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# Ulyanovsk Calls for Medvedev to End Tax Breaks

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ULYANOVSK — By all appearances, Ulyanovsk Governor Sergei Morozov has a good thing going.

His region is one of about a dozen in Russia that offers generous tax breaks to foreign companies, attracting the likes of British-based brewer SABMiller and U.S. chocolate maker Mars.

Another seven contracts worth more than 1 billion euros ($1.4 billion) are expected to be signed in the first half of this year.

But the 51-year-old former police official says he's ready to risk it at his next meeting with President Dmitry Medvedev.

Morozov said the tax breaks program should be replaced by a system used by some European countries where the government reimburses private investors with a portion of their startup costs. Putting his money where his mouth is, he intends to hand a proposal to that effect to Medvedev at the next State Council meeting of governors and other senior officials.

"We should give up the practice of providing tax breaks," Morozov said Friday at a conference on improving the country's investment climate in Ulyanovsk.

By doing so, he said, the government will "provide equal conditions for all investors."

Why Morozov would care about leveling the playing field for investors might puzzle some. But Sergei Vasin, executive director of the Ulyanovsk government agency responsible for working with investors, explained by telephone that the reimbursement program would promote investment better than tax breaks because it would reduce the time before a new project becomes profitable. Also, he said, Ulyanovsk essentially already has a reimbursement program in place since its tax-breaks scheme requires it to return taxes to investors.

Any company that invests at least 5 million euros doesn't have to pay regional taxes for eight years.

The tax-breaks program in the Ulyanovsk region, whose hilly east is divided from its largely flat west by the winding Volga River, helped bring in 6 billion rubles ($210 million) in direct foreign investment last year, according to regional government figures. Overall investment totaled 44.8 billion rubles.

Among those constructing production facilities in the region is Takata, a Japanese manufacturer of car parts and automobile safety systems that is scheduled to launch production next year. Five foreign and two Russian contracts worth more than 1 billion euros will be signed in the first half of this year, Vasin said. Morozov declined to identify the companies but told journalists after the conference that the contracts involved engineering equipment construction, cars and the aircraft industry.

Ulyanovsk is home to the Aviastar-SP plane-building plant, which is to host a $250 million project to make aviation composites under an agreement reached by Morozov, the AeroComposite company and United Aircraft Corp. last month. The agreement is not among the seven pending contracts, Vasin said.

Morozov said the government should follow the example of Germany, where investors get 30 percent of their investment back in the first year after implementing a project.

In Russia, the money for reimbursements should come from a combination of the federal, regional and municipal budgets, Morozov said.

"The federal government has pointed to the importance of attracting investment and creating a favorable investment climate. But in fact the government has focused on macroeconomic issues rather than on practical ones, which are very important for any ... investor," Morozov said.

The result, he said, is that investors only get "real financial support" in special economic zones that offer tax breaks, leaving other regions out in the cold.

He said his reimbursement proposal should be fixed in federal legislation.

His proposal found support from Sergei Belyakov, head of the Economic Development Ministry's investment policy department. But Belyakov noted that the tax-breaks program was introduced in the first place as a painless way for the government to save on spending.

"The idea is a good one, but it raises questions because its implementation would require a source of financing," he told The Moscow Times on the sidelines of the conference. "But we might be able to find this money somewhere."

Foreign companies would not be distressed about an end to tax breaks because they take into account other significant factors when deciding whether to invest in a region, said Pyotr Medvedev, head of the tax and legal division for Russia and other former Soviet republics at Ernst & Young.

One of the most crucial factors for investors is good infrastructure, including roads, especially for those looking to initiate production, he said by telephone.

One risk in ditching the tax breaks program is the possibility that the government will fail to set aside enough money to reimburse investors, he said.

Just as problematic, he said, would be the task of determining which investors are eligible for reimbursement. "Even if providing subsidies were fixed in legislation, determining who is eligible to get a subsidy would likely remain the result of the subjective decision of officials," he said.

A shift from tax breaks to government reimbursement might face resistance in regions like Kaluga, a magnet for foreign investors with $1.2 billion in investment last year and at least $1 billion more expected this year. Among the investors in the region are French cosmetics maker L'Oreal and carmakers Volkswagen, PSA Peugeot Citroen and Mitsubishi.

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