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Transport tax

Proposals to introduce tax incentives and to eliminate the tax altogether

Several draft laws currently under review would stipulate amendments to the transport tax. Two draft laws propose repealing the transport tax while others would introduce tax incentives.

• Repeal of the transport tax

The Russian State Duma is currently reviewing draft laws No. 937952-6 and No. 1005835-6, which are similar in content. Both suggesting eliminating the transport tax. The Russian Government and the State Duma Committee on Federal and Local Government have already issued negative comments on draft law No. 937952-6 and have recommended that it should be discarded in the first hearing. According to the comments, lowering the tax burden on taxpayers through the reduction of regional taxes alone without compensating for the lost profits through intra-budget transfers may cause some regions to go bankrupt. Since draft law No. 1005835-6 also fails to suggest any compensation mechanism, we believe it will receive similar negative comments.

• Introduction of tax incentives

Both the Russian Government and the special committees of the Russian State Duma have commented that charging owners of vehicles with an allowed maximum permitted weight over 12 tons both the transport tax and the new road toll payable via the Platon e-collection system is unjust and leads to double taxation. Therefore, the introduction of offset schemes is required.

The Russian State Duma has received for its review draft law No. 966991-6, which suggests reducing the road toll by the amount of the transport tax. The Ministry of Transportation has proposed another draft law that suggests reducing the transport tax by the amount of the road toll. Draft law No. 966991-6 is currently undergoing revisions, but we believe that one of the suggestions for the offset of payments will likely appear in the final law. Should one of draft laws be approved, taxpayers will be able to apply the benefits to the entire period after 1 January 2016.

Draft law No. 966991-6 suggests eliminating the maximum tax rate of RUB 8.5 per horsepower for trucks whose engine capacity exceeds 250 horsepower. However, the draft law fails to specify whether a lower ratio will apply to these vehicles, or if these vehicles will be exempt from the transport tax. We expect the draft law to be amended to address these questions.

The possibility of deferring payment of the road toll up to 60 days is also being discussed.

Regional legislative authorities have adopted similar initiatives. On 1 January 2016, St. Petersburg Law No. 887-178 of 25 December 2015 came into effect, which amends certain city tax and levy laws. The law exempts businesses and individuals from the transport tax for vehicles that run on natural gas.
Federal Legislation News

Transport tax

New list of luxury cars for calculating the transport tax in 2016

The Russian Ministry of Industry and Trade has updated the list of passenger cars priced over RUB 3 million that are regarded as luxury items and subject to specific multipliers for calculation of the transport tax.

Given the overall rise in vehicle prices, some Nissan and Chevrolet models are included for the first time.

See the table below for the increase in the number of high-priced cars in each price category over RUB 3 million.

<table>
<thead>
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<th>Year</th>
<th>Number of cars</th>
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<tr>
<td></td>
<td>RUB 3-5 million</td>
</tr>
<tr>
<td>2014</td>
<td>100</td>
</tr>
<tr>
<td>2015</td>
<td>239</td>
</tr>
<tr>
<td>2016</td>
<td>354</td>
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This increase demonstrates that the threshold for applying multipliers to luxury cars fails to serve the economic purpose initially intended by the legislative authority and should be increased.
Environmental duty

Taxable items, calculation procedure and payment due dates

Federal law No. 456-FZ of 29 December 2014, which amended Federal Law No. 89-FZ “On Production and Consumption Waste”, subjects some producers and importers to an environmental duty. The environmental duty will not be applicable to goods produced for export or that are not intended to be used in Russia.

Together with the Ministry of Natural Resources and Environment, the Russian Government has approved the list of finished goods, including packaging, that are subject to recycling upon use, and has established a waste disposal ratio for each group of products according to the list.

The waste disposal ratio in 2015 is set at 0% for all categories of goods, so the first payment period will be 2016. The payment of the duty is due by 15 April 2017.

Environmental duty management

The Federal Service for Natural Resource Management Supervision (Rosprirodnadzor) will control and supervise the calculation and payment of the duty. Currently, the authority is preparing document templates for the environmental duty, including:

- Environmental duty calculation report (which presumably will consist of two parts: one for the general information on the manufacturer / importer of the goods and packaging, and the second for the duty calculation);
- Request for environmental duty reconciliation and environmental duty reconciliation report;
- Application for offsetting / refunding excess environmental duty;
- Decisions to offset / refund / reject to offset or refund excessive environmental duty.

