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Survey

Deloitte experts keep constant track of the Russian automotive market. As part of our market-watching activities, we would like to invite you to take a poll we run to probe into the market’s mood and map its trends. It will take you less than a minute to complete and your input will be much appreciated. We will anonymize the collected data and use them to prepare a market overview that will appear in the next issue of the Automotive News.

We hope that you will find today’s issue interesting and useful. Our experts are ready to comment on the topics covered and answer the related questions you might have. Enjoy your reading!

Best regards,
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Public support initiatives
New industrial assembling regime

Within the framework of a new car industry strategy until 2025, the Russian Ministry of Economic Development in collaboration with the Ministry of Industry and Trade have developed a new industrial assembling regime.

The new regime is expected to serve the following purposes:

- Leverage on existing regulatory and public support mechanisms;
- Implementation of new investment regimes, including the execution of Special Investment Contracts (SPIC);
- Fostering the production of auto parts and technology development in R&D.

The expectation is to boost exports of auto parts as well as cars.
Subsidizing Russian manufacturers of wheeled remote control and unmanned vehicles

Subsidies to Russian manufacturers of wheeled vehicles

The Resolution of the Russian Government No. 637 of 7 July 2016 approves the rules for the provision of federal subsidies to Russian wheeled vehicle manufacturers to compensate partially costs arising out of the establishment of remote control and unmanned vehicles production.

The subsidies are offered on a monthly basis and may not exceed RUB 1 billion.

The Resolution sets forth the terms and conditions for granting subsidies and the procedure regulating the execution of subsidies agreements with the Russian Ministry of Industry and Trade.

Subsidizing interest expenses to Russian wheeled truck manufacturers

The Resolution of the Russian Government No. 865 of 31 August 2016 approves the rules for the provision of federal subsidies to Russian manufacturers of wheeled trucks as partial reimbursement of the costs on payment of coupon income earned on bonds and/or payment of interest on loans raised to develop preparatory production operations, and upgrade of the model range and production capacities.

In particular, the subsidies will be granted to companies engaged in the manufacturing of wheeled trucks under the industrial assembling regime, if such manufacturers have secured the bonds with public guarantees, had their investment project business plans approved and have been assigned an international manufacturer identification code.

Subsidies on loans will be granted on a quarterly basis, and subsidies on bonds will be granted on a half-year basis.

 Provision of subsidies aimed at reimbursement of transportation, homologation and compliance verification costs

The Resolution of the Russian Government No. 905 of 10 September 2016 approves the rules for granting federal subsidies to car manufacturers to compensate transportation and homologation costs as well as costs incurred to obtain certificates of compliance with international standards and costs of membership in international associations.

The document establishes the subsidy provision terms and conditions and the procedure for calculating the subsidies depending on the type of costs.
Subsidizing Russian agricultural equipment producers to reimburse part of transportation, homologation and compliance verification costs

The Resolution of the Russian Government No. 957 of 10 September 2016 approves the rules for granting federal subsidies to agricultural equipment producers to compensate transportation and homologation costs as well as costs incurred to obtain certificates of compliance with international standards and costs of membership in international associations.

The subsidies are aimed at decreasing the cost of operating vehicles of emission Tier 3 and above for transporting end products, reducing freight traffic on federal and regional roads, and fostering combined freight transportation.

A total of RUB 1.5 billion in federal subsidies was assigned in 2016.

Provision of subsidies to purchase emergency vehicles

The Resolution of the Russian Government No. 1951-r of 14 September 2016 approves additional budget allocations of RUB 1 billion for the purchase of emergency vehicles in 2016 by regional organisations selected by the Russian Ministry of Health.

The Resolution of the Russian Government No. 1695-r of 10 September 2016 has previously assigned RUB 3 billion to purchase emergency vehicles in 2016.

All in all, 34 constituent entities of the Russian Federation will receive 473 emergency vehicles in addition to 1,317 budgeted earlier.

Increase of excise duty rates on certain vehicles imported into Russia

The Russian Federal Tax Service Order No. 1311 of 1 July 2016 provides for the increase of excise duties on passenger cars and motorcycles with HP 150 and higher imported into Russia, and the decrease of excise duties on imported fuel, motor oil, and diesel.

