

Legislative and court practice news for companies in the automotive industry





Dear friends,

We would like to present the latest legislation news for automotive industry companies.

Nowadays, the automotive industry in Russia suffers from a range of significant problems, including reduced sales, toughening of competition and changes in customer's habits, accompanied by an increase in the level of their expectations. Furthermore, constant changes in legislation regarding tariffs for utilization services and transfer pricing requirements also have an effect on the activities of automotive industry companies working in Russia.

In this publication, we will also review the latest changes in movable and immovable property tax, as well as benefits to boost regional investment projects, which can have a significant influence on the automotive industry.

We would be grateful to hear your comments and are happy to discuss any topics of interest.

Kind regards

Svetlana Fedorova

Partner

Tax & Legal

Head of the Automotive Industry Practice, Deloitte CIS

Tax benefits for participants in regional investment projects

Federal Law No. 267-FZ of 30 September 2013 makes amendments to the parts of the Tax Code related to boosting investment projects in the Far Eastern Federal District, the Republics of Buryat and Tyva, the Trans-Baikal territory and the Irkutsk region. In particular, the rate of income tax payable to the federal budget for participants in investment projects is established at the rate of 0 percent during 10 tax periods; the rate of income tax payable to the budgets of subjects of the Russian Federation must not exceed 10 percent during the first five tax periods and must not be lower than 10 percent during the following five periods. The minimum level of capital investments must total 50 million RUB for three years or 500 million RUB for five years.

The law will enter into force on 1 January 2014, but not earlier than one month following the date of official publication and not earlier than the first date of the next tax period.

The Federal Law of the Russian Federation No. 267-FZ of 30 September 2013 "on making amendments to parts one and two of the Tax Code of the Russian Federation related to boosting regional investment projects on the territory of the Far Eastern Federal District and individual subjects of the Russian Federation".

Property tax

1 Movable property

The Ministry of Finance is currently clarifying issues regarding property tax and the application of sub-item 8, item 4, article 374 of the Tax Code of the Russian Federation.

- Inventory items of movable property (air-conditioners, fire and security alarms, and other movable property), which are not single capital construction items, that are placed on the balance sheet as fixed assets from 1 January 2013, are not subject to property tax. *Letter of the Ministry of Finance No. 03-05-05-01/41301 of 4 October 2013.*

- Movable property, acquired for subsequent lease, which is included in accounting in 2013 as income-bearing investments in tangible assets, is not subject to property tax.

Letter of the Ministry of Finance No. 03-05-05-01/33164 of 15 August 2013.

2 Immovable property

According to the changes introduced by Federal Law No. 307-FZ of 2 November 2013, the tax base regarding certain immovable property items is determined as their cadastral value on the first date of the tax period. The changes cover the following types of immovable property:

- I Administrative business centres and trade centres (complexes) and premises in these centres.
- II Non-residential premises, which, according to their cadastral certificates or technical records (inventory), can be used as offices, mercantile facilities and catering facilities, or premises which are actually used for offices, mercantile facilities and catering facilities.
- III Items of immovable property of foreign organisations that do not conduct business in Russian Federation through permanent establishments and items of immovable property of foreign organizations unrelated to the activity of the given organizations in the Russian Federation through permanent establishments.

The law will go into force on 1 January 2014, but not earlier than one month following the date of official publication and not earlier than the first date of the next property tax period.

Federal Law No. 307-FZ of 2 November 2013 "on making amendments to article 12, part one and chapter 30, part two of the Tax Code of the Russian Federation".

The Laws of the City of Moscow and the Moscow region establish specific features of property tax computation. *The Law of the Moscow region No. 137/2013-OZ of 15 November 2013;*
The Law of the City of Moscow of 20 November 2013.



Transfer pricing issues

Some statistical data

Deputy Director of the Federal Tax Service (FTS) A.L. Overchyk and the head of the transfer pricing and international cooperation department of the FTS D.V. Volvach announced major performance results of tax authorities regarding the implementation of Tax Code provisions on transfer pricing.