Producers and importers are required to pay an environmental duty or to independently recycle goods and packaging subject to disposal upon use.
Independent waste disposal

Alternatively, producers and importers may choose to independently recycle goods and packaging subject to disposal upon use.

At the end of 2015, the Russian Government published two resolutions, one stipulating a procedure for the independent recycling of goods and reporting on meeting the established waste disposal ratio, and the other providing for deployment of the unified state informational system to monitor goods recycling.

Independent waste disposal may performed through:

- Setting up independent facilities for collecting, processing and disposing of the waste from used goods;
- Concluding agreements with contractors handling solid municipal waste and regional contractors;
- Establishing an association (union) of manufacturers or importers of finished goods (including packaging) subject to waste recycling after they are not longer suitable for use.
- Should the producer or importer be unable to achieve the established waste disposal ratio, the environmental duty will be calculated based on the difference between the established and the actual waste disposal ratio.
Federal Legislation News
Recycling duty

Recycling duty for vehicles (car frames) and trailers

A number of amendments have been introduced to the list of types and categories of wheeled vehicles and car frames subject to the recycling duty, as well as the size of the recycling duty.

The recycling duty is applied to each wheeled vehicle imported to or manufactured in Russia (except for certain categories of wheeled vehicles which are not directly referred to in the list of vehicles subject to recycling duty). The amount of the recycling duty for each category (type) of wheeled vehicle is calculated as the base rate (RUB 15,000 or RUB 20,000) multiplied by the ratio stipulated for the specific group of items.

- **Russian Government Resolution No. 1350 of 12 December 2015** increased the recycling duty rate by 50% to 100% on average for all new vehicles and car frames and for some vehicles and car frames more than three years old.

- **Russian Government Resolution No. 81 of 6 February 2016** specifies that the recycling duty is also charged on trailers, and establishes ratios for calculating the duty.

Recycling duty for self-propelled vehicles and trailers


**Russian Government Resolution No. 81 of 6 February 2016** approves the list of self-propelled vehicles and trailers subject to recycling duty (including vehicles used for construction, loading, felling and agricultural work, and some types of off-road vehicles and snowmobiles) along with the rules for the levy, calculation, payment and collection of the recycling duty for them.

The recycling duty applies to the period after 10 February 2016 only for self-propelled vehicles and trailers that appear on the list. The recycling duty does not apply to vehicles not included on the list or put into circulation on or before 10 February 2016.

The recycling duty rules for self-propelled vehicles are identical to those for other vehicles. Self-propelled vehicles are divided into categories (types), and a base ratio and a multiplier is stipulated for each, depending on the vehicle’s date of production. The recycling duty is expected to result in a decrease in imports of preowned non-environmentally friendly vehicles and the modernization of fleets of such vehicles, including with those manufactured in Russia.

In the meantime, the base rate for self-propelled vehicles and trailers is RUB 150,000 (10 times higher than that of wheeled vehicles). In some cases, the recycling duty is as high as the cost of the vehicle/trailer itself. Therefore, the business community expects to see an increase in the prices of the vehicles.
Procedure for acknowledging producers of self-propelled vehicles and/or trailers in the category of largest manufacturer

Order by the Russian Ministry of Industry and Trade No. 406 of 18 February 2016 approves the procedure for recognizing a recycling duty payer of self-propelled vehicles and/or trailers in the category of largest manufacturer for the purposes of applying a special procedure for calculating and paying the recycling duty.

A recycling duty payer shall be acknowledged as a largest manufacturer and included into the respective register if, jointly with its affiliates, the manufacturer welds car frames, bodies and bunkers, mounts electrical equipment and performs other works with a high degree of local content, and owns service centers across Russia. In addition to these qualitative criteria, a “presence criterion” has been introduced. According to this criterion, a company must have been producing industrial products for over three years by the date of application and hold the right to engineering and technical documentation sufficient to develop production over the next five years.

However, this general rule has a number of exceptions. The right to be included into the register of the largest manufacturers of self-propelled vehicles is granted to participants of state-commissioned R&D projects and special investment projects as well as manufacturers of vehicles produced from self-propelled vehicles and/or trailers manufactured by another largest manufacturer.

