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LT in Focus
Review of tax disputes revised by the Constitutional Court and the Supreme Court in 2H2015

On 19 January 2016, the Russian Federal Tax Service published a Review of tax disputes revised by the Constitutional Court and the Supreme Court in 2H2015 (hereinafter, the Review).

The Review covers a number of tax cases related to VAT, profit tax, transport tax and land tax.

In this edition, we will cover the most interesting cases dedicated to VAT, in particular:

- Calculation of VAT on an insurance indemnity received under a business risk insurance agreement;
- Application of 0% VAT to the provision of passenger seats under codeshare agreements with foreign airline companies;
- Application of 0% VAT to the sale of goods placed under the export customs procedure after crossing the border of the RF;
- Claiming VAT for recovery for the purchase of energy by network companies to compensate for losses;
- Restoring VAT earlier claimed for recovery when obtaining subsidies from the regional budgets;
- Claiming VAT for refund beyond the three-year period.

Calculation of VAT on an insurance indemnity received under a business risk insurance agreement

The Russian Constitutional Court (hereinafter, the CC) acknowledged subclause 4 item 1 art. 162 of the Russian Tax Code as failing to conform to the Russian Constitution. The CC rules that the receipt of an insurance indemnity under a business risk insurance agreement should not be subject to VAT, provided the taxpayer has paid VAT on the sale of goods and/or services.

This approach differs drastically from the previous position of both the CC and arbitrage courts, which have ruled multiple times that, according to subitem 4 item 1 art. 162 of the Tax Code, any insurance indemnity must be subject to VAT (please refer, for example, to the ruling of the Supreme Court No **305-KG14-3516** of 11 November 2014 on case Sony Mobile Communications Rus LLC). Prior to CC Ruling No **19-P** of 1 July 2015, the court practice was only negative for taxpayers. In practice, taxation of an insurance indemnity received by a taxpayer who is a supplier of goods under the insurance agreement against the buyer's failure to perform its contractual obligations meant that the sale of these goods was double taxed. With the publication of this ruling, taxpayers have the right to have the earlier court rulings reviewed (see **Ruling** of the Commercial Court of Moscow of 18 November 2015 on case No A40-114274/2013).

We expect relevant amendments to be introduced to the Tax Code in the near future that will regulate calculation of VAT on an insurance indemnity obtained under a business risk insurance agreement. The Draft Law No **968427-6**, which suggests amending art. 162 of the Tax Code has already been submitted to the Russian State Duma. In particular, the Draft Law suggests that the amount of the received insurance indemnities under a business risk insurance agreement in case of the buyer's failure to perform its contractual obligations will only be included into the VAT base if the taxpayer has not calculated VAT on the sale of these goods / services at the date of their shipment / rendering.

Application of 0% VAT on the provision of passenger seats under codeshare agreements with foreign airline companies

The Supreme Court has put an end to multiple disputes between airline carriers regarding the application of VAT to the transfer of seats to partner airline companies under codeshare agreements. By acknowledging that chartering an airline with the crew was the formal subject of such agreements, the Court recognizes that it is the airline passenger who is the end recipient of the service, and regardless of which airline processes his tickets, the passenger is entitled to equal rights, including the right to present claims against the actual carrier. Based on the substance of the transaction, the Court concluded that the carriage of both one's own and partner passengers by an international airline should have equal tax consequences, which in this case is the application of 0% VAT.

By bringing clarity into this practice, the Supreme Court has taken an extremely significant step. Judicial practice on VAT application under codeshare agreements has been fairly controversial up to this point. Some courts had acknowledged as lawful the application of 0% VAT to such transactions (see **Ruling** of the Ninth Commercial Appellate Court of 22 June 2015 on case No A40-111561/13), but others considered it unlawful (**Ruling** of the Supreme Court No BAC-5723/12 of 18 May 2012 on case No A40-41526/11).

Application of 0% VAT to the sale of goods placed under the export customs procedure after crossing the border of the RF

The Review includes clarifications as to the legality of applying 0% VAT to the sale of exported goods that were placed under the export customs procedure after they had actually been transported across the Russian border.

The Supreme Court stressed that the determination of the place of sale related to the beginning of the movement of the goods out of Russia is not violated when goods are placed under the export customs procedure after their transportation from Russia and consequently, the sale transaction should be taxed at 0% VAT.

Claiming VAT for recovery for the purchase of energy by electric distribution companies to compensate for losses

Since energy transfer services are VATable transactions, and the purchase of energy to compensate for excess losses in the network is directly related to the business of electric distribution companies and is carried out under the direct provision of the law, the Supreme Court ruled that electric distribution companies should be entitled to claim for recovery VAT charged by the power supplier.

Thus, electric distribution companies are entitled to claim VAT for recovery on energy purchased to compensate for losses, and tax authorities are not entitled to reject this claim. The Ministry of Finance had previously issued clarifications in favor of the taxpayers (see the Letter of the Ministry of Finance No **03-07-15/48602** of 29 September 2014); however, disputes on these matters still arose, and courts would not always rule in favor of the taxpayers.

Restoring VAT earlier claimed for recovery when obtaining subsidies from the regional budgets

The Supreme Court ruled that the receipt of a subsidy from the regional budget does not lead to tax consequences stipulated by obligation on VAT restoration to the tax authority stipulated by subitem 6 item 3 art. 170 of the Tax Code, since such subsidy cannot be acknowledged as a subsidy from the federal budget.

Even though the Ministry of Finance takes a similar position regarding VAT restoration in case of obtaining subsidies from the regional budgets (see Letters of the Ministry of Finance No **03-07-11/462** of 30 October 2012, No **03-07-11/38849** of 19 September 2013, No **03-07-11/22383** of 20 April 2015), the terms and conditions for VAT restoration and precise definition of subsidies are not clarified in these Letters.

Claiming VAT for refund beyond the three-year period

The CC ruled that VAT may still be refunded beyond the three year period envisioned by item 2 art. 173 of the Tax Code if the taxpayer could not have executed this right due to objective and sufficient reasons, including the failure of the tax authority to perform its obligations or the inability to receive the refund despite timely measures taken by the taxpayer.

The CC has referred to the issues related to taxpayers exercising their right to a VAT refund multiple times, and in practice, some taxpayers have successfully defended their right to claim the excessively paid tax from the budget beyond the three-year period.

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