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Discussions are still ongoing regarding the complete or partial repeal of the transport tax. Below you will find some of the draft laws under review, which would amend the procedure for transport tax payments.

**Benefits for owners of vehicles weighing more than 12 tonnes**

On June 3 the president has signed the Federal Law No. 249-FZ which aims to improve the system of taxes levied on the owners of vehicles with a gross vehicle weight rating exceeding 12 tonnes. Specifically, the law proposes to:

- Reduce the amount of transport tax assessed by a legal entity on heavy goods vehicles as of the end of a fiscal period by the amount of the road toll paid in respect of such vehicles in the same fiscal period;

- Limit the types of expenses recognisable for corporate income tax purposes to road toll amounts exceeding the transport tax assessed on heavy goods vehicles;

- Exempt individuals from the transport tax levied on heavy goods vehicles if the road toll payments equal or exceed the assessed transport tax;

- Grant taxpayers using a simplified tax system the right to recognise road toll payments as deductible expenses.

It is worth noting that prior to adoption of the Federal Law No. 249-FZ the Russian Constitutional Court outlined the opposite position concerning the imposition of the road toll, as outlined in Resolution No. 14-P of 31 May 2016. According to the Russian Constitutional Court, the toll levied on heavy goods vehicles for the use of federal roads is neither a tax nor does it result in double taxation when imposed alongside transport and fuel taxes, and was therefore legitimately introduced by the Russian Government.
Increase in threshold value of luxury passenger cars for transport tax purposes in 2016

As a result of the devaluation of the Russian rouble, the historical threshold of RUB 3 million that gives passenger cars luxury vehicle status has ceased to reflect the actual situation. For example, according to the Russian Ministry of Industry and Trade, in 2016 some Nissan and Chevrolet models qualified as luxury cars for the first time, while the total number of luxury cars registered by the Ministry rose from 187 in 2014 to 708 in 2016.

In the wake of this trend, the Russian Ministry of Finance started developing a draft law that would amend the procedure for assessing transport tax and introduce a number of changes with effect from 2019. Specifically, the draft law would:

- Raise the minimum value of luxury cars subject to transport tax multipliers to RUB 5 million (presently, the luxury category includes cars worth more than RUB 3 million);

- Abolish the existing multipliers applicable to passenger cars worth between RUB 3 and 5 million, if the car’s life, calculated from the year of manufacture, does not exceed three years.

The draft law also envisages the application of special multipliers (0.9 to 2) to the transport tax rates used for trucks and buses based on their environmental and other features.
The Russian State Duma is considering Draft Law No. 1072817-6, which would repeal the transport tax and incorporate road tolls into fuel taxes. With reference to international practices, the initiator of the legislative proposal highlights that the draft law builds on the economic rationale behind the law, meaning that "the more you drive, the more you pay". However, the draft law does not envisage any increases in fuel taxes or mechanisms for intra-budget transfers to compensate for profits lost by the regional budgets. As of today, the draft law has been returned to the initiator for formal reasons. Please note that in 2015 and early 2016, the Russian State Duma rejected a number of other draft laws, namely draft laws No. 895030-6, No. 937952-6 and No. 1005835-6, which are similar in content and received negative comments from the Russian Government and the State Duma Committee on Federal and Local Government with no re-consideration to follow. Considering that the new draft law does not include the recommendations previously issued by the Russian Government and dedicated committees of the State Duma, we deem the passing of it unlikely unless material changes are made to its content.

Nevertheless, the overall trend towards the transition from direct taxation to higher excise duties also manifests itself in Draft Law No. 1043241-6, which incorporates the charge for vehicle emissions into fuel prices. The size of the emissions charge and the respective payment procedure will be determined by a Russian Government resolution taking into account actual adverse impacts. Unlike the above-mentioned law abolishing the transport tax, this draft law provides a detailed description of the procedure for allocating tax receipts to the budgets of the Russian fiscal system (this is where the main flaw of the draft law on transport tax lies, according to reviewers). If adopted, the law will come into force 30 days after its official publication.
Russian Government Resolution No. 310 of 15 April 2016 amended the procedure for levying the toll intended to compensate for damage caused to federal roads by vehicles with a gross vehicle weight rating exceeding 12 tonnes. Specifically, it introduces a mechanism allowing for deferred toll payments to be made by the owner of a vehicle if all of the following conditions are met:

- As of the date of application for deferment, the vehicle of said owner has been on the register for over two months;
- The place of state registration of the legal entity or the place of residence of the individual owning the vehicle as well as the place of registration of the vehicle is the Russian Federation;
- The vehicle is furnished with an on-board unit, either integrated or external;
- The owner of the vehicle has no outstanding administrative fines for failure to comply with the Russian legislation governing the payment of road tolls, if an appeal against or objection to the resolution imposing such administrative penalties was not satisfied;
- The owner of the vehicle has no outstanding debts on road tolls within the six consecutive months preceding the filing of the application for deferment.