Recycling duty management

The Letter of the Russian Federal Tax Service No SD-4-3/2437@ of 16 February 2016 provides a list of types and formats for calculating the recycling duty for self-propelled vehicles and trailers as well as for trailers to wheeled vehicles.

The Russian government continued to introduce recycling duties aimed at compensation of lost profits in result of reduction of customs duties according to WTO requirements. In 2016 the list of vehicles subject to recycling duty was expanded with self-propelled vehicles and trailers.
The matter of legalizing parallel imports in Russia has long been discussed. In April 2015, Prime Minister Dmitry Medvedev conducted a meeting during which the matter of adopting the international exhaustion principle for trademarks was discussed, and a number of assignments were made. One such assignment was a charge to consult with the Eurasian Economic Commission (EEC) regarding the gradual transitioning to parallel import. As the EEC is a common customs territory, should Russia alone adopt the international trademark exhaustion principle, this action may infringe upon the interests of other EEU member states.

The Russian Federal Antimonopoly Service (hereinafter, “FAS”) is still the main initiator of the process of legalizing parallel imports by Russia. Since early 2014, the FAS has been actively working on the concept and expects to have the list of goods for “parallel import” agreed by the EEU member states by 2020. To this end, the authority has prepared a draft law that aims to amend Part Four of the Russian Civil Code. In January 2015, the Russian Ministry of Economic Development prepared a negative conclusion on the regulating impact of the draft project, arguing “the legalization of parallel imports will result in an increase in counterfeit products by 20% on average and a deterioration of companies’ KPIs by 50%-65%. Around 40% of companies will consider relocating their production outside of Russia.”

As of now, the Russian State Duma has received no draft laws for its review suggesting the legalization of parallel imports. According to the latest data, however, the FAS and the Russian Government are preparing a new draft of the amendments to the Russian Civil Code. Adoption of such a law would lift the ban on parallel imports for certain industries (as a pilot project). Importantly, the FAS suggests lifting the ban for all goods in the automotive and pharmaceutical industries and some consumer goods, such as personal hygiene products.

However, the risk of an increase in the amount of counterfeit products as well as a decline in investments into the Russian economy (forecast at the level of 60%-70% for the automotive industry), are major obstacles to the full legalization of parallel imports. The increase in the number of importers will inevitably make it harder for rights holders to control the quality of the products being imported. The problem of the illegal circulation of goods must be tackled to make parallel imports happen.

The Expert Council for Innovative Development of the Automotive Industry and Special Vehicles under the State Duma’s Industry Committee has developed a strategy for fighting illegal sales of industrial products in Russia until 2020 (hereinafter, “the strategy”). The automotive industry was named as a priority industry for monitoring and combating illegal sales of industrial products. The annual losses of manufacturers from counterfeited automotive parts in the passenger car segment are estimated at RUB 5 to 8 billion.

1 Resolution No. DM-P13-35 of 22 April 2015
2 http://economy.gov.ru/minec/activity/sections/ria/info/monitoring/201503307

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Recommended measures for tackling illegal sales of industrial products and improving the anti-counterfeit framework include the following:

1. Improving the legislation that governs the sales of industrial products;
2. Developing and implementing a comprehensive state system for monitoring the situation with counterfeit industrial products in Russia;
3. Cooperating with other countries to fight against illegal turnover of industrial products, etc.

At this point, parallel imports remain just an idea, but active measures are being undertaken by the FAS and the Russian Government to bring it to life. The legislative authorities believe that the strategy will help overcome a number of issues related to the import and turnover of counterfeit products in Russia. As of now, the strategy comprises broad and declarative concepts, which need to be further elaborated and approved by legislation.
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The Russian Government has approved the **Automotive Industry Support Program for 2016**, which provides a number of measures aimed at encouraging the development of the automotive industry in Russia, such as:

- Refreshing the fleets of wheeled vehicles;
- Providing subsidies to automotive manufacturers to compensate for part of the interest payments on investment loans;
- Providing benefits on leasing wheeled vehicles; and
- Subsidising part of the interest payments on customers’ car loans.

