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The end of 2018 saw a number of important changes in the regulatory environment, which primarily concerned the government support measures. From now on, concessional loans will replace the subsidies to industrial companies. Funds will be allocated to industrial exporters under the International Cooperation and Export projects via the Russian Foundation for Technological Development, the Russian Export Centre, the Industry Development Fund, and the relevant financial institutions. The measures are implemented as part of the so-called “competitive growth programmes”, a long-term export-driven corporate development initiative.

Despite the changes, a number of subsidies will remain, e.g. those compensating the industrial producers’ transportation costs, and a package of subsidies to partially compensate the electricity costs, warranty obligations, and workplace maintenance costs.

In its subsidy policy, the Government specifically focuses on boosting production of the Russian agricultural machinery. Learn more about the new subsidy rules in the "Government support initiatives" section.

Another Government’s plan calls for formalising the recycling fee in the Russian Tax Code: a bill to that effect is currently pending with the lawmakers. For more details, please refer to the "Recycling fee" section.

The enactment of amendments to Resolution of The Supreme Eurasian Economic Council No. 72 of 29 May 2014 “On applicability of the complete knock-down (CKD) regime in the Customs Union and Common Economic Space member states”, setting limits on the distribution of CKD vehicles with a localisation rate below 50 percent after 1 July 2018, was postponed indefinitely. To learn about the developments, please refer to the "Customs regulations" section.

Priority measures ensuring introduction of electronic vehicle passports in the EAEU were approved. The national segments of the e-passport system are planned to have been tested by 1 November 2019, after which the system must go live across the EAEU. The Government also approved the track-and-trace and labelling systems. Learn more in the “T&T and paperless procedures” section.

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Government support initiatives
By 2024, industrial companies will receive RUB 258 billion in concessional loans

According to the recent updates to the government support policies introduced by the Ministry of Industry and Trade, such loans will replace the subsidies to industrial companies. Funds will be allocated to industrial exporters under the International Cooperation and Export projects via the Russian Foundation for Technological Development.

Allocation-wise, 40 percent of all loans will go to the mechanical engineering companies with nearly a third of them, or 12 percent of the entire programme’s volume, designated for the automotive manufacturers.

The Ministry of Industry and Trade released amendments to the Government resolution that regulate the extension of subsidies to exporters to compensate their transportation costs.

The amendments to Government Resolution No. 496 of 26 April 2017 were developed in line with the Government’s International Cooperation and Export project and are aimed at streamlining the mechanism of compensations of the industrial producers’ transportation costs.

Supporting the export-oriented companies by compensating their transportation costs is one of the most popular and effective measures. Over 2017-2018 (as at 1 December 2018), over 230 industrial producers with average supplies exceeding RUB 408 bln were supported, with an average multiplier effect of the subsidies amounting to 1/19 (volume of exports per each rouble spent).

However, due to the high demand for the subsidies, the following rules were introduced:

- sectoral limits
- limits per producer per financial year
- provision of subsidy is conditional on meeting the supply commitments (including the new exports) and the previous subsidies’ effectiveness
- minimum multiplier effect requirements
- additional incentives for achieving a particular multiplier effect value and using the Russian transportation companies.

New regulation of subsidies to Russian car makers to partially compensate the costs of production of wheeled vehicles and associated components

The subsidies will be granted to Russian-registered producers of wheeled vehicles or associated components that use imported completely knocked-down (CKD) kits (the “industrial assembly” regime).

The subsidies will compensate up to 90 percent of CKD acquisition costs (net of VAT), incurred since 1 January 2018.

The costs compensated through the programmes supporting Euro IV- and Euro V-compliant vehicle manufacturers will be out of the scope of these subsidies.

The Ministry of Industry and Trade is currently working on a respective resolution for 2019.

SPIC 2.0 projects might be suspended

Deputy Prime Minister Dmitry Kozak proposed suspending work on the new special investment contracts’ regime (SPIC 2.0), advocated by the Ministry of Industry and Trade, limiting their availability to the car manufacturers that signed SPICs.

The current document is viewed as an interim version that might either be turned down or subsequently replaced by the previous version, featuring a scoring system and R&D requirements, which the manufacturers deem impracticable. Nevertheless, the requirements to use Russian-made engines, gearboxes, and body metal are preserved, but they cannot be complied with by all players.
**Ministry of Industry and Trade and GAZ Group sign SPIC to produce new models**

The Ministry of Industry and Trade, Gaz Group, and the government of Nizhny Novgorod Region signed a special investment contract to produce new vehicle models.