Russian Government Resolution No. 326 of 19 April 2016 raises the road toll levied on motor vehicles driving on Russian roads but registered in foreign states to RUB 850 per day and RUB 120,000 per annum (currently, the daily and annual toll rates are RUB 385 and RUB 60,000, respectively). This regulation is designed to align the positions of foreign and local freight carriers that pay distance-based road tolls. Nevertheless, given that, according to one source, the average annual distance driven by heavy goods vehicles is around 200,000 kilometres, the maximum amount of the annual toll collected from a vehicle owned by a foreign freight carrier is on average five times lower, regardless of the distance.

The same Resolution includes Latvia and Lithuania in the list of foreign states whose freight carriers are required to pay tolls for the use of Russian roads (previously, the list comprised 15 countries not sharing international land borders with the Russian Federation).
Russian Government Resolution No. 284 of 9 April 2016 establishes environmental duty rates for 36 groups of goods subject to disposal upon reaching the end of their useful lives. The duty must be paid by producers and importers who do not independently dispose of waste generated from the use of their goods.
Subsidies for producers of self-propelled vehicles and trailers

The Russian Ministry of Industry and Trade reported the development of draft Russian Government resolutions to support producers of self-propelled vehicles and trailers. These draft resolutions envisage subsidies for Russian producers of self-propelled and towed machinery in the form of partial compensation for payroll expenses, the cost of energy resources and expenses relating to the issuance and renewal of warranties for high-performance machinery. These subsidies will be granted using criteria similar to those set out in Russian Ministry of Industry and Trade Order No. 406 of 18 February 2016. Subsidies will be paid on the 42nd day following the end of the reporting quarter.

Currently, all of the draft resolutions are undergoing public hearings.

Official list of major producers of self-propelled vehicles and trailers

The Russian Ministry of Industry and Trade released a list of entities recognised as major producers of self-propelled vehicles and/or trailers and subject to the payment of recycling duty. Please note that major producers have the right to independently administer and assess recycling duty and to determine the schedule of payments.
**Reduced recycling duties on trailers for wheeled vehicles**

Russian Government Resolution No. 401 of 11 May 2016 repeals the recycling duty for trailers with a maximum authorised mass below 10 tonnes, and reduces the multipliers applicable to the recycling duty rates for trailers with a maximum authorised mass of over 10 tonnes as follows: from 2.7 to 1.0 for new trailers and from 11.9 to 7 for trailers with a service life exceeding three years starting from the year of manufacture. The resolution came into effect upon its official publication on 12 May 2016.

Furthermore, Russian Government Resolution No. 81 of 6 February 2016 introduced a recycling duty on trailers for wheeled vehicles and established multipliers applicable to the base rates and used in the calculation of this duty. The multipliers have had a significant impact on the price of the trailers produced (according to some data sources, the price has doubled), which has resulted in order cancellations and shutdowns. The decision to reduce the size of the recycling duty is clearly aimed at stabilising the situation on the trailer market.

**Repeal of recycling duty for semi-trailers**

The Russian Ministry of Industry and Trade explained that Russian Government Resolution No. 401 of 11 May 2016 does not levy the recycling duty on semi-trailers imported into or produced in the Russian Federation. According to the Association of International Motor Carriers (ASMAP), the Russian Ministry of Industry and Trade sent letters elucidating this issue to the Federal Customs Service and the Federal Tax Service.

**Repeal of recycling duty for wheeled vehicles and trailers intended for export**

The Federal Tax Service provided clarifications on particular aspects of the assessment and administration of the recycling duty explaining that:

- Vehicles (chassis, trailers) produced in the Russian Federation and intended for export are not subject to the recycling duty;
- The Federal Tax Service has no legal grounds to initiate discretionary control over producers by monitoring the release of vehicles intended for export.
Federal legislation news

Recycling duty

Forms and procedure for reporting assessed and paid recycling duties on wheeled vehicles and trailers

A Federal Tax Service Letter introduces Form No. 7-US “Report on Recycling Duty Assessed and Paid on Wheeled Vehicles (Chassis) and Trailers” and provides guidelines on the procedure for completing the form for reporting purposes in 2016.

