCL’s provisions.

The penalty thus now applies not only to expressly-prohibited operations, but also operations performed not strictly in line with the specific procedures established by the CCL for such operations.

Russian lawmakers also established a non-exhaustive list of such illegal currency operations, which as from the Effective Date include:

- any sale or purchase of foreign currency or checks (including travelers’ checks) nominated in foreign currency which bypasses Russian licensed banks;
- any settlements under currency operations which:
  - bypass accounts (deposits) opened with either Russian licensed banks or foreign banks; or
  - involve funds being credited to accounts (deposits) in banks located outside Russia, when Russian currency legislation does not expressly allow these.

Liability is generally imposed only for operations performed after the Effective Date. That said, if settlements are made with funds illegally credited to accounts during preceding periods, they may also be deemed illegal and give rise to fines.

Notably, the list of illegal operations remains non-exhaustive. This creates an opportunity for wide interpretation by Rosfinnadzor and Russian courts. The Amendments thus force residents to comply with currency controls they had earlier ignored in the absence of effective sanctions.

Main Impact: Use of Foreign Bank Accounts

The Amendments will primarily hit operations of residents frequently using foreign bank accounts to receive funds from various sources outside Russia. In this connection, residents must exercise extreme caution. 10

As a general proposition, the CCL expressly authorizes residents to open foreign bank accounts 11 in foreign currency. So, the opening of a foreign account in and of itself is not illegal – rather, it is what happens next. In particular, residents must follow certain reporting requirements 12 and moreover follow a special regime for use of such accounts once they are opened. 13

The CCL provides a limited list of permitted transfers which may be credited to residents’ foreign bank accounts. Generally, residents may credit / transfer to their foreign accounts only funds from other accounts they themselves have opened in their own names (whether onshore or abroad). As for the transfer of funds from such foreign accounts, they generally may do this (where the funds were lawfully credited to such accounts to begin with), except where these are:

- currency operations made by resident legal entities with other residents (subject to limited exceptions), and
- currency operations made by resident individuals connected with payments for the transfer of property or

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8 For example, residents are generally prohibited from carrying out currency operations between themselves (save for certain exceptions).

9 This term includes credit organizations incorporated under Russian law and authorised to conduct banking operations with foreign currencies.

10 Given the current practice of selective enforcement of laws in Russia, certain individuals may be more concerned than others, e.g. politically exposed persons (PEPs), persons actively involved in political opposition activities, businessmen and other high-profile individuals (including expatriates) and the like.

11 This term means accounts opened directly by a resident in his or her name with a bank located outside Russia. A bank account opened with a foreign branch or subsidiary of a Russian licensed bank located abroad should also be treated as a foreign bank account. An account opened in the name of a foreign fiduciary, a trustee or an offshore holding company (shares in which are held by the resident) does not fall under this definition. As a general rule, to date Russian legislators have not regulated beneficial interests in foreign assets to the same extent that other developed economies’ legal systems have.

12 Residents must notify the local Russian tax authorities on the opening or closing of foreign accounts and (in certain cases) report to tax authorities on the movement of funds in such accounts. These are notification requirements and do not require additional acknowledgements, approvals or permits from the tax authorities.

13 Article 12 of the CCL.
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As a general rule, therefore, residents may credit / transfer to their foreign accounts only their own funds from other accounts which they themselves hold in their own names (either onshore or abroad). So, after the Effective Date residents are at risk for:

- allowing their own accounts in foreign banks to be credited with:
  - employment salary, consultancy (or other) fees, commissions or other remuneration from employers (including foreign employers) or clients (as well as pension, insurance or other payments), even where this concerns services rendered abroad;
  - payments of earned interest, rental payments for real estate (even if located abroad), royalties or other earnings;
  - dividends on securities, distributions of profit on partnership interests, income from securities or commodities trading and other transactions on foreign financial markets;
  - moneys received by way of inheritance (from whatever country); and

- any operation with unlawfully transferred funds (including transfers of such funds after the Effective Date to accounts opened in Russian licensed banks).

To avoid penalties, residents must therefore follow the above rules or restructure their foreign accounts.

Monitoring and Detection of Violations

The Russian regulator Rosfinnadzor is authorized to bring sanctions against residents who engage in illegal currency operations. This will include levying penalties under the Amendments as described above. But how will Rosfinnadzor learn of violations to begin with?

As in other countries, Russian licensed banks and other entities are by law deemed to constitute ‘currency-control agents’ As such, they play a vital role in detecting exchange violations by their own clients. By law, where agents learn of non-compliance, they must ‘whistleblow’ by notifying Rosfinnadzor of offences and violators. Nonfulfillment of this obligation in and of itself constitutes a violation for the agent (and its employees), triggering sanctions for it.

Rosfinnadzor may also carry out independent regular or special audits of residents. Rosfinnadzor may perform unscheduled audits on the basis of various grounds, including (i) statements or claims made by any individuals or legal entities (including but not limited to currency-control agents), and even (ii) information published in the mass media.

Where Rosfinnadzor suspects these violations arise in connection with criminal activities (e.g., money-laundering or tax evasion), it may also involve Russian law-enforcement authorities with authority to take more intrusive investigatory measures (e.g., monitoring telephone lines or emails, searching of homes or offices in Russia and seizing residents’ personal records, documentation, computers, hard drives and the like). This can lead to detection of operations with foreign accounts by residents which might otherwise go unreported by currency-control agents.

It seems unlikely that foreign banks would be prepared to provide Rosfinnadzor data qualifying as ‘banking secrets’ under their own law. That said, the possibility of foreign banks’ cooperating with Russian authorities cannot be excluded, particularly if enquiries are submitted through appropriate legal channels in the context of investigations of criminal tax evasion, money laundering or other crimes.

Note that the statute of limitations for Rosfinnadzor to levy penalties under the Amendments (or otherwise under the AOC) is one (1) year which in the case of continuing violations is calculated from the date of detection. There is varied Russian judicial practice as to what constitutes a ‘continuing’ violation. One view is that each individual operation should be viewed as a separate violation. However, the prescriptions of the RF Supreme Court are not particularly helpful. Accordingly, there is some risk a court might find that a pattern of regular payments into an account constitutes a ‘continuing’ violation, hence giving Rosfinnadzor the right to ‘look back’ during the entire period of such a pattern.

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14 In addition to licensed Russian banks, this term also includes the State Corporation Bank for Development and Foreign Trade (Vneshekonombank), professional participants of the Russian securities market, RF customs agencies and RF tax agencies (article 22 (3) of the CCL).

15 Article 4.5 of the AOC.
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Accordingly, residents should bear in mind that as enforcement policy strengthens, the regulator may well look back over a substantial period.

What Next?

Clearly, the increase in administrative fines may bring to a halt, or at least frustrate, various business arrangements of Russian residents in their foreign account operations. Given the punitive nature of the Amendments, residents should really vet their compliance.

Since interpretation of the Amendments and the CCL remains ambiguous, we expect further clarifications from the CBR or Rosfinnadzor on their application. In the meantime, residents should consider redirecting payments emanating from overseas sources into their Russian bank accounts or making suitable alternative arrangements.

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