The contract signed until 2028 envisages the production of new and the upgrade of the existing vehicles, using GAZ’s production capacities.

According to the SPIC, over RUB 20 billion will be invested in the localised production of new vehicles and units with a high export potential, in particular, light commercial vehicles and modern diesel engines for LCVs.

**The Ministry of Industry and Trade signed a SPIC with Hyundai Motor Manufacturing Rus**

The contract worth RUB 16.6 bln is signed for ten years and envisages investments from other Hyundai Motor companies, e.g. Hyundai WIA, the engine producer. The total investments may reach up to RUB 35 bln.

The company committed to the production of passenger cars, using Russian-made key components: the engine, automatic transmission, and control system elements. Other obligations under the SPIC include export commitments and R&D localisation.

**Dmitry Medvedev chaired the meeting on fostering agricultural machinery industry held at CLAAS machinery plant on 18 January**

In 2018, Russian agricultural machinery producers received RUB 10 bln in subsidies, with another RUB 8 bln allocated for 2019. Dmitry Medvedev said that he had signed a resolution to streamline the subsidy rules.

Prime Minister underlined that domestic agricultural machinery was not only in demand on the Russian market, but was sought after abroad, and the volume of exports kept growing. A decision was made to allocate nearly RUB 340 bln to support the export of agricultural machinery until 2024.

According to Minister of Industry and Trade Denis Manturov, Russian-made combine harvesters accounted for nearly 15 percent of the global market and high-power tractors – for up to 25 percent, the figures also driven by the government support initiatives, such as producer discounts as per Government Resolution No. 1432.

**The Ministry of Industry and Trade called for refining the national strategy for car component industry**

As the government subsidy policy is made stricter by Government Resolution No. 719 of 2015, the car manufacturers are not ready to attract suppliers to Russia to comply with the statutory requirements and are waiting to be incentivised by the Government.

Thus, Andrey Kossov, head of AEB’s Committee of Car Component Producers, explained that importing a ready-made catalytic converter at a zero import duty was cheaper than producing one; furthermore, as a particular model becomes obsolete, retooling of production capacities would be required.

The discussion of incentives to lure suppliers to Russia are currently on the table as part of the car component strategy agenda. One of the options is to establish a PPP foundation that would select projects for localisation investments. The idea appealed to the Ministry of Industry and Trade; however, it will be difficult to administrate and align with the Budgetary Code.
The Ministry of Industry and Trade prepared amendments to Resolution No. 719, aiming to foster the development of the national component base and breakthrough technological solutions, thus laying ground for the industry’s digitalisation, expected to increase the competitiveness of Russian machines in the global market.

The Ministry of Industry and Trade calls for granting discounts to users of construction equipment and utility vehicles

A draft resolution developed by the ministry provides for compensating discounts offered by the Russian machinery manufacturers to the buyers of road construction equipment, utility vehicles, logging machinery, and trailers.

The discounts may reach 15 percent of a contract’s value, or 20 percent for remote regions.

The Ministry of Industry and Trade includes high-tech agricultural machinery into subsidised goods’ list

To remind, the Russian producers of agricultural machinery are partially subsidised for the costs incurred from product buyback guarantees.

The subsidy rules are established by Government Resolution No. 1269 of 24 October 2018.
Recycling fee
A new bill adding environmental tax and recycling fee to the Tax Code is developed

The new tax replaces the former pollution charges, while a single recycling fee is introduced instead of the now-applicable environmental and recycling fees.

A more detailed review of the bill will follow shortly.

Article 24 of Federal Law No. 89-FZ of 24 June 1998 “On Production and Consumer Waste” requires payment of a recycling fee for each vehicle imported into or produced in the Russian Federation, regardless of the purpose.
Customs regulations
Resolution of The Supreme Eurasian Economic Council No. 72 of 29 May 2014 “On applicability of the complete knock-down (CKD) regime in the Customs Union and Common Economic Space member states” sets limits on the distribution of CKD vehicles with a localisation rate below 50 percent, starting from 1 July 2018.