More stringent administrative liability for the use of vehicles generating excessive emissions

The Russian State Duma is considering Draft Law No. 1089379-6, which makes the administrative liability for the operation of automotive vehicles generating excessive pollutant emissions or noise more stringent. Specifically, it is proposed that vehicle owners be held liable for the failure to undertake measures aimed at minimising harmful emissions in adverse weather conditions.

It is expected that penalties resulting from such offences will be calculated based on the company’s revenues received in the period when the adverse weather conditions were observed.
Federal legislation news

Unification of vehicle registration certificates (VRCs)

Federal Law No. 156-FZ of 2 June 2016 ratified the Agreement on the Introduction of Unified Forms of Vehicle (Chassis) Registration Certificates and Registration Certificates for Self-Propelled Machines and Other Equipment and the Creation of Electronic Certificate Management Systems between the member states of the EEU. The Agreement includes a description of the regular and electronic vehicle registration certificates, but, unfortunately, does not provide clear instructions on the status of these documents. It specifies that VRCs are issued for automotive vehicles designed for transportation, with an internal combustion engine of a cubic capacity exceeding 50 cubic centimetres or an electric motor with a capacity of over 4 kW and/or a design speed of over 50 km/h, and trailers. It does not specify, however, whether the vehicle registration certificate proves the owner’s title to the vehicle, which means that disputes regarding the status of the document will arise in the future.
Government support measures
Government support measures

Extension of concessional lending and leasing programmes involving wheeled vehicles

Russian Government Resolution No. 344 of 23 April 2016 extended the effective period of the state-run programmes aimed at stimulating the automotive market through concessional lending and leasing of wheeled vehicles to 2016. Furthermore, the procedure for participation in the programmes was amended as follows:

- The maximum value of a car qualifying for the state concessional lending programme was raised to RUB 1.15 million;
- An alternative qualifying criterion was introduced, allowing leasing companies with charter capital of over RUB 500 million to apply for subsidies for the leasing of wheeled vehicles;
- The resolution prohibits the use of subsidies for the purchase of foreign currency (except when foreign currency is purchased to procure high-tech foreign equipment, raw materials or components).

Credit organisations and leasing companies may file an application for a subsidy with the Russian Ministry of Industry and Trade before 10 May 2016.

More than 275,000 new cars were sold in the period from 1 January 2016 to 12 June 2016 under the state support programmes (including the programmes for fleet renovation, concessional lending and concessional leasing). Furthermore, more than 499,000 cars were produced in Russia within the first five months of the year.

Sales of new cars of all types during this period shrank by 14 percent compared to the same period a year ago. Even though sales continue to demonstrate a negative trend, the outlook seems more optimistic now as opposed to early 2016, when sales were down by 40 percent.
Government support measures

Special investment contracts

Nowadays, special investment contracts (SPICs) are one of the most widely discussed forms of raising investment in Russia. When entering into a SPIC, an investor undertakes to set up, upgrade or develop industrial production in Russia and may apply for state support.

Under the existing laws, state support is available in the following forms:

• Preservation of a favourable environment for tax-paying investors during the entire effective period of a SPIC;
• Accelerated depreciation of products manufactured under a SPIC;
• Application of a zero-rated profit tax over the entire effective period of a SPIC.

In practice, when considering entering into a SPIC, investors face a number of challenges, including:

• A lack of incentives that may positively influence investors’ decisions;
• A lack of legally established procedures for assigning the status of “Russian product” to products manufactured by a party to a SPIC;
• A lack of clear instructions for accounting for project investments to ensure compliance with the terms and conditions of a SPIC;
• A lack of regulations allowing investors to terminate a SPIC by mutual consent with a public entity without penalty.

Currently, draft amendments to Russian Government Resolution No. 708 of 16 July 2015 “On Special Investment Contracts in Particular Industries” (hereinafter, “the Draft Amendments”) under development, which envisage:

New rules for investment accounting, which would allow investors to offset up to 20 percent of the project investments made prior to entering into a SPIC;

Updated requirements towards acquiring investor status, which would prohibit companies registered in low-tax jurisdictions from entering into SPICs;

A new procedure for making amendments to SPICs.
Government support measures

Furthermore, the Draft Amendments enable investors to apply for government support in the form of tax benefits. For example, automotive companies operating under a SPIC are likely to be able to enjoy benefits in terms of recycling duty. The issue of customs benefits for parties to a SPIC remains open. Despite the fact that the Draft Amendments provide benefits on all types of non-tax duties, these changes have not yet been harmonised with the EEU customs legislation and WTO regulations and, therefore, no customs benefits can be anticipated for parties to a SPIC until holistic legislative changes take place.

