RFS0007

Written evidence submitted by Business for Ukraine (B4Ukraine) Coalition and Kyiv School of Economics

1.1 B4Ukraine is a global coalition of 90 civil society organizations driven by a common goal: to block access to the economic and material resources sustaining Russian aggression. We aim to help Ukraine restore its peace and security by advancing responsible business conduct. Since the full-scale invasion of Ukraine on 24 February 2022, we have collaborated to track and analyze company behaviour, engaging companies, industry bodies and governments with our findings.

1.2 This submission focuses on whether financial sanctions instituted by the UK on Russia are complete and effective in terms of the entities that have been designated, and the entities which have to comply with the rules. It highlights how gaps in economic sectoral sanctions and government policy have allowed thousands of Western companies to continue doing business in Russia, indirectly financing the war of aggression against Ukraine and placing them at risk of complicity in Russia's war crimes and crimes against humanity.

2.1 In the days following Russia's invasion of Ukraine, global companies by and large condemned Russia's actions and rushed to ensure the safety and wellbeing of affected employees. Hundreds withdrew or suspended operations and investment in Russia – or announced their intention to do so. Several major companies went further, providing support and needed services to Ukrainian refugees and their families.

2.2 Yet two years after Russia's invasion, more than 2100 multinational companies, including many western household names, continue doing business in Russia. Their presence helps sustain the war on Ukraine and undermines the rules-based international system.

2.3 Since the full-scale invasion of Ukraine, only a tiny number of foreign firms (358) have completed a full exit from the Russian market through sale or liquidation.

2.4 The Kyiv School of Economics estimates the amount of taxes paid by all foreign companies operating in Russia in 2022-2023 at $20 billion (€18.6 billion). This undercuts the significant bilateral humanitarian, financial and military aid provided by G7 and allied countries. For every $7 G7 governments declare in bilateral aid to Ukraine, its companies are paying $1 in taxes to the Russian state.

3.1 This picture is reflected when we look at the data for UK-headquartered companies. 109 (40%) of UK-headquartered companies who were present in Russia at the start of the war are still there.

3.2 On a country basis, **UK firms were the 5th biggest contributors to the Kremlin's coffers through taxes on profit, paying $189m in profit tax to the Russian government in 2022.** Profit tax is just one of many taxes paid to the Russian government, so this is likely a substantial underestimate of the total tax bill.

3.3 On average, Russia business represented 2.6% of global sales for those British firms staying in the Russian market in 2022.

3.4 See Annexe 2 for more detailed information of UK company presence in Russia.

4.1 All companies which remain in Russia today risk contributing to the war against Ukraine, either indirectly, through the taxes they pay to the State; or directly, through the resources they provide to the Russian army.

4.2 In a recent Advisory for business, the US government warned American firms they risk complicity in the Kremlin's war crimes by remaining in Russia.

4.3 As Russia moves to a Military-Civil Fusion war economy, the companies which stay are required by law to help conscript their employees to the army and provide other resources to support the war machine. See Annexe 1 for details on the associated legislation.

4.4 Examples of western companies involved in conscription into the Russian army include Raiffeisen Bank and SLB (formerly Schlumberger). In a letter to B4Ukraine, British company Unilever confirmed it would comply with Russian conscription law if its staff were called up.

5.1 The United Nations Guiding Principles on Business and Human Rights (UNGPs) acknowledge that all businesses, regardless of industry or context, bear a responsibility to respect human rights. These principles are widely accepted and considered the benchmark for responsible business conduct, applying both within and outside conflict-affected areas. Under the UNGPs, companies are expected to conduct ongoing human rights due diligence to identify and address the human rights impacts associated with their business activities. When operating in conflict-affected areas, companies are expected to implement heightened human rights due diligence (HHRDD) that considers the company's impact on rights-holders, the geopolitical context of the conflict itself and adherence to international humanitarian law.