The consideration of amendments to Resolution No. 72 was to take place earlier, but was postponed indefinitely due to the reshuffling in the Government of Belarus. Along with the postponement of the localisation threshold increase, the Eurasian Economic Commission (EEC) and the Customs Union states’ ministries are discussing the rules for confirming the country origin, say sources close to the matter. Alternatively, the Ministry of Economy lobbies against the postponement and have repeatedly reported their position to the EEC. With the production localisation rate for 90 percent of the vehicles hitting nearly 60 percent, Russia will have no trouble complying.

New rules for declaring goods illicitly imported in the EAEU

The document proposes enabling the declaration of goods and payment of customs duties and taxes by the buyers of such goods identified by the customs authorities.

Relevant declaration procedures are enabled by Article 104 of Federal Law No. 289-FZ of 3 August 2018, but have not been formally established.

The buyers of illicitly imported goods will be able to file a declaration with an authorised local customs body.

The document requires putting the code “НВТ” (NVT) in Box 7 of the declaration and listing the documents required for the clearance of illicitly imported goods in Box 44.
Track and trace (T&T) and paperless procedures
EEC meeting on e-passports

Approval of priority measures ensuring introduction of electronic vehicle passports in EAEU

• The list includes nearly ten measures, to name but a few:
  • designating an authority in each EAEU member state that will oversee the implementation on the intercountry agreement on uniform electronic vehicle passports
  • appointing the national operators that will be interacting with the EAEU administrator of the electronic vehicle passport system
  • determining the rules for creation and maintenance of national segments of the EAEU register of e-passport issuers and the methods of e-passport testing in the EAEU
  • analysing the applicable regulations of the Eurasian Economic Commission for the necessary updates
  • testing the national segments of the e-passport system by 1 November 2019, after which the system must go live across the EAEU.

The governments of the EAEU states must ensure the implementation of the majority of activities by Q4 2019.

T&T for tyres

The Government approves the concept of the T&T and the labelling systems

The concept sets forth the tasks and objectives of the T&T and the labelling systems, their key parameters and requirements.

Starting from 2019, labelling will be required for 10 categories of goods, including tyres and tyre casings.

The system will have the status of a government database and can be based on a public-private partnership.

The labelling and T&T processes will rest upon the following principles:

• before requiring that a particular category of goods must be labelled, feasibility of this must be analysed
• labelling will be the responsibility of the parties involved in the production and distribution of goods
• mandatory data will be owned by the state
• the use of labelled goods’ T&T data for third parties’ commercial purposes will be banned
• to test the mechanism’s efficiency, voluntary labelling will be permitted

• the minimisation of labelling costs for all stakeholders must be ensured
• every product item must be identified by a label
• all stages of a product’s life cycle, from the production or import to retail sale, where cash register equipment is used, must be recorded
• the Government will charge a fee for generating label codes
• effective public control of the labelled goods must be ensured.

Businesses will be obliged to label goods, submit data to the government database, and install labelling and machine vision equipment to verify the labels and aggregate goods into multiple and/or transportation packages.
Other federal legislation news
Property tax exemption for movables

Effective 1 January 2018, the movable property items as per Paragraph 25, Article 381 of the Russian Tax Code that are not older than three years, as well as the property classified as innovative high-performing equipment, can enjoy additional regional tax benefits up to a full exemption.

The benefit was introduced in 2018 by Moscow, Saint Petersburg, and Leningrad Region.

The date of manufacture can be verified with technical passports, labels, product labels, Russian catalogues, catalogues of foreign publishers and other documents, as well as based on the results of an independent examination, taking into account the following factors:

• if the manufacturer indicated only the year of manufacture, 1 June will be taken for the product’s manufacture date
• where the month and the year of manufacture are indicated, a product will be deemed produced on the 15th day of the indicated month
• if only the year of manufacture is indicated and a movable property item was purchased and recorded before 1 July, the acquisition date will be taken for the date of manufacture.

VAT rate increase to 20 percent & electronic services

VAT rate of 20%

By force of Federal Law No. 303-FZ, starting from 1 January 2019, the VAT rate was increased to 20 percent for all transactions. This will require companies to re-design their VAT invoices and adjust contract templates accordingly.

VAT on electronic services

Federal Law No. 335-FZ of 27 November 2018 introduced amendments to Article 174.2 of the Russian Tax Code, that entered into effect on 1 January 2019. From that date onwards, foreign suppliers of e-services must assess VAT themselves or have their agent(s) involved in customer settlements do it for them.