The program aims to improve the efficacy of the automotive industry, upgrade production facilities, introduce new technologies and encourage competitiveness of Russian products on both the local and international markets.
State support
Special investment contracts

After Federal Law No 488-FZ of 31 December 2014 “On Industrial Policy in Russia” was enacted, many investors started to take a keen interest in special investment projects in the country.

The state policy provides a number of benefits to investors that set up, upgrade or improve industrial production in Russia, such as tax and levy benefits, customs benefits, lease benefits on state and municipal property, including land plots, and other benefits and incentives stipulated by Russian law. Moreover, the government undertakes the obligation to preserve the favorable fiscal and regulatory environment for the next decade.

According to the available information, many automotive producers are already discussing relevant terms and conditions with the Russian Ministry of Industry and Trade (e.g. Hyundai Motor Manufacturing Rus in St. Petersburg; Volkswagen Group Rus and Volvo Group Russia, which have production facilities in Kaluga; and Mazda Sollers Manufacturing Rus, which intends to establish motor production facilities in Vladivostok).

Property tax may be abolished for vehicles produced after 1 January 2013

Under the 2016 Transport Machine Building Support Program, the Russian Ministry of Finance has prepared a draft law that abolishes the limitation of property tax benefits on movable property (purchased from a related party or received through reorganization) for vehicles manufactured on or after 1 January 2013. The draft law has successfully passed public hearings, has been positively assessed for its regulative impact and is being prepared for submission to the Russian Government.
State support
“Industrial assembly” mechanism is under development

The Russian Ministry of Economic Development is preparing a draft order that will amend the procedure for manufacturing motor vehicles and automotive parts under the “industrial assembly” mechanism (Order No. 73 of the Russian Ministry of Economic Development, Order No. 81 of the Russian Ministry of Industry and Energy and Order No. 58n of the Russian Ministry of Finance of 15 April 2005). The amendments are aimed at further developing motor vehicle production and encouraging the upgrade of automotive parts production in Russia. The planned amendments will apply to both motor vehicle and automotive parts manufacturers.

For manufacturers that upgrade their existing facilities, a unified localization ratio of 45% is suggested for the third and fourth year of execution of the industrial assemblage agreement. For manufacturers of automotive parts, changes to the periods for localization stages are suggested, in particular, the first stage of applying the agreement will be extended until the end of 2015.

The draft order provides an opportunity for non-inclusion of customs value of recycled waste and/or waste returned to suppliers into the localization ratio calculation.
### Court practice

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Court practice
Transfer pricing

Negative cases
The arbitration courts reviewed a number of cases related to the application of transfer pricing (TP) methods to automotive wholesale transactions between foreign suppliers and local distributors. When reviewing the cases, the courts concluded that the tax authorities lawfully shifted from the comparable uncontrolled price (CUP) method to the resale price method (RPM) when reviewing the above transactions since identical products were not available on the market. The courts accepted the tax authorities’ argument that wholesale and retail prices of identical vehicles should not have been regarded as identical products.

The courts further supported the conclusions by the tax authorities that the distributors bore no key risks and possessed no tangible assets, should not have negative profitability and all losses, if any, would be reimbursed by their parent companies.

Resolution of the Russian Supreme Court No. 305-KG15-12240 of 14 October 2015 on case No. A40-4381/13; Resolution of the Moscow Arbitral Court of 10 June 2015 on case No. A40-89807/14; Resolution of the Russian Supreme Court No. 305-ES15-17755 of 20 January 2016 on case No. 09AP-18467/2015)

Positive case
The tax authority concluded that the taxpayer was selling goods purchased from a related supplier, below their cost value, thus incurring losses.

The tax authority claimed that the taxpayer acted in the interest of its foreign parent company, which, as the only supplier on the Russian market, had unlimited possibilities to support its subsidiary distributor by providing discounts, which it chose not to do in those circumstances. Additionally, the contracts with independent distributors provided that the suppliers would reimburse the discounts provided by distributors to dealers. This conclusion was rejected by the court due to the actual circumstances of the case, which testified to the opposite. First, the purchase prices between Itochu Corporation and the taxpayer were initially set at a level of 18% below that set for independent distributors. Itochu Corporation also chose to bear the FOREX risks, which turned out to be a significant support to the taxpayer in the midst of the depreciation of the ruble in 2008 and 2009. Secondly, the parent company was not interested in its subsidiary’s losses and even had to reimburse the losses to improve the net assets position of the subsidiary.