It should be noted that the business community was actively involved in the public discussion of the Draft Amendments. As part of the communication process, investors submitted proposals and comments regarding further changes to the Draft Amendments to the Russian Ministry of Industry and Trade. Deloitte professionals were also involved in the negotiations regarding amendments to the legal regulation of SPICs, liaising with the Russian Industry Development Fund, the body in charge of administering SPICs.

The automotive industry outdoes other sectors of the economy in terms of the number of SPICs. According to publicly available sources, two SPICs with representatives of the automotive industry have been approved so far. Applications from another two industry representatives are currently being reviewed by the Inter-Departmental Committee. If approved, these investors will also be authorised to enter into a SPIC. Currently, the Inter-Departmental Committee has approximately 20 investor applications under review from the automotive, textile, chemical, oil and gas, and machine-tool industries.
Government support measures

Special economic zones

According to publicly available information, the Russian Government was instructed to develop a unified strategy for the operation of special economic zones (SEZs), ensure the optimisation of public funding, and propose mechanisms for transferring SEZs to the federal subjects of Russia. Plans also call for the suspension of further SEZ establishment until the unified approaches have been developed, and for the closure of all ineffective SEZs.

It is also reported that the Russian Ministry of Economic Development is preparing a draft federal law that would reduce insurance payments for legal entities or individual entrepreneurs holding the status of a resident of the Kaliningrad special economic zone. If the draft law is adopted (in the form available for review), the total rate of insurance payments will be as low as 6.6 percent and will remain effective for 10 years starting from the registration as a resident of a special economic zone. The text of the draft law does not envisage any restrictions in terms of retrospective application; therefore, if adopted, residents of special economic zones (of which a major portion belong to the automotive industry) will be entitled to refund impressive amounts of previously paid insurance contributions from extra-budgetary funds.

Russian Ministry of Finance approves submission process for identification of foreign goods placed under free customs zone customs procedure in Kaliningrad

Russian Ministry of Finance Order No. 30n of 21 March 2016 approves the procedure for submitting the information and documents required for the preparation of reports on the identification of foreign goods placed under the free customs zone customs procedure, among the goods produced/created in Kaliningrad Region with the use of such foreign goods. It approves the list of such data and documents, as well as the format and procedure for the preparation, issuance and invalidation of reports.

The Order was published on 4 April 2016 and came into effect upon its official publication.
Government support measures

Draft regulations for subsidising Russian automobile manufacturers

The Russian Ministry of Industry and Trade is preparing a draft resolution of the Russian Government, which would approve the rules for subsidising Russian automobile manufacturers using funds from the federal budget. Specifically, the document envisages the granting of subsidies to reimburse expenses in the following categories:

- The shipping of a company’s own products (provided that shipping involves a particular means of transport);
- The certification of product conformance with international standards;
- The development of prototypes for testing purposes.
Expansion of international cooperation with the Asia-Pacific Region
Entry into force of Agreement for the Avoidance of Double Taxation between Russia and China


The agreement is based on the OECD Model Tax Convention and sets out the criteria for recognising individuals and legal entities as tax residents of the contracting states and methods for dealing with residency conflicts, as well as the criteria for recognising permanent establishments and outlines the taxation procedure for different types of income. The agreement significantly reduces the rates for withholding tax:

- Withholding tax on interest has been reduced from 10 percent to 0 percent;
- A reduced rate of 5 percent has been set for withholding tax on dividends, provided the majority shareholding criteria are met (more than 25 percent in the equity of a foreign subsidiary, and more than EUR 80,000 of total investment in the equity of the company); however, the base rate for withholding tax on dividends remains at 10 percent;
- Withholding tax on royalties has been reduced from 10 percent to 6 percent.

We believe that these innovations will facilitate closer economic cooperation between Russian and Chinese companies, who are well represented in the automotive industry.

In a letter, the Federal Tax Service explains that the provisions of the Agreement and the Protocol effective from 9 April 2016 will apply to income received from 1 January 2017.