However, the provision on VAT exemption for warranty repair services will reappear in Sub-paragraph 37, Paragraph 3, Article 149 of the Russian Tax Code (cf. Article 2 of Law No. 424-FZ of 27 November 2018). Therefore, the use of the benefit will become voluntary.

Warranty repairs

Starting from 1 January 2019, Sub-paragraph 13, Paragraph 2, Article 149 of the Russian Tax Code on free-of-charge repair and maintenance of goods, home appliances, including medical devices, during the warranty period, including the cost of spare parts and components, is no longer applicable.

By 15 February 2019, foreign suppliers of e-services to companies or individual entrepreneurs tax registered in Russia (including branches of foreign entities) were to file a VAT registration request. VAT registration is mandatory even for the providers of VAT-exempt services (e.g. software licensing).
Court practice (precedent cases)
**VAT refund (upon expiration of three years)**

Case No. A40-99400/2018

A portion of spare parts supplied by the taxpayer was found defective after their importation to Belarus and payment of import VAT. Having recalled the defective products, the taxpayer filed a downward-adjusted tax return and claimed a refund of the overpaid VAT.

The request was denied by the tax authorities on the grounds of expiration of the statutory three-year period.

A three-year period of limitation is indeed established by the Russian Tax Code; however, there are exceptions – namely, the instances where the tax was assessed and paid correctly, but had to be subsequently adjusted for objective reasons.

The taxpayer’s claims were found legitimate by a commercial court.

**Recovery of VAT on spare parts used for creating a prototype**

Case No. A66-11467/2017

A company teaming up with the Russian Defence Ministry made a joint decision to upgrade a single-bucket military excavator model. The company undertook to design, produce and test at its own expense a prototype with better tactical and technical properties.

Once completed, the prototype was leased by the Company to a third-party entity, which is confirmed by the relevant documents.

In the tax authorities’ opinion, the company had performed VAT-exempt R&D, therefore, had wrongfully reclaimed VAT on the purchase of the spare parts used in the project.

The court cited that:

1) Pursuant to Article 769 of the Russian Civil Code, under a research contract, the contractor undertakes to perform research activities in accordance with the principal’s statement of work; under a prototype development contract, the contractor must develop a prototype and design documents thereto, while the principal must accept the results and pay for the work. Yet, the joint decision provides both for a statement of work and prototype development and sets the limits and conditions for using the excavator (in accordance with Paragraph 1, Article 772 of the Russian Civil Code).

Therefore, the joint decision qualifies for a prototype development contract.

2) According to the joint decision, intellectual property rights to the excavator prototype are owned by the Russian Federation.

Therefore, the Company leasing the prototype to the third party without the Defence Ministry’s consent infringed upon the attached IP rights and the tax authorities had rightfully denied VAT recovery, citing the taxpayer’s failure to comply with the key requirement of Paragraph 2, Article 171 of the Russian Tax Code.

**Property tax benefits for non-residential buildings of the High energy efficiency class**

Case No. A40-71051/18-140-2435

A taxpayer applied the tax benefit, envisaged for the High energy efficiency class properties, to a non-residential structure (a garage with a vertical extension, used by a dealership).

The property was commissioned in 2013, its energy passport dated 2017.

The court resolved in favour of the tax authorities, citing as follows:

• there are no regulations categorising non-multifamily buildings into energy efficiency classes

• according to the existing regulations, energy efficiency classes are assigned only to multi-family buildings

• energy efficiency parameters for non-multifamily buildings are not defined.
Treatment of expenses to advertise cars in car races
Case No. A55-1367/2018

Circumstances of the case:
- The Company (the Contractor) signed a contract with the Principal for the provision of advertising services, namely, for the preparation and organisation of sports cars (used as advertising media) participation in the World Touring Car Championship.
- The Company engaged subcontractors to perform its contractual obligations.

The tax inspectorate disallowed the subcontractors’ fees, paid by the Company, citing the intent to generate unjustified tax benefits without a business purpose.

According to the tax inspectorate, the expenses had been actually borne by the Principal that engaged the subcontractors directly, and the information reflected in the service report (website screenshots, extracts from magazines, etc.) was publicly available.

