



LT in focus

Incorporation of permanent establishments resulting from foreign companies' advertising and marketing activities

Court practice

On 28 May the Supreme Court of the Russian Federation confirmed the lower courts' ruling on Case No. A40-155695/2012 and refused to submit the case for the consideration of its Judicial Chamber for Economic Disputes.

The case concerned a dispute as to in whose interest advertising and marketing activities of a foreign company were performed and whether or not these activities resulted in the incorporation of the foreign company's permanent establishment in the Russian Federation.

It is worth noting that the basic criteria in determining whether or not a foreign company is a payer of income tax in the Russian Federation is whether or not its business activities in the Russian Federation result in the incorporation of a permanent establishment. Permanent establishment incorporation is often determined depending on whether the foreign company's business activities in the Russian Federation are core or non-core and whether such activities are performed in the interest of the foreign company's head office or third parties. The court and parties to the dispute in question attempted to determine the subtle difference between these notions.

According to the tax inspectorate, the foreign company Astellas Pharma Europe B.V., represented by its Russian representative office, performed advertising and marketing activities in the Russian Federation not only in its own interest, but also in the interest of a third party, the sole distributor of its pharmaceutical products in the Russian Federation CJSC Astellas Pharma.

The arguments of the tax inspectorate were the following:

- the documents required to import and distribute pharmaceutical goods in Russia were not used by the foreign company and were submitted directly to CJSC Astellas Pharma;
- pursuant to the distribution agreement, advertising and marketing activities, as well the receipt of approvals by supervisory authorities for ASTELLAS pharmaceutical products were the distributor's liabilities;
- by fulfilling the contractual obligations of CJSC Astellas Pharma, the foreign company acted solely in the interest of CJSC Astellas Pharma;
- the foreign company incurred expenses for the state registration, clinical trials and promotion of ASTELLAS pharmaceutical products;
- the foreign company did not sell ASTELLAS pharmaceutical products in the Russian Federation; all products were sold exclusively via the distributor.

In view of these arguments, the court ruled in favour of the tax inspectorate's conclusion that the claimant's business activities in the Russian Federation were regularly and continuously performed in the interest of the third party, namely the independent distributor CJSC Astellas Pharma, rather than in their own interest.

The court specified that the preparatory and auxiliary activities of the company's representative office in Russia are not subject to the limitations stipulated by Clause 4 of Article 5 of the Double Taxation Treaty entered into by the Russian Federation and the Kingdom of the Netherlands and ruled that these activities resulted in the incorporation of a permanent establishment in Russia.



The history of related court practice is rather extensive. However, it was not until quite recently that the tax authorities started paying much closer attention to the activities of foreign companies in Russia.

The existing judicial practice on this issue is at the same time fairly controversial.

For example, the tax authorities sought to prove in a similar case (Federal Arbitration Court of the Moscow District [Resolution](#) of 17 December 2013 and RF Supreme Arbitration Court [Ruling](#) No. VAS-4237/14 of 28 April 2014 on Case No. A40-157543/2012) that the Moscow-based representative office of the foreign company LLC Berlin-Chemie/Menarini Pharma GmbH performed advertising and marketing activities in the Russian Federation in the interest of the third party CJSC Berlin-Pharma, which is the sole distributor of the foreign company's pharmaceutical products.

However, the court determined that these activities were performed in the interest of the taxpayer's head office and ruled in favour of the taxpayer.

The court additionally specified that as a pharmaceutical products supplier in the Russian Federation, the foreign company also retains its commercial interest in the supplied products subsequent to their sale to the distributor as it seeks to increase the volume of their sales. Due to this specific reason, the foreign company is interested in organising marketing and advertising campaigns in the Russian Federation in order to drive the sales of its pharmaceutical products and consequently receive more purchase orders from the distributor.

It should be noted that the court did not confirm this conclusion when hearing the Astellas Pharma Europe B.V. case, although the claimant used it as the main argument. The court dismissed this argument on the grounds that the foreign company did not sell ASTELLAS pharmaceutical products in the Russian Federation and all such products were sold exclusively via the distributor. Besides, the court determined that all costs on marketing and advertising activities incurred by the foreign company were aimed predominantly at stimulating and increasing the sales of its official distributor on the Russian domestic market.

Hence, the case in question establishes an unfavourable practice for foreign companies and increases the tax risks related to the advertising and marketing activities of their non-commercial representative offices in the Russian Federation.

The difference between the foreign company's principal and auxiliary activities is rather difficult to define, as is the difference between preparatory/auxiliary activities performed in its own interest and those performed in the interest of third parties. Foreign companies should therefore structure all relevant transactions more accurately, the agreements should include detailed specifications of each party's functions, and the companies should control the manner in which advertising and marketing activities are performed.

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We hope that you will find the information in this issue both interesting and useful. Our specialists are available to answer any questions you may have with regard to the contents of this issue.

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