5.2 The UNGPs specify that businesses that cause (or may cause) and contribute (or may contribute) to harm should cease or prevent adverse human rights impacts. If businesses are directly linked to harms associated with Russia's war effort, they have a responsibility to use or increase their leverage to mitigate the impacts to the greatest extent possible. Where the use of leverage is impossible or where human rights impacts are particularly severe or unmitigable, such as gross violations of international humanitarian and human rights law committed by Russia in Ukraine, the UNGPs direct businesses to consider terminating relationships or operations and exiting the market to ensure they do not contribute to harm.

6.1 On the basis of our engagement with over 180 companies since the full-scale invasion, we find companies are not implementing the UNGPs. Our research shows that businesses are not adequately undertaking heightened human rights due diligence (HHRDD), which should be the first and most crucial step in assessing companies' human rights risks.

6.2 Further, the majority of businesses we talk to point to the following six categories as 'complexities' that now prevent a clean exit from the Russian market: 1) the provision of essential goods and services, 2) employee safety, 3) benefiting Russia, 4) nationalisation and expropriation, 5) finding a responsible buyer, and 6) legal barriers.

6.3 Use of the essentiality argument has been particularly problematic with the lack of an internationally agreed definition leaving the term open to abuse. We have documented companies stretching the definition of essentiality to include chocolate, biscuits, ice cream and aftershave; none of which are essential for the maintenance of human life and all of which can be provided by local Russian companies.

6.4 Almost every single company we have spoken with stresses that they are 'sanctions compliant' to defend their continued presence in Russia. Increasingly, they claim to be stuck in Russia: powerless to act in the face of barriers to exit imposed by the Russian state. These justifications, and their corresponding actions, demonstrate a dismissal or misunderstanding of their responsibilities under these frameworks and a failure to recognise the risks associated with operating in an aggressor state, as defined by international law. After more than 122,000 reported war crimes in Ukraine, citing 'complexity' and 'sanctions compliance' is a wholly inadequate response under internationally accepted standards on business and human rights.

6.5 While challenges exist, it is possible to responsibly exit the Russian market in line with hHRDD under the United Nations Guiding Principles on Business and Human Rights - an approach which walks the line between reducing the negative human rights impacts of exiting while avoiding complicity or complacency in Russia's war of aggression and war crimes in Ukraine. Where no credible sale option exists, and in the face of clear direct contributions to mass human harm, companies should write down the loss and/or take the case to international arbitration or seek other legal remedies (like FinFortum has recently done).

Options for the UK government to increase restrictive measures on companies operating in Russia

7.1 Publicly call on companies not covered by sanctions to responsibly exit the Russian market to avoid further financing the war and the risk of complicity.

7.2 Update the UK's overseas business risk register to include a section on Russia and issue guidance which clarifies the expected standard of corporate conduct, and promotes ethical business practices that align with internationally accepted and endorsed human rights principles. See for example, the US Business Advisory on Russia Risks and Considerations for Doing Business in the Russian Federation and Russia-Occupied Territories of Ukraine.

Any guidance must include an expectation to better define essential goods and services in the context of Russia as an aggressor state, alongside a call for companies to conduct heightened human rights due diligence as mandated by the UN Guiding Principles.
Where a company claims to be providing an essential good or service, the onus should be on a company to demonstrate that the goods provided are essential to the maintenance of life and cannot be provided on the local market, and how the actor will mitigate its proximity to human rights harms; or that their continued operations are essential to maintaining open access to the internet and information.

7.3 Stop any company still working in Russia from participating in tenders for projects related to Ukraine's reconstruction and funded by the UK.

7.4 Oblige companies and other legal entities to disclose information on their business ties with Russia.

Disclosure should include the existence of such ties; profits generated in Russia and/or from Russia-related transactions; taxes paid to the Russian budget; the identity of Russian counterparts, and the nature of the relationship; as well as compliance and human rights due diligence, and 'essentiality assessments' carried out by the entity doing business in/with Russia.

This should be a separate reporting obligation in addition to existing annual and interim reports and material development reporting. These reports should be submitted to stock market regulators or to component sanctions authorities and published on companies' websites.

7.5 Introduce a windfall tax on annual turnover for those businesses still present in Russia.
Funds from the windfall tax should be used to finance Ukraine's recovery and reparations for victims of Russia's gross human rights abuses and violations of international humanitarian law.