- Since 2012, the FTS of the Russian Federation received 47 drafts of pricing agreements. Following their review, 22 decisions were made. Eight pricing agreements were concluded and are still in force, the parties to which are the 32 largest tax payers of the Russian Federation.
- At present, more than 4.5 thousand reports on controlled transactions have been uploaded onto the federal database. These reports are being processed and analysed by FTS specialists. Based on risk-analysis information regarding controlled transactions, the FTS of the Russian Federation will make decisions at the stated time on conducting first inspections on the completeness of tax computation and tax payment in respect of the settlement of transactions between affiliated parties in 2012. Thereby, 99.7 percent of transactions will be provided through telecommunication channels.
Official site of the Federal Tax Service of the Russian Federation.

Completing reports on controlled transactions

Due to incoming queries from taxpayers and tax authorities on issues of completing reports on controlled transactions, the FTS of the Russian Federation published a letter clarifying the specifics for completing reports on financial operations and other matters (recording the amount of excise tax, service transactions, transactions with permanent establishments of foreign organisations, agency agreements, completing the title page for a separate division of a foreign organisation).
Letter of the Federal Tax Service No. OA-4-13/19652@ of 11 November 2013 "on completing reports on controlled transactions".

Rules of thin capitalization for leasing companies

The Ministry of Finance clarified that if an organisation whose activity is based on acquiring rights and leasing them to others establishes a subsidiary, this does not constitute grounds to declare that this organisation does not exclusively conduct leasing activity and, consequently, it cannot be a reason to limit the right to apply the capitalisation ratio of 12.5:1

Letter of the Ministry of Finance No. 03-03-06/1/30015 of 29 July 2013

The amount of transport tax will not be included in the price of fuel.

The Ministry of Finance confirmed that transport tax will not be included in the price of fuel.

Letter of the Ministry of Finance No. 03-05-06-04/46815 of 1 November 2013.

Termination of the government programme to boost preferential car loans

The Ministry of Industry and Trade of the Russian Federation decided to terminate the preferential car loans programme on 31 December 2013, as the programme's major goal of maintaining the production level of light vehicles and light commercial vehicles was achieved.

Official site of the Ministry of Industry and Trade of the Russian Federation



Legal and court practice

Transfer pricing court cases: development

As we mentioned in the previous edition, the court supported the large vehicle distributor in case No. A40-111951/12-20-580 on transfer pricing issues. We would like to remind you that the tax authorities disputed the loss when calculating the income tax base for 2009 due to the overstatement of procurement prices for vehicles.

However, the court then ruled in the company's favour and later resolutions (of the Moscow Arbitration Court of 19 March 2013 and of the Ninth Arbitration Appellate Court of 31 May 2013) were overridden by the Federal Arbitration Court of the Moscow district on 16 September 2013 and to the Arbitration Court of Moscow for re-examination.

The court of appeal, taking into account the submissions of litigators' representatives, presumes that the previous court decisions are subject to be cancelled and the case is to be re-examined in the Moscow Arbitration Court.

The main submissions of the tax authorities are:

- The courts did not evaluate evidence of the absence of wholesale vehicles supply on the automotive market
- The courts did not evaluate the grounds for additional tax assessment by tax authorities and penalties in respect to the understatement of profits tax in the tax reports

Decision of the Federal Arbitration Court of the Moscow district for case No. A40-111951/12-20-580 of 16 September 2013

VAT taxation of revenue from attracting investments

The actions of the bank that did not include in the VAT base the amount of revenue for the provision of automotive company services to attract funding, which was redirected by the agent-bank to arrange a syndicated loan were declared illegitimate by the tax authorities.