Supporting development of electric and natural gas vehicles

Russian Government initiatives to support electric vehicles

The Russian Government has prepared the draft programme for electric vehicles development in Russia until 2025 that encourages the use of environmentally friendly cars.

The owners of electric cars will enjoy special benefits: discounts on road tolls, free parking, the use of bus lanes, and vehicle tax exemptions (for hybrid cars, a reduced tax rate). Other measures discussed include the development of public charging station networks, including a simplified land allocation procedure for the installation of such stations, a mandatory share of electric public transit and installation of charging stations in shopping malls and public parking lots.

The final draft of the programme has not yet been released.

Reduction of customs duties on electric vehicles and natural gas vehicle parts imported into Eurasian Economic Union (EAEU)

Customs duties

- Customs duties on natural gas vehicle parts, including duties on fittings and valves, are zeroed from September 2016 to the end of 2020; and on natural gas tanks—from 2 September 2016 to the end of 2016;

- Import customs duties on electric vehicles will be reduced from 2 September 2016 to September 2017 as follows: from 17 percent to 0 percent on electric passenger vehicles, and from 15 percent to 5 percent on trucks with gross vehicles below five tons.
**Change of regional tax incentives for car manufacturers**

Tax incentives are granted to car manufacturers operating in key regions with a high concentration of automotive clusters (Primorsky Territory, Leningrad, Kaliningrad and Kaluga Regions).

Respective legislative amendments were introduced in September 2016 in order to expand public support opportunities for such manufacturers.

Thus, a draft law providing for the transformation of the Kaliningrad Region’s special economic zone (hereinafter, the SEZ) into a regime similar to that of a territory of advanced social and economic growth (TASEG) was presented for public discussion.

The Kaliningrad Region’s SEZ residents will be able to pre-register and keep the existing tax incentives and even get additional support envisaged by the TASEG regime in Russia subject to investing RUB 75 million.

The draft also suggests establishing a free port regime in the Kaliningrad Region. The Project establishes the general business principles, including simplified visa processing, provision of tax incentives and insurance contribution cuts to the residents as well as other benefits.

The Leningrad Region approved the procedure for subsidizing car manufacturers as compensation for service costs arising out of researching and testing sample materials used in manufacturing as well as applied technologies testing.

To receive a subsidy, a car manufacturer should operate in the Leningrad Region and be registered as a tax resident with the local tax authority. Furthermore, it needs to enter into a subsidy agreement with the Economic Development and Investment Committee of the Leningrad Region. The subsidy amounts to 75% of total actual costs incurred by the subsidy recipient over the previous fiscal year.

The Kaluga Region adopted a Resolution that regulates the execution of the special investment contracts subject to a minimum investment of RUB 300 million. However, the law introducing tax incentives for this category of investors has not yet been adopted.

**Special investment contracts**

As of September 2016, fifty-four regions amended their legal framework to provide for the possibility of executing a SPIC. The procedure already exists in twenty-two regions, and seventeen regions have adopted the laws providing for tax incentives, including for car manufacturers.
Foreign trade issues
Free Trade Agreement between EAEU and Vietnam

Federal Law No. 120-FZ of 1 May 2016 ratified the Free Trade Agreement between the EAEU and Vietnam as well as Protocols No. 1 and No. 2 to the Agreement aimed at reducing customs duties.

Protocol between the Russian Federation and Vietnam on support of motor vehicles production in Vietnam


The Protocol was enacted on 5 October 2016.

Pilot project on simplified customs transit extended

The Russian carriers admitted to participate in the pilot are entitled to transport goods in accordance with the customs transit procedure subject to no customs duties if the customs destination is a Russian customs authority.

Assessment of VAT on imported goods subject to license fees

The Letter of the Russian Ministry of Finance No. 03-10-11/45719 of 4 August 2016 highlights the importance of including embedded royalty in the import tax base if such royalty is subject to inclusion in the customs value of imported goods (sub-item 7 of item 1 of Article 5 of the Agreement of 25 January 2008 “On Assessing the Customs Value of Goods Carried Across the Customs Union Border”).