Breaches were also found in the relations with subcontractors of the second- and further tiers as well.

The court took the taxpayer’s side, citing the following:
- the taxpayer’s vendors were active legal entities with relevant qualifications and business connections, necessary to provide for the use of the sports cars as advertising media during the world championship
- the taxpayer did not have the technical capabilities and experience of preparing cars for the global championships and managing contracts with foreign counterparties
- the taxpayer lacked equipment and experts, required for assembling and servicing sports cars, exposed to high workload
- there was no overlap between the services procured by the taxpayer with those paid directly by the Principal
- the services in question generated high returns
- the tax authority itself did not challenge the volume of works performed under the contracts
- the business purpose of the expenses was proved
- the taxpayer presented duly executed source documents, verifying the transactions
- the court did not establish that the vendors were shell companies and their managers – nominal.

Lower withholding tax on interest reclassified into dividends
Case No. A23-1331/2018

A tax inspectorate reclassified interest into dividends by virtue of the thin capitalisation rules and denied the application of a lower tax rate envisaged by the tax treaty with Sweden.

According to the treaty, the dividend tax shall not exceed five percent, if:
- the beneficial owner holds directly 100 percent of the capital of the company paying the dividends (or 30 percent in the case of a joint venture)
- the foreign capital invested exceeds USD 100,000.

According to the tax inspectorate, the direct ownership requirement was not complied with.

In fact, the whole dispute comes down to whether the shareholding must be calculated taking into account the Supreme Court’s position in SUEK-Kuzbass and Kashirsky Dvor-Severyanin cases on the classification of controlled debt as capital.

The court noted that the direct shareholder’s 100-percent interest in the taxpayer and the lender must be taken into account for DTT purposes.

The taxpayer has no other shareholders uncontrolled by the Company’s Group, whose share should be excluded from the total shareholding calculation.

The court also noted that in its rulings on the above-mentioned cases, the Supreme Court instructed that investments in the form of a loan must be taken into account to calculate the absolute capital investment amount and not the relative one.
In line with the principle of consistency of tax treatment, the shareholding in relative terms must be determined consistently, both for the purposes of interest reclassification into dividends and the selection of an applicable interest rate.

Furthermore, the court underlined that borrowing from a foreign sister company was not aimed at generating tax savings, since opting for a loan instead of capital investment and further dividend payout did not create any advantages for the parties.

Use of the five-percent threshold for VAT on expenses from VAT exempt operations

Case No. A66-16122/2017

A taxpayer was engaged in VAT-exempt operations (warranty repairs for a car dealership), the share of exempt operations in the total revenue amounting to nearly two percent.

Since the parts at the time of purchase could not be allocated to any particular activity for accounting purposes, the taxpayer included the following provision into its accounting policy: input VAT on the parts used in warranty repairs that was previously reclaimed would be reinstated in the tax periods, in which the costs attributable to the VAT-exempt operations exceeded five percent.

Since the five-percent threshold had not been exceeded, the taxpayer did not reinstate the VAT.

The taxpayer’s position was supported by the court.

Recovery of VAT on parts used for warranty repairs

Case No. A36-10052/2017

The tax authorities challenged the recovery of VAT on parts used in warranty repairs.

According to the tax audit findings, the taxpayer, having expended the cost of parts used in VAT-exempt warranty repairs, failed to reinstate the VAT claimed on the purchase of such parts.

In the tax inspectorate’s opinion, when calculating the share of VAT-exempt and VATable operations, the taxpayer did not take into account the operations subject to the unified tax on imputed income.

Consequently, the expenses attributable to the VAT-exempt operations were below five percent; and the taxpayer had not reinstated VAT on the sale of exempt goods (works, services) in accordance with Paragraph 4, Article 170 of the Russian Tax Code.

The tax inspectorate’s position was challenged by the taxpayer. In the opinion of the latter, expenses attributable to the operations subject to the unified tax on imputed income must not be included into the expenses from VAT-exempt operations in accordance with Article 170 of the Russian Tax Code.

Having considered the positions of the parties, the court supported the tax inspectorate in that the five-percent expense threshold could not be calculated separately per each VAT-exempt operation.

Therefore, since the company had previously claimed VAT attributable to the warranty repairs (a VAT-exempt operation), it had to reinstate the tax in the respective tax period.
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