The bank was paid a commission for organising the syndicated loan, which was calculated on the basis of a certain amount of interest for the borrower on the amount borrowed under the syndicated loan. The inspectorate believes that the remuneration paid by the bank should qualify as cash received as payment for the provision of self-directed services by the bank, i.e., syndicated financing of the borrower, rather than in terms of provision of banking services, and that is why the income is subject to VAT.

In compliance with the bank's requirements, the court stated that the disputed services provided by the bank were not independent, but were an integral part of the core banking operations regarding the issuance of syndicated loans. The terms for paying the commission were included in the terms of the syndicated loan agreement. All the bank's actions were related to the issuance of credit and aimed exclusively at granting the syndicated loan; therefore, the disputed services are legitimately qualified as part of the bank's core financing service, so the revenue from the provision of this service is not to be included in the VAT base.

Decision of the Federal Arbitration Court of the Moscow district for case No. A40-71030/12-108-57 of 6 September 2013

Accounting of costs under a provision of personnel contract

An automotive company was able to successfully defend its position in court in terms of accounting for profits tax expenditures for services under a provision of personnel contract, as well as those under a services provision contract.

When justifying its position, the tax inspection referred to the following:

- The expenses, incurred by the company under the provision of personnel contract in the absence of formalized labour relations with the specialists provided, are not economically feasible
- The company illegally accounted expenses under the provision of personnel contract, while paying wages under labour contracts to the specialists provided, with no evidence that functions were not duplicated.
- The presence of the service contracts between the company and other group companies indicates that the group companies were shifting the burden to the company
- The tax authorities did not consider expenses under the provision of personnel contract to be properly documented: there is no confirmation that services were rendered, which may be in the form of written cost estimates and written reports on the total actual cost.

In favour of the taxpayer, the court found the following:

- The expenses under the provision of personnel contract are economically feasible and warrant the economic and administrative activity of the company; expenses are directly related to the economic activities of the company and are aimed at expanding the market of products sold, increasing sales, supporting global functions, etc.

- The provision of personnel contract takes into account the interests of all three sides of the transaction.
- The use of the extensive experience and high qualifications of outside specialists is aimed at generating income, which proves the validity of these expenses.
- Double recognition of expenses: payments under the provision of personnel contract and payment of wages under labour contracts to the same specialists were feasible, because the functions performed by these specialists under the provision of personnel contract and under labour contracts were different.
- Work on service contracts was carried out in order to support the functioning of the company.

Decision of the Moscow Arbitration Court for case No. A40-122536/13 of 22 November 2013

Thin capitalization

The calculation of interest on controlled debt must be done discretely, i.e., quarterly; the maximum interest on end of year results must not be recalculated. The court pointed out that the rules established in paragraph 2, Art. 269 of the Tax Code of the Russian Federation for determining the maximum amount of interest on controlled debt to a foreign organisation exclude their appliance on an accrual basis. If the ratio of controlled debt and equity capital of the Russian organisation changes in a subsequent report period, compared to the prior report period, expenses as a percentage of the previous reporting period are not subject to recalculation.

Decision of the Presidium of the Supreme Commercial Court of the Russian Federation No. 3715/13 of 17 September 2013

State support of Russian motor vehicle manufacturers in the Russian Federation

Federal subsidies are to be provided for Russian legal entities producing motor vehicles classified as items 8701 – 8705 in the Customs Union Commodity Classification of Foreign Economic Activity, in the territory of the Russian Federation, as well as their components and parts with the use of the goods imported into the customs area of the Customs Union for the manufacture of motor vehicles, their components and parts and codes classified by the Customs Union Commodity Classification of Foreign Economic Activity corresponding with the items related to the motor vehicles and the industrial assembly of their components and parts.

Federal Law of 23 July 2013 No. 190-FZ

Introduction of Utilization Fee for Russian Manufacturers

The new revision contains the provisions of Article 24.1 of the Federal Law concerning "Production and Consumption Waste" according to which the deduction exempt from the utilization fee will not be applied as from 1 January 2014 in regard to the following vehicles:

- manufactured and produced by organizations that assumed liability to provide the subsequent safe handling of waste formed as the result of the loss of consumer properties by the specified vehicles;
- imported into the Russian Federation from the territories of state members of the Customs Union within the EEC and with the Customs Union duty status;

The adoption of this law creates equal conditions for domestic manufacturers and importers of vehicles regarding utilization fee payment.