A few other publicly available sources also reported on a possible trade and economic agreement with China. The Eurasian Economic Commission (EEC) plans to open official negotiations with China over this trade and economic agreement. Following a meeting of the Supreme Eurasian Economic Council, the EEU member states coordinated their key proposals (so-called directives) in order to initiate negotiations with China regarding the development of a non-preferential trade and economic agreement. The document is expected to primarily address the issue of simplifying trade procedures, including the exchange of customs-related information and mutual recognition of certificates. Furthermore, the agreement will include specific chapters governing the provision of services and investment.
Actions to support ratification of Agreement for the Avoidance of Double Taxation between Russia and Hong Kong

On June 3 the president has signed the Federal Law No. 234-FZ "On the Ratification of the Agreement Between the Government of the Russian Federation and the Government of the Hong Kong Special Administrative Region of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and the Protocol Thereto". Based on the OECD Model Tax Convention, the agreement reflects the economic realities and objectives and extensive legal provisions on combating tax evasion. The agreement envisages levying withholding tax on passive income at the following rates:

- 0 percent: withholding tax on interest;
- 5 percent: withholding tax on dividends provided that the entity is a beneficial income owner and holds an equity stake of over 15 percent; the base rate for withholding tax on dividends stands at 10 percent;
- 3 percent: withholding tax on royalties.

After the ratification, which is scheduled for 2016, the agreement will apply to legal relations arising from 1 January 2017. This agreement, combined with Hong Kong’s local tax system, highly developed infrastructure and well-established banking system, will enable Hong Kong to compete with Asian financial hubs such as Singapore, on the one hand, and prominent European jurisdictions who have not yet lifted their sanctions against Russia, on the other hand.
Parallel imports
Parallel imports

The EEU member states continue their efforts on the legalisation of “parallel imports”. On 13 April 2016, the Eurasian Intergovernmental Council adopted a pivotal resolution to prepare a draft protocol to the EEU Agreement, which would legalise the parallel import of specific categories of goods.

The plans call for the Eurasian Intergovernmental Council to be given the authority to establish exceptions from the trademark right exhaustion principle for specific categories of goods. Thus, so-called “parallel imports” will be legalised. The Eurasian Economic Commission is reported to have initiated the development of the draft protocol in cooperation with the EEU member states. The exact date by which the amendments to the EEU Agreement will be completed remains unclear.

The next stage will be to identify the commodity groups to which the new “parallel import” rules will be applied by all of the EEU member states. It is likely that each country will invited to put forward their proposals on such commodity groups, while the Eurasian Intergovernmental Council will subsequently approve the final list. According to the Russian Federal Antimonopoly Service, the Russian Federation has already proposed a list of such commodity groups, which specifically includes automotive goods (spare parts), pharmaceuticals, and children’s goods.

Thus, the process of legalising “parallel imports” has entered an active phase, leading us to believe that the laws of both the EEU and the Russian Federation are likely to be amended shortly. Moreover, Head of the Russian Federal Antimonopoly Service, Mr. Igor Artemiev announced the completion of all domestic procedures required to change the regulatory framework for implementing the rules on “parallel imports” in Russia.
Administration of foreign trade
Release of reference materials on customs benefits in Russia

The Federal Tax Service prepared a collection of reference materials on the application of customs benefits in the Russian Federation, which provide instructions for completing certain columns on the customs declaration when applying for customs benefits. The collection includes the benefits envisaged under the laws of the Eurasian Economic Union and the Russian legislation.

Russia reduces import duties on certain categories of goods as part of its WTO commitments

Eurasian Economic Council Resolution No. 40 of 16 May 2016 reduces the import duties on certain categories of goods as part of Russia’s WTO commitments. Duty rates will be reduced for a limited range of goods, including particular cars and engines intended for the assembly of vehicles under commodity item 8704.

The Resolution will take effect on 1 September 2016, excluding certain provisions that will take effect on 31 December 2016.

Possible zeroing of customs duties on selected parts and components imported for natural gas vehicles

The United Nations Economic Commission for Europe is considering zeroing the 3-percent import customs duty levied on gas injectors for natural gas engine cylinders from September 2016 through to the end of 2020. The plans also call for a temporary zeroing of duties applicable to other parts and components to be considered, particularly in relation to gas pressure regulators, gas tanks and certain gas fixtures.
Reduced duties on electric cars within EEU

Russia is considering an extension of the customs benefits applicable to electric cars within the Eurasian Economic Union. The Russian Ministry of Economic Development requested that the EEU speed up the decision-making process regarding the extension of the zero-rated customs duty on conventional electric cars imported into the EEU for another year, as well as the reduction of the import customs duty on electric-powered commercial vehicles from 15 percent to 5 percent.