The Ministry advises that the royalty inclusion in the customs value for the purpose of import VAT assessment and the payment of such VAT on royalty by a tax agent shall not be regarded as a double taxation, since the tax is imposed on different entities (an importer and a licensor) and on different positions (goods import into Russia and transfer of rights).

Furthermore, the draft considerably expands the functions of the Eurasian Economic Commission, which will foster the flexibility of the common customs regulation in the EAEU.

In addition, the Ministry has noted that the customs value of goods shall include the total amount of royalty paid to the rights holder before tax, and not the actual transferred amount.

The draft Agreement on the EAEU Customs Code is to be approved internally by the states by 20 September 2016 as the signing is due to take place in December 2016 at the meeting of the Supreme Eurasian Economic Council.
Development of environmental law
Approval of new pollution charges and additional multipliers

The Resolution of the Russian Government No. 913 of 13 September 2016 establishes new rates and additional multipliers on pollution charges for 2016–2018 that will be applied effective 1 January 2016.

The document provides that the pollution charges with regard to the protected areas will be doubled.

Introduction of cumulative environmental effect concept

The Russian Ministry of Natural Resources has prepared a draft law amending the Law “On Environmental Protection” and certain regulations of the Russian Federation relating to the removal of consequences of a negative environmental impact and compensation of the environmental damage inflicted and cumulated as a result of past operations.

If adopted, the draft law provisions introducing corporate responsibility for removing the cumulative environmental effect will be enacted on 1 January 2019.

Procedure for compensation of cumulative environmental impact

The Russian Ministry of Natural Resources has also developed a draft law that specifies the environmental damage compensation procedure.

The existing laws (item 3 of article 77 of Federal Law No. 7-FZ of 10 January 2002) provides for environmental damage compensation based only on the established rates and calculation methodology.

Management of cumulative environmental effect removal works

The Russian Ministry of Natural Resources is said to be preparing a draft for the Government Resolution that is planned to approve the procedure for the removal of the cumulative environmental effect.

Russian Government updates list of pollutants subject to public environmental regulations

The Russian Government has updated the draft Resolution that specifies the list of pollutants subject to public environmental control.

The list extends to include 114 new pollutants (or new pollutant names), including those used in car and car parts manufacturing subject to pollution charges.

The possibility of zeroing pollution charges for new pollutants until 2018 is being discussed.
Russian Ministry of Natural Resources approves draft list of waste types containing valuable substances that may not be buried

The Russian Ministry of Natural Resources prepared a draft for the Resolution of the Russian Government that suggests approving a list of waste types containing valuable substances that may not be buried.

For instance, the draft prohibits the burial of scrap metal and ferrous and non-ferrous metal waste effective 1 January 2017; rim, tyre and inner tube waste effective 1 January 2018, and computer, electronic and optical waste effective 1 January 2020.

The draft is aimed at fostering the waste disposal industry, listed among the priority sectors of the public waste management policy.

If adopted, the document will be enacted on 1 January 2017.

Approval of procedure for provision of public services relating to licensing of collection, transport, treatment, disposal, decontamination and placement of waste

The Order of the Russian Ministry of Natural Resources No. 379 of 1 July 2016 approves the administrative procedure governing the provision of a public service relating to the licensing of collection, transport, processing, disposal, decontamination and dumping of I-IV hazard class waste disposal.

Before 31 December 2015, only decontamination and dumping of I-IV hazard class waste disposal required licensing.

Approval of forms for joint reconciliation of environmental duty, offset or recovery of overpayments

The Order of the Federal Supervisory Natural Resources Management Service No. 489 of 22 August 2016 approves the forms of documents for reconciliation of the environmental duties, an offset or recovery of overpaid duties.
Other federal legislation news
Electronic passports for vehicles, unmanned and other machines across EAEU

Approval of formats and structures of electronic passports for vehicles, unmanned and other machines across EAEU

The Resolution of the Eurasian Economic Commission Board No. 81 of 12 July 2016 approves the format and the structure of electronic vehicle passports (vehicle chassis passport) and electronic passports of unmanned and other machinery. Thus, an electronic passport can be issued in the form of an electronic document signed using a digital signature.