Federal Law of 21 October 2013 No. 278-FZ

Revised Requirements for Wheeled Vehicle Tires

The revision of requirements for wheeled vehicle tires will be introduced on 1 January 2015. In particular, the requirements stipulate that it is forbidden to use tires if the remaining tread depth (in case of no wear indicators applied) does not exceed:

- for L class vehicles – 0.8 mm;
- for N2, N3, O3, O4 class vehicles – 1 mm;
- for M1, N1, O1, O2 class vehicles – 1.6 mm;
- for M2, M3 class vehicles – 2 mm.

The remaining tread depth of winter tires, marked with a sign in the shape of a mountain top with three peaks and snowflakes, as well as marked with the "M+S", "M&S", "M S" signs (in case of no wear indicators applied), while using on the specified surface, shall not exceed 4 mm.

Government Decree of the Russian Federation of 15 July 2013 No. 588

FAS News

1 Draft Government Decree of the Russian Federation aimed at changing the anti-monopoly control of relations between distributors (manufacturers) and dealers.

This draft document identifies the list of general exceptions concerning agreements between the business entities regarding the organization of motor cars sales and aftersales service of cars.

The draft document imposes some restrictions on car manufacturers and distributors. In particular, the following is prohibited:

- to obstruct dealers from performing car maintenance and repairs;
- to limit access to electronic parts catalogs and to establish discriminatory sales terms on original spare parts;
- to limit the use of spare parts without a manufacturer's trademark, but which were produced with the consent of the car manufacturer or which are used/ were used for the assembly of new vehicles (if the manufacturers of such parts can confirm that the spare parts correspond in terms of quality to the components which are used/ were used, for the assembly of such vehicles) for non-warranty repairs performed by authorized service centers.

The agreement between the dealer and the car manufacturer shall contain the procedure and an exhaustive list of grounds for its early termination.

If the distributor demands the early termination of the agreement for reasons not specified in the agreement, the distributor shall pay the dealer compensation, the amount of which shall also be identified in the agreement.

Draft Government Decree of the Russian Federation aimed at changing the anti-monopoly control concerning "Amendments to the Government Decree of the Russian Federation of 16 July 2009 No. 583"

2 The car distributors' code of conduct in new vehicle and spare parts markets

The FAS of Russia approved the draft car distributors' code of conduct in new vehicle and spare parts markets. This document produced by the specialist committee of the Association of European Businesses (AEB) specifies the general principles of interaction between the participants of the market. The main objective is the creation of transparent non-discriminatory rules.

As the participants of the AEB that joined the Code assume liabilities to adhere to the principles introduced therein, the FAS considers it necessary to specify in agreements between car distributors, official dealers and independent service stations that the provisions of the Code are applied to the relevant legal relationships.

In addition, for the purpose of effective implementation of the principles stipulated by the Code, and the development of self-regulation in this area, the FAS recommends that the AEB stipulate responsibility for non-compliance with the Code, including the creation of a body for the pre-trial review of disputes between the car distributors, official dealers and independent service stations.

Legal and court practice

Case of compelling car distributor to conclude a dealer agreement

Court ruling on refusal for case referral to the Presidium of the Supreme Arbitration Court of the Russian Federation. Earlier, according to the FAS of the Moscow district ruling of 21 May 2013 regarding case No. A40-84943/12-56-783, the court ruled that the distributor of a large car manufacturer shall pay damages, and also sign the dealer sales and servicing agreement with the partner in the specific territory of the Russian Federation for at least 7 years.