The preferential regime for importing electric cars into the EEU, which includes Russia, Belarus, Kazakhstan, Armenia and Kyrgyzstan, expired at the end of 2015. The current import duty rate on such vehicles stands at 17 percent.

Federal Tax Service clarifies procedure for maintaining register of customs declarations and shipping documents

In Letter No. ED-4-15/8235 of 10 May 2016, the Federal Tax Service clarifies the procedure for maintaining the register of customs declarations (detailed customs declarations), as well as shipping and other documents to be submitted to the tax authorities electronically to substantiate the application of the zero VAT rate when selling goods for export.

Less stringent administrative liability for specific customs offences

Federal Law No. 207-FZ of 23 June 2016 amends the Russian Administrative Code. Specifically, the minimum sizes of penalties imposed for certain offences are subject to significant reduction.

The Federal Law took effect on 4 July 2016.

Approval of procedure for suspending or terminating export and/or import licences

Collegium of the Eurasian Economic Commission Resolution No. 34 of 19 April 2016 approves the procedure for suspending or terminating an export and/or import licence and approves the template for the verification letter confirming the fulfilment of an export and/or import licence.
Transfer pricing: Federal Tax Service statistics

The Federal Tax Service published an official review of the outcomes of transfer pricing audits. Following the tax audits for 2012, three audit reports were issued showing RUB 428 million of additional tax assessed, with another three audit reports being developed. Seven more audits were initiated on a group of similar transactions closed by six taxpayers (five resolutions relate to the sale of metallurgical products and the other two relate to exports of mineral fertilisers). The outcomes of these audits have not been published yet.

The statistics show that taxpayers readily enjoy the benefits of symmetrically adjusting the tax base. Thus, in 2014 taxpayers applied tax base adjustments amounting to around RUB 8 billion and reduced the amount of prior-year losses by RUB 1 billion. This generated additional budget receipts of RUB 1.4 billion (including RUB 1.25 billion of profit tax). In 2015, taxpayers applied tax base adjustments to a total of over RUB 30 billion and reduced the amount of prior-year losses by almost RUB 3 billion. This generated additional budget receipts of around RUB 5 billion (including RUB 4.9 billion of profit tax).

The authority also published statistical data on tax audits that were conducted in 2015 to identify the unjustified tax benefits obtained by taxpayers through price gouging in related-party deals that do not qualify as controlled transactions. Local tax authorities issued 195 assessment notices amounting to additional taxes worth RUB 1,210.6 million. The total value of rejected tax refund applications was RUB 50.1 million.
Position of the Russian Supreme Court on legitimacy of local tax audits verifying compliance with transfer pricing regulations

Discussions are still ongoing on the legitimacy of local tax audits verifying compliance with the transfer pricing (TP) regulations. In the second quarter of 2016, the Russian Supreme Court resolved a number of disputes.

Russian Supreme Court Ruling No. 308-KG15-16651 of 11 April 2016 confirmed that local tax authorities are not authorised to verify compliance with the TP regulations. However, one month later, the Supreme Court of the Russian Federation issued Appellate Ruling No. ALL 16-124 of 12 May 2016 on a case regarding the invalidation of Paragraph 12 of Russian Ministry of Finance Letter No. 03-01-18/8-145 of 18 October 2012, in which it was specified that it is important to differentiate between cases when a local tax authority initiates an inspection to verify the application of the TP regulations and cases when the tax authorities use TP methods to calculate the amount of unjustified tax benefits received by the taxpayer concerned (in the latter case, the Supreme Court finds the actions of the tax authority legitimate).

It is important to note that in this Appellate Ruling, the Supreme Court states that when engaged in disputes with the tax authorities on the matter of alleged price gouging in related-party transactions, the taxpayer should assess the overall tax effect for both the inspected company incurring expenses and the company receiving income from the transaction. If the value of the transaction does not match the arm’s length price with no positive tax effect at the group level, this is indicative of the fact that the taxpayer has not received any unjustified tax benefits.

Application of Resale Price method (RPM) to calculate arm’s length price of transaction

In Letter No. 03-01-18/13135 of 10 March 2016, the Russian Ministry of Finance commented on whether the Resale Price method could be used to verify the conformance of the value of transactions involving services with the arm’s-length prices. In particular, the Russian Ministry of Finance states that according to the Russian Tax Code, this pricing method is applicable to transactions involving the sale (resale) of goods. The Tax Code does not envisage the application of this method to verify compliance with the arm’s length principle in transactions involving services.
Russian Ministry of Finance provides explanations on interest-free loans between related parties

According to Russian Ministry of Finance Letter No. 03-01-18/30778 of 27 May 2016, transactions involving interest-free loans between related parties constitute an example of commercial or financial terms that differ from those which would be typical of transactions referred to as comparable under Section V.1 of the Russian Tax Code, between non-related parties. To this end, according to the Ministry, any income that could have been received by either related party under such transactions but was not received because of this difference should be accounted for tax purposes.