Referring to the relations between the taxpayer and the supplier, the tax authority tried to prove that the contractual terms had not been set at arm’s length. Similarly to the stand taken in the cases described above, the tax authority claimed there were no comparable transactions on the wholesale market, which made it impossible to apply the CUP method, due to which the tax authority applied the RPM.
The tax authority also attempted to prove that the transactions in the previous quarter of the same year between the suppliers and independent distributors involving identical vehicles could not be used as valid comparators. However, the subject matter experts involved confirmed that the transactions in the previous quarter between the supplier and independent distributors involved identical products and therefore created a market for those goods. Given that situation, the deviations in the contractual terms and conditions could be appropriately adjusted and were not an obstacle to the comparative analysis. The experts commented that in order to apply the arm’s length principle to the transactions in an earlier period, the prices could be adjusted to the disputable period based on the key market trends. Additionally, the experts noted that a quarter difference was not a barrier to comparison as the standard period in comparative analysis was one year. Thus, the finding of the tax authority regarding the non-applicability of the CUP method was acknowledged as unjustified and illegal.

Additionally, the experts noted that while applying the RPM, the tax authority used the transactional net margin method, which the tax authority has itself claimed as incorrect. Based on the above, the Arbitration Court of Moscow ruled in favor of the taxpayer.

In recent years arbitration courts demonstrated intention to rely on the opinion of independent subject matter experts involved into litigation. Hence, it becomes crucial to address the latter with proper questions highlighting the details of the case, which should be considered.

Resolution of the Moscow Arbitral Court of 3 February 2016 on case No A40-111951/12-20-580
In a dispute over the application of thin capitalization rules to loans from foreign sister companies, the Ninth Arbitration Court ruled in favor of the tax authority despite the taxpayer’s arguments that the Group’s financial company was not a conduit company.

Inchcape LLC obtained a loan from Inchcape Finance PLC, a foreign financial company; the Borrower and the Lender were each a subsidiary of Inchcape PLC. To justify its stand regarding the non-applicability of thin capitalization rules to the loan, the Taxpayer provided the following information on the Lender: Inchcape Finance PLC was established in 1987 and operated as a centralized treasury, performed its functions independently and bore relevant risks. The Borrower only partially belonged to the Inchcape Group, and had been established jointly with an independent party as an investment into the developing Russian market. Therefore, investing into the daughter company through sheer contribution to its charter capital would have contradicted the Group’s financial interest, yet some loan agreements were concluded on interest-free terms.

The tax authority argued, however, that despite the presence of a business purpose for establishing the Treasury, the Group’s ultimate parent company remained in charge of the intragroup debts (namely, through monitoring a number of ratios, such as loan-to-equity, interest-to-EBITDA, and interest-to-market value) and the Lender was entitled to request early redemption of the loan should the borrower leave the Group.

The Ninth Arbitration Court supported the tax authorities, pointing out that Article 269 of the Russian Tax Code applied, among other situations, to sister companies, which was evident from the Commentaries to the OECD Model Tax Convention and the vast judicial practice on Article 269. However, the court avoided evaluating the background of the case and acknowledging the Lender as a real or conduit company.

Resolution of the Ninth Arbitration Court of 3 December 2015 No 09AP-47431/2015 on case No A40-25939/15

Arbitration courts tend to avoid evaluating the background of cases, such as acknowledging “sister” lenders as real or conduit companies. Should be noticed that the new thin capitalization rules coming into effect from 2017 provide that all borrowings from foreign “sister” companies should be regarded as controlled debt.
Court practice
Thin capitalization rules

Deduction of interest on a loan from a foreign founder acknowledged as unjustified

The tax authority simultaneously applied several provisions of the Russian Tax Code to challenge the deduction of interest on a loan from a parent company in the case of Continental Tire Rus LLC.

First, the tax authority limited interest deduction for profit tax purposes according to thin capitalization rules. Since the taxpayer only referred to the specific provisions of the Russia-Germany Double Tax Treaty related to non-discrimination to support its position regarding the non-application of thin capitalization rules, the arbitration court ruled in favor of the tax authority as according to the current judicial practice.