The distributor's liability arose from a protocol of intent concluded between the distributor and the dealer. The latter undertook to construct the new dealer center of a certain vehicle manufacturing company. The court concluded that such a protocol of intent is a provisional agreement as it contains all essential signs of such a document.

Thus, the court confirmed the possibility of the dealers to defend their rights by compelling their counter parties to sign dealer agreements with them, depending on the content of the provisional agreement between the car distributor and the potential dealer.

*Ruling of SAC of the Russian Federation
No. BAC-8487/13 of 01 August 2013*

Case of dealer agreement termination by car distributor

The resolution from the court of appeal approved the amicable settlement, according to which:

- The provisions of the dealer agreement on unilateral refusal were added with the condition that such refusal is possible where a detailed description of objective and clear reasons according to which the decision on unilateral agreement termination are given;
- The car distributor undertook not to perform actions aimed at unilateral agreement termination (excluding legal causes) within 3 years of the court's ruling upon the amicable settlement coming into force.

Earlier, a resolution was made on the this case by the AC of Moscow of 11 July 2013 on case A40-148325/2012 in which a number of principled points were expressed, in particular:

- The termination of the dealer agreement initiated by the car distributor without specifying the grounds for termination can be considered invalid due to abuse of the right, as:
 1. The dealer business has a long-term nature, assumes considerable investments both in business creation and development and is characterized by a complication of reorientation to towards other brands;
 2. Refusal will result in repeated credit and social risks of the dealer;
 3. The business is profitable for the car distributor as evidenced by the expansion of the dealer network;
- The dealer agreement was considered by the court as a merger agreement which contains an explicitly onerous condition for the dealer regarding the right of unilateral refusal.
- The car distributor's refusal to fulfill the dealer agreement was stated invalid.

*Ruling 9 of the Arbitration Appeal Court
of 23 September 2013 for case A40-148325/2012*



Case of competition restriction in the vehicle servicing market

Under the terms of the signed agreement, the car manufacturer contracted activities related to pre- and after-sale service of freight vehicles of a certain brand in the territory the Russian Federation constituent entity to a service station.

Additionally, the service station undertook not to be engaged in any competing activities, namely the servicing and repair of any freight vehicles of the car manufacturer's competitors within the entire duration period of the agreement, as well as within a year after its termination in the territory of the constituent entity of the Russian Federation, in the same market segment or without the written consent of the car manufacturer.

The appendix to the agreement specified that the service station can perform the maintenance and repair of the freight vehicles manufactured by the companies competing with the car manufacturer, but only provided that the specified services shall not be advertised elsewhere.

According to the FAS of Russia, the service station, having signed such an agreement with the car manufacturer, refused its independent actions in the maintenance of the cargo vehicles of all brands, except for the car manufacturer's brand, and also undertook to perform servicing activities for the freight vehicles of the car manufacturer's brand only in the limits of the territory determined in the specified agreements.

The court of appeal confirmed the first-instance court conclusions that:

- The servicing agreements containing a non-competition clause are vertical agreements (the parties are not competitors);
- The concluded agreements have signs of a dealer agreement, a commercial concession agreement;
- The non-competition clause aims to avoid confusion in the consumers' minds;
- There is no proof of the actual restriction of competition, and the station performed repairs of other brands.

Ruling 7 of the Arbitration Appeal Court of 28 October 2013 for case A45-4580/2013

Contacts

Should you have any questions regarding the materials in this information bulletin, please, please contact our specialists at the Tax and Legal Department:



Svetlana Fedorova

Partner
Tax & Legal Services
Head of Automotive Services Group in CIS
Tel: +7 (495) 787 06 00, ext. 2329
sfedorova@deloitte.ru



Tatyana Kofanova

Director
Tax & Legal Services
Tel: +7 (495) 787 06 00, ext. 5210
tkofanova@deloitte.ru



Roman Tarasov

Director
Tax and Legal Services
Legal practices
Tel: +7 (812) 703 71 06, ext. 2559
rtarasov@deloitte.ru

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