Switching to electronic vehicle passports will result in the establishment of a single data base of vehicles, agricultural, road construction and other types of machinery in the EAEU aimed at streamlining vehicle participation in road traffic, enhancing anti-theft efforts and other violations pertaining to such vehicles as well as the improvement of control of payment of vehicle import customs fees.

In accordance with the Resolution of the Eurasian Economic Commission Board No. 122 of 22 September 2015, the issuing of paper vehicle passports will cease effective 1 July 2017. Until then, paper vehicle passports may be exchanged voluntarily.

However, the scrappage charges issue has not been addressed by the above-mentioned Resolution.

Preservation of existing road damage charges for vehicles weighting over 12 tons until 1 January 2019

The Russian Ministry of Economic Development suggests preserving road damage charges for vehicles weighting over 12 tons (Platon system) at RUB 1.53 per 1 km until 1 January 2019.

Furthermore, the Ministry sees the importance of addressing the issue of rate differentiation depending on road conditions, traffic load, availability of bypasses and relief roads and temporary traffic restrictions.
Clarifications by Russian Ministry of Finance and Russian Federal Tax Service
Transfer pricing issues
Russian Federal Tax Service clarified issues relating to control of pricing in uncontrolled transactions between related parties

If a local tax authority establishes the facts of tax evasion by way of price manipulation in related party transactions that are not qualified as “controlled transactions”, it may prove unjustified tax benefits during its field and desk tax audits, including using the methods established in Chapter 14.1 of the Russian Tax Code.

The Russian Supreme Court acknowledges that the tax authorities may not control pricing between related parties, but permits price adjustments in case of the discovery of unjustified tax benefits from price manipulations (see cases No.А63-11506/2014, АПЛ16-124 and A40-63374/2015).

For more details, please refer to the LT in Focus Edition of 22 July 2016.

Go-live of updated Transfer Pricing software

The Order of the Russian Federal Tax Service No. MB-7-6/368@ of 21 June 2016 introduces a software update for the establishment of Transfer Price, an information resource designed to automate symmetric and reverse adjustment processes and review the completeness of taxes assessed and paid on related-party transactions.

Beneficial ownership concept

Application of reduced tax on dividends paid by a Russian company to a German company through another entity

The Letter of the Russian Ministry of Finance No. 03-08-05/46320 of 8 August 2016 clarifies the application of the provisions of the Double Tax Treaty with Germany in an instance when a Russian company pays dividends to a German company, indirectly participating in such Russian company, through another German company.

In the opinion of the Russian Ministry of Finance, taking into account item 1 and item 1.1 of Article 312 of the Russian Tax Code, a reduced tax on dividends provided for by the Double Tax Treaty can be applied when a foreign dividend recipient indirectly participates in a Russian company that pays such dividends through a foreign company that is not a beneficial owner of such dividends and is not seeking the application of the Double Tax Treaty.
Application of thin capitalization rules

Calculation of controlled debt value per creditor

The Letter of the Russian Ministry of Finance No.03-03-06/1/36454 of 23 June 2016 advises that a company’s controlled debt value shall be determined per each creditor separately based on the aggregate debt owed to such company. In the Ministry’s opinion, the capitalization ratio shall be calculated separately in respect of the outstanding debt to each entity a controlled debt is owed to or in respect of each affiliate or a foreign company that acts as a surety or guarantor or otherwise secures the obligation.

Court practice in respect of controlled debt assessment has been controversial. Thus, in cases No. A05-12258/2014 and No. A09-3038/2011, the Commercial Court concluded on limitation of interest expenses considering debt-to-equity ratio calculated based on the total amount of controlled debt, while in the case № 33-23100/2013 the Court upheld the position of the taxpayer regarding the assessment of a controlled debt per each creditor.

Please be reminded that in accordance with the amendments to the thin capitalization rules introduced by the Federal Law No. 25-FZ of 15 February 2016 that will be enacted on 1 January 2017, a controlled debt value shall be determined on an aggregate basis.
Court practice
Transfer pricing

The tax authorities have concluded that the company purchased goods from a related party at a price that was substantially above the market, which has led to profit underestimation for taxation purposes.