It should be noted that the courts generally support the position that interest-free loans constitute a deviation from the non-arm’s length principle, however they rule in favour of the taxpayer either because they find price audits conducted by local tax authorities illegitimate (see Arbitration Court of the North Caucasian District Resolution of 4 May 2016 on Case No. A32-19725/2015), or because of the failure of the tax authorities to assess additional income correctly (see Moscow Regional Arbitration Court Resolution of 28 February 2016 on Case No. A40-204810/2014).

Safe harbour interest rates on loans between related parties for RUB-denominated debt repaid in foreign currency for profit tax purposes

According to Russian Ministry of Finance Letter No. 03-03-06/1/32742 of 6 June 2016, if a RUB-denominated loan between related parties is repaid in a foreign currency, the calculation of the profit tax base should be based on the actual rate specified in the loan agreement taking into account the ranges of acceptable interest charges established by sub-item 1, item 1.2, Article 269 of the Russian Tax Code for RUB-denominated debts.
Determining the arm’s length price in related-party transactions

The tax authorities established that a taxpayer had sold goods purchased from a related supplier (the parent company) at prices below the procurement cost, which resulted in a loss.

According to the tax authorities, the taxpayer served the interests of the foreign parent company, which, as a sole distributor of certain cars on the Russian market, was not limited in providing discounts in order to promote the subsidiary distributor, which the subsidiary did not take advantage of. Contracts with independent distributors included provisions envisaging the reimbursement by the supplier of discounts granted by distributors to dealerships. This finding was declined by the court because, firstly, the procurement costs specified in the contracts between the related supplier and the taxpayer were initially 18 percent lower than the prices offered to independent distributors. Furthermore, the parent company assumed the foreign exchange risks, which was of substantial support to the taxpayer, considering the plummeting rouble in 2008-2009. Secondly, the parent company was not interested in the subsidiary suffering losses. On the contrary, it had to compensate the subsidiary for these losses to improve its net asset position.

Referring to the relationship between the taxpayer and the supplier, the tax authorities tried to prove that the transactions were not based on the arm’s length principle. Similar to the position stated in the disputes on cases where the tax authorities insisted that there were no comparable transactions on the wholesale market, which made the application of the Comparable Uncontrolled Price (CUP) method impossible (Russian Supreme Court Ruling No. 305-KG15-12240 of 14 October 2015 on Case No. A40-4381/13; Moscow Regional Arbitration Court Resolution of 10 June 2015 on Case No. A40-89807/14, Russian Supreme Court Ruling No. 305-ES15-17755 of 20 January 2016 on Case No. 09AP-18467/2015), the Resale Price method was applied in the situation concerned. The tax authorities, however, failed to explain why it could not consider the transactions of the same supplier and independent distributors involving identical vehicles and conducted in the previous quarter of the same year valid comparable. The subject matter experts involved confirmed that in the transactions closed in the previous quarter between the supplier and independent distributors, the taxpayer’s parent company supplied identical products, which created a market for such goods. Given that situation, the deviations existing in the contractual provisions could have been adjusted accordingly and did not prevent the tax authority from performing a comparative analysis.
As for the fact that the transactions proposed for comparative analysis were conducted in an earlier period, the experts commented that the application of the arm’s length principle to the taxpayer’s earlier periods could be transposed to the disputed period based on the key market trends. Additionally, the experts noted that a quarter’s difference was not a barrier for comparison as the standard period in comparative analysis was one year. Therefore, the findings of the tax authority regarding the non-applicability of the CUP method were unjustified and illegal.

Additionally, the experts noted that while applying the Resale Price method, the tax authority used the net margin method on a number of disputed transactions, which the tax authority itself has claimed to be incorrect.

The court of first instance and the court of appeal resolved in favour of the taxpayer. The court of cassation referred the case for a retrial. During the retrial proceedings, the court of first instance and the court of appeals supported the taxpayer’s position.

(Moscow Arbitration Court Resolution of 3 February 2016 on Case No. A40-111951/12-20-580, Resolution of the Ninth Arbitration Court of Appeals No. 09AP-12749/2016 of 4 May 2016 on Case No. A40-111951/12-20-580).
Unjustified deduction of interest on loans from foreign founder

Following a field tax audit, the tax authorities disputed the deduction by a taxpayer of interest on loans from a foreign parent company (100-percent indirect participation) for two reasons: the application of the thin capitalisation rules and the concept of unjustified tax benefits.