Annexe 1: Russia's war economy and the role of foreign businesses

Russia is operating a 'Military-Civil Fusion' war economy. All businesses operating in Russia are now legally mandated to service the military and defense industrial sectors. In 2024, Russia's military spending is set to reach more than $156 billion (€145 billion), a 70% increase from 2023. In this war economy, 30% of fiscal expenditure will be directed towards the armed forces in 2024. It appears Russia pursues a strategy of civil-military fusion similar to that of China. While China's approach has been coined by the West (please see "Military-Civil Fusion and the People's Republic of China," U.S. Department of State), there is no such clear understanding when it comes to Russia, despite mounting evidence that the private sector is now fully instrumentalised in service of the Russian war economy. This evidence includes:

Procurement law. In July 2022, the Russian parliament enacted federal law No. 272-ФЗ ("On Amending Certain Legislative Acts of Russian Federation"), whereby businesses in Russia cannot refuse entering into governmental procurement contracts in general and military procurement contracts in particular, if they are deemed necessary by the government to ensure the conduct of foreign counter-terrorism and other operations by the Russian armed forces. Simultaneously, many private companies in Russia willingly contribute to the war effort. A grotesque example is the bakery manufacturing combat drones in Russia, which was widely reported and the entity in question has since been sanctioned.

Conscription law. On September 21, 2022, President Putin enacted federal law No. 31-ФЗ "on mobilization decree" requiring all businesses in Russia to conduct military registration of their staff if at least one of the employees is eligible for military service. The decree also requires businesses to assist with delivering the military summons to their employees. According to the decree, businesses must also, upon government request, deliver equipment to assembly points or military units and provide information, buildings, communications, land plots, transport, and other material means of support to the war effort. Russian law prohibits businesses from refusing mobilization orders or terminating government contracts to avoid carrying out conscription or resource-related tasks. Refusing these orders can result in civil fines, criminal penalties against company executives, and forced performance of contractual obligations by Russian government authorities. In the summer of 2023, the Duma approved new laws that significantly increase the fines for failing to report to a recruitment office and created a new offense, "failure to assist military registration and enlistment offices to notify citizens of their mobilization and obligation to report to recruitment points."

Windfall retroactive taxation. On 4 August 2023 Russian government enacted Federal Law No. 414-ФЗ "On Windfall Tax" which came into effect on 1 January 2024. The law applies retroactively to all companies operating in Russia that meet certain quantitative criteria and covers profits generated in 2021-2022. The 10% windfall tax applies to companies whose arithmetic average profits for 2021 and 2022 surpassed 1 billion rubles.[1]

[1] The taxable amount is calculated as a difference between an arithmetic average of profit for 2021-2022

Annexe 2: Kyiv School of Economics analysis of the economic contributions of UK companies to the Russian State

Number of companies still in Russia: 109 or ~40% (out of total number 274 companies identified)[1].

As of March 4, 2024 only 29 (10.6%) British firms have completely pulled out of Russia by selling or liquidating their business, and 136 (49.6%) are in the process of leaving.

At the end of October 2022[2] the KSE Institute identified 248 companies from Great Britain, including 15 (6.1%) with KSE status "exited", 131 (52.8%) with KSE status "leave" and 102 (41.1%) "staying" companies.

So, as we can see, in 16 months % of British firms have completely pulled out of Russia has changed immaterially while % of companies that are still in Russia have almost not changed.

The following table is based on KSE data available for the top British companies operated/operating in Russia:

Status by KSE	total # of companies in KSE database	# of companies with revenue in KSE database	Revenue in RF, 2022, USD m	Revenue in RF, 2021, USD m	Assets in RF, 2022, USD m	Assets in RF, 2021, USD m	Taxes in RF, 2021, USD m
exited	29	29	9 608	11 056	5 720	5 007	1 617
leave, including:	136	18	1 453	5 767	69 451	70 822	30
complete withdrawal	*66*	*6*	*818*	*2 091*	*1 176*	*1 566*	*11*
suspended operations	*70*	*12*	*635*	*3 676*	*68 275*	*69 256*	*19*
stay	109	37	5 188	4 664	4 572	3 468	539
Total	**274**	**84**	**16 248**	**21 487**	**79 743**	**79 297**	**2 186**

Based on data presented above it is worth noting that even though the percentage of staying companies is still quite high (~40%), a significant portion of revenue (59%+) has already been withdrawn with the exit of just 29 companies. The same trend is observed on the taxes side: – 74% (or $1.617bn vs $2.186bn) of taxes paid by British companies before the invasion was started is not linked anymore with British business in Russia.