The Commercial Court of Cassation resolved in favour of the tax authorities on the following grounds:

- Vehicle sales agreements entered into between the company and the shareholder were cross-border transactions;
- The company’s operations were fully controlled by the shareholder and the company was unable to adjust the dealer sale prices or the recommended end customer prices; furthermore, the company was not able to develop a common marketing or reward strategy or establish any dealer cooperation principles as all conditions were determined by the shareholder;
- Foreign vehicles could be purchased from foreign dealers only by related Russian distributors that were specifically established for these purposes by foreign car manufacturers; no other entity was entitled to purchase the vehicles from a foreign dealer, therefore, there was no free movement of goods, which is a key attribute of the market;
- Retail and wholesale markets are incomparable in terms of operation conditions;
- The differences in the terms and conditions of vehicle sale to the company and other buyers are material, therefore, such transactions cannot be considered as made upon comparable terms and conditions;
- The arm’s length pricing algorithm the tax authority referred to has not been challenged by the company.

In another proceeding, the Commercial Court ruled in favour of a company on the basis of the following grounds:

- The procurement costs denominated in a foreign currency were similar for all cars within one model range, therefore, the tax authorities’ claims actually referred to the profitability of certain sales transactions that was lower than that on the other sold cars, rather than to the procurement costs;
- A lower or even negative margin on certain vehicle sales was driven by a significant rise in FX rates in September-October 2011, due to which the tax authority had to make respective FX adjustments;
- The profitability of the disputable transactions was strongly impacted by the varying cost of each vehicle delivery to different regions as well as by car hauler load, therefore, the arm’s length price had to be calculated on the basis of the average transportation costs on all vehicles;
- The tax authority compared the margin on the company’s concrete transactions with the peer’s margin for the entire period (net of adjustments required to exclude other types of operations [sale of car parts and accessories]).


Deductibility of consulting services purchased from related party

A tax authority has challenged the expensing of the fees of consulting services purchased from a related party as well as the deduction of the respective amounts from input VAT.

The Commercial Court upheld the tax authority’s position taking into account the circumstances below:

- Work acceptance certificates are of a formal nature with identical content and contain no detailed description of the business operations; they offer only high-level information and contain no reference to the contractors’ reports, service providers and services rendered over a specific month;
• No information is provided on the pricing methodology or the calculation of cost of specific services; the contractual price approval minutes are not in place;

• Additional evidence provided by the company in terms of verification of the product promotion services cannot be taken into account as 97.5 percent of the company’s consumers account for the group entities, and only 2.5 percent are the uncontrolled buyers. Therefore, purchasing the disputable services was not necessary;

• Certain targets set by an annex to the service agreement in question have not been achieved.

Based on the foregoing, the Commercial Court concluded that entering into a disputable agreement with a related party was not feasible either from an economic or business perspective or for profitability purposes, however, the transaction result had effected the company’s tax liabilities by granting unjustified tax benefits in the form of VAT deductions and recognition of consulting fees as expenses for profit tax purposes.

Property tax incentives

The fourth quarter of 2015 saw a considerable rise in the number of court proceedings pertaining to the applicability of corporate property tax benefits to public railways, federal roads, main pipelines, power transmission facilities and property, which is an integral technological component of the above facilities (item 11 of Article 381 of the Russian Tax Code [as per amendment No. 122 of 25 December 2012]). Most disputes related to the applicability of tax benefits to the power transmission facilities in the balance sheets of the power companies as well as trading companies.

The court practice on the matter is quite ambiguous. The litigation outcome both for a taxpayer and tax authority will directly depend on the strength of the parties’ arguments offered in support of the tax benefit claims: not only from a taxation perspective, but also from the perspective of the industry-specific laws, construction regulations as well as technological aspects of the property the tax benefits are applied to.

Effective April 2016, the number of decisions issued in favour of taxpayers has grown significantly vs. 2015 and early 2016.

For a detailed review of relevant court practices, please refer to the overview of litigation practice on tax incentives.
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