Secondly, the tax authority noted that the loan had been received in compensation for the lack of working capital, which was caused by the mismatch in the arbitration terms of purchasing goods from the German parent company (with a minimal deferral period) and selling them to independent customers (with a significantly longer deferral period). The tax authority also noted that the parent company, Continental AG, was loss-making, which implied that the taxpayer was simulating conditions for obtaining the loan while the actual purpose was to redistribute profits in favor of the parent company.

The court accepted the position of the tax authority, noting that interest expenses were not associated with the taxpayer's business needs, but rather were aimed at covering the losses of the parent company, with the sole purpose of avoiding paying taxes in either Russia or Germany. The court acknowledged as unjustified the deduction of interest, applying both thin capitalization rules and the unjustified tax benefit concept.

Resolution of the Arbitral Court for the Moscow District of 8 December 2015 on case No A40-123542/2014
Amount of penalties under extenuating circumstances challenged

The Arbitration Court of St. Petersburg and Leningrad Region rejected the appeal of PCMA Rus LLC regarding the amount of penalties imposed following a tax audit. The additional tax was charged due to the taxpayer’s incorrect application of regional corporate property tax incentives. In 2015, arbitration courts supported the tax authorities in three other cases regarding the application of these tax incentives, which had a prejudicial effect on this dispute, so the Company did not challenge the additionally charged tax, but asked the court to take a number of extenuating circumstances into account, including:

1. The vagueness of the legislation related to the legal succession of regional benefits (the argument was rejected by the court because the fact that many hearings were conducted before making a prejudicial decision did not imply the lack of clarity of the legislation).

2. Bona fide of the taxpayer (the argument was rejected by the court since at the date of the tax audit, the Company was already aware of the tax authority’s claims around a similar issue in an earlier period; as stated in the prejudicial resolution of the arbitration court of 30 January 2015 on case No A56-26419/2014, the disputable situation around the corporate profit tax was created by the taxpayer itself in order to avoid the legal conditions of obtaining the benefits).

3. Voluntary remediation by the Company of the negative consequences of the breach (the argument was rejected by the arbitration court since making a payment upon the enactment of the tax authority’s decision is the taxpayer’s obligation and bona fide behavior; actually, the tax payment was deferred by 830 days in 2012 and 466 days in 2013).

4. Implementation of a strategic investment project of high social and economic value (the argument was rejected by the court as not directly related to the dispute).

The Company filed an appellate petition against the decision with the Arbitration Court of St. Petersburg and Leningrad Region, and the appellate hearing is scheduled for May 2016.

Resolution of the Arbitration Court of the North-Western District of 27 May 2015 on case No A56-26419/2014; Decision of the Arbitration Court of Saint Petersburg and Leningrad Region of 28 January 2016 on case No A56-84046/2015
Unilateral termination of dealership agreement invalidated

An automotive dealer filed a claim against an automotive distributor to invalidate its unilateral termination of a dealership agreement, to acknowledge the defendant as the dominant player of the wholesale primary market for the relevant passenger car brand in Russia and to invalidate certain provisions of the dealership agreement.

The courts rejected the claim, arguing that according to Article 5 of the Federal Law “On Protection of Competition,” the position of a company on the market of certain products can be considered dominant in cases where the company is able to decisively impact on the general product turnover conditions for the respective product market and remove from the market and/or complicate the access thereto of other companies. A product market is considered a turnover space for a product that has no substitutes or for interchangeable products within which buyers can buy a product based on economic, technical or other possibilities or practicalities, and such possibilities or practicalities are non-existent beyond this space. Therefore, the law covers certain characteristics and consumer qualities of a product rather than its brand. The removal of cars of a certain brand from the product market will have no impact on the possibility of buyers to buy passenger cars of other manufacturer(s) in Russia.

Based on the above, the court ruled that the automotive distributor did not possess the characteristics of a dominant market player on the passenger car market as according to Article 5 of the Federal Law “On Protection of Competition.”

Resolution of the Russian Supreme Court No 305-ES15-1293 of 5 November 2015 on case No A40-79786/14. A similar position was taken in the Ruling of the Arbitration Court for the Moscow District No F05-8375/2015 of 9 July 2015 on case No A40-181992/14 and Ruling of the Arbitration Court of the Moscow District on case No A40-183607/14.
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