At the same time, it's critical to concentrate on those companies which are still in the country as they were able to generate even more revenue in 2022 vs 2021 (~$5.2bn vs ~$4.7bn). The conclusion could be that smaller companies with lower revenue prefer to stay and those who have higher revenue are more eager to wait, limiting their investments as an excuse (at the same time they continue to earn and reinvest their local profit). Also, it's clear that money matters for those companies who are still tied with its local business in Russia.

Top 5 industries (by number of remaining in KSE database[5]):

- Pharma, Healthcare 9
- Consulting, Law 8
- Insurance 8
- Energy, oil and gas 7

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and for 2018-2019; The tax rate is 10%; The tax must be paid no later than 28 January 2024; Companies can receive a 50% discount if they pay the tax before 30 November 2023.

- Finance and payments 6

Top 5 industries of remainers (by revenue generated in 2022):

- Consumer goods and clothing $1.698bn
- Pharma, Healthcare $1.576bn
- Alcohol & Tobacco $508.0mn
- IT $423.5mn
- Energy, oil and gas $409.0mn

Top 6 industries of remainers (by total taxes paid in 2021):

- Consumer goods and clothing $331mn
- Pharma, Healthcare $97mn
- Energy, oil and gas $34mn
- Manufacturing $18mn
- IT $16mn
- Finance and payments $15mn

Top 5 industries of remainers (by profit tax paid in 2022):

- Consumer goods and clothing $37mn
- Pharma, Healthcare $32mn
- Alcohol & Tobacco $16mn
- Energy, oil and gas $15mn
- Finance and payments $14mn

Top 5 British remaining companies (by revenue generated in 2022):

- Unilever $1.24bn
- AstraZeneca $1.13bn
- Reckitt Benckiser Group $458mn
- GlaxoSmithKline $395mn
- Softline Holding plc (now renamed to Noventiq Holdings plc) $309mn

Top 6 British remaining companies (by assets in Russia, 2022):

- AstraZeneca $1.268bn
- Unilever $870mn
- IG Group $346mn
- Softline International $334mn
- Reckitt Benckiser Group $320mn
- Imperial Energy Corporation $310mn

Top 5 British remaining companies (total taxes paid in 2021):

- Unilever $331mn
- AstraZeneca $90mn

- JCB $18mn
- KCA Deutag $16mn
- IG Group $15mn

Top 5 British remaining companies (by profit tax paid in 2022):

- Unilever $34mn
- GlaxoSmithKline $16mn
- AstraZeneca $14mn
- IG Group $14mn
- KCA Deutag $9mn

How much taxes did those British firms staying in RF paid to the Kremlin in the two years since the start of the war?

Only in profit tax British companies staying in RF paid $189 mn in 2022.

March 2024

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[1] According to KSE Institute methodology, companies with local revenue $1+/year and significant control (50%+) in the capital were taken into account, for more details please see https://kse.ua/selfsanctions-kse-institute/ or https://leave-russia.org/
[2] https://kse.ua/about-the-school/news/25th-issue-of-the-weekly-digest-on-impact-of-foreign-companies-exit-on-rf-economy/
[3] https://youcontrol.com.ua/en/data-research/2-tysiachi-brytanskykh-kompaniy-prodovzhuiut-biznes-iz-rosiieiu/
[4] https://cyberleninka.ru/article/n/rossiya-britaniya-ekonomicheskie-otnosheniya-v-usloviyah-sanktsiy-i-brekzita/viewer
[5] https://docs.google.com/spreadsheets/d/1EFlhBQYyvRdSn4U6CY2yomeHEhTqbMKS/edit