As for the thin capitalisation rules, the tax authorities established that the debt-to-equity ratio governed by the Russian Tax Code exceeded the threshold in one of the quarters within the disputable period and re-calculated the amount of interest expense by applying the thin capitalisation rules, and assessed the withholding tax on excess interest.

As for unjustified tax benefits, the tax authorities established that the taxpayer artificially created a working capital deficiency, which was compensated for with loans from the parent, allowing the taxpayer to reduce the profit tax base and transfer part of the income abroad. The tax authorities established the following from the tax audit:

- The funds raised by the Russian company were used to repay loans previously received from the same parent company, meaning that they were not invested in its business operations;
- By offering its customers a deferred payment arrangement over a period of up to six months, the taxpayer artificially created a working capital deficiency, which was compensated with borrowings from the parent company;
- Through questioning the CEO of the Russian company, it was established that the ultimate beneficiary had always been the parent company.

The court accepted the position of the tax authorities, noting that the purpose of the loans extended by the parent company to the company (subsidiary) was the transfer of assets and income in order to avoid paying taxes in Russia and the generation of fictitious “income” in Germany without actually paying any income taxes.

(Russian Supreme Court Ruling No. 305-KG16-1901 of 5 April 2016)
Identification of beneficial owner of income from sublicensing fees for foreign company

The Federal Tax Service published Resolution No. СА-4-9/1907@ of 9 February 2016 on a taxpayer’s claim against the decision of the interregional tax inspectorate issued following a field tax audit. The taxpayer transferred sublicensing fees for the use of trademarks and manufacturing rights in favour of a Swiss company, which, in turn, paid royalties to a Japanese company, the right holder. According to the DTT between Russia and Switzerland, royalties are only subject to tax in the jurisdiction of incorporation of the income recipient, therefore the Russian taxpayer did not withhold profit tax when making sublicensing payments in favour of the Swiss company.

Considering that the Japanese company, the Swiss company, the taxpayer and other entities of the trading group are all related parties, and the Japanese company is the holder of the title to the trademarks under which cars and spare parts are sold, it holds the exclusive rights and exercises control over the engineering data and confidential information (know-how) required to manufacture and assemble the cars and spare parts, the tax authorities concluded that the Swiss company acted purely as an intermediary serving the interests of the Japanese company by transferring funds received from the taxpayer through the sale of cars in Russia, without performing any other functions or bearing any risks, i.e. it is not a beneficial owner of the royalty income.

The Japanese company is recognised as a beneficial owner of the income, and, therefore, when resolving the disputed payments, the provisions of the Russian-Japanese DTT must be applied, which envisage a 10-percent tax on royalties.

The Federal Tax Service accepted the position of the taxpayer, considering the following circumstances:

- The functions of the Swiss company include the development of know-how and trademarks (specifically, it defines the strategy and designs solutions for the European market, adapts models to the requirements of the European and the Russian markets, ensures quality control at local production facilities, etc.);

- The Swiss company bears associated risks (in particular, quality risk, risk of trademark compliance, and foreign exchange risk);

- The Swiss company’s supposed role as a conduit for payments was not proven.

In view of the above, the Federal Tax Service concluded that the Swiss company was the beneficial owner of the sublicensing fees, which proves the legitimacy of the application of the tax exemptions in Russia under the DTT between Russian and Switzerland.
Russian Supreme Court releases Plenum Resolution clarifying certain issues in court practice on customs law

The Russian Supreme Court released Plenum Resolution No. 18 of 12 May 2016 “On Certain Issues Regarding the Application of Customs Law by Courts”.

The Plenum of the Russian Supreme Court approved the resolution clarifying the customs legislation, specifically, the issues of customs valuation, the classification of goods and the payment and refund of excessive customs duties and taxes.

Adjustment of customs value

According to Russian Ministry of Finance Letter No. 03-10-11/22119 of 18 April 2016, the effective Russian regulations governing the customs valuation of goods do not envisage adjustments to customs values due to difference between the price actually paid or charged for imported goods and the price specified in the risk profile used by the customs authorities.

Should any enforcement practice arise in which a customs authority chooses to adjust the customs value of goods simply because the declared customs value is different from the value specified in the risk profile, such decisions may be challenged both under administrative proceedings and in court.
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