



**The Association of European Businesses**

# Trade Law and taxation issues in the retail & consumer industry

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27 April 2011

Marriott Grand Hotel

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Association of European Businesses in the Russian Federation



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# Bonuses: judicial practice

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- there are different approaches to determining tax implications for suppliers and customers (networks);
- to additionally assess the VAT to the buyer the tax authorities classify the bonus (remuneration, premium, reward) as payment for the services (Resolutions of the Ninth Arbitration Court of Appeal No. 09AP-31126/2010 dated 11 February 2011 and No. 09AP-3968/2011-AP dated 29 March 2011);
- to assess additional VAT to the supplier the tax authorities attempt to classify the discounts (bonus discounts) as remuneration that does not affect the prices of goods.

# Bonuses: Federal Law “On the fundamentals of state regulation of



## commerce”

- the bonus, although it is paid under a supply agreement, is not taken into account for calculating prices of goods (clause 4, article 9 of the Law);
- the rule that a bonus is not included in the price of goods is only valid for foodstuffs. Bonuses on non-foods are included into prices in accordance with the general rules (Letter No. 03-07-11/436 of the Russian Ministry of Finance dated 13 November 2010);
- the rule that the bonus is not included in the price of goods covers all supply agreements.

# Bonuses: draft law on amendments to Chapter 21 of the Tax Code



- the draft law stipulates a procedure for documenting VAT adjustments due to retrospective discounts;
- in accordance with the draft law, VAT based on VAT-invoice marked as “adjusted invoice” should be deducted in the period where the discount was provided;
- under the draft law a discount is understood as a payment that reduces the price of a contract.

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## Service charges – recent practice



- Historically under close attention of tax authorities - questions to substance and supporting documentation
- Enhancing complexity of achieving deductibility of Retail service charges for a distributor:
  - substantial increase of scope and fees for Retail services caused by conversion of bonuses into services after introduction of Trade Law,
  - determination of certain service fees as a percentage of value of supplied goods,
  - potential inconsistency of practices applied for food and non-food supplies,
  - deviation of actual service charges from price lists for Retail services available on web-sites
  - Practical difficulties in collecting and maintaining supporting documentation
- FAS audits – certain Retail services are deemed providing under supply agreement and contradicting Trade Law

## Logistic bonus – recent practice



- Not allowed to be provided under supply agreement for food products under Trade Law
- Not easily convertible to a service – lack of substance for a service arrangement
- Other options to structure the payment (e.g. reduction of price if goods are delivered to distribution center) may not be possible in practice



## Service fees/Logistic bonus – what to do?



- To review existing agreements for Retail services – scope, level of fees, consistency with price-lists available on Retail web-sites
- To assess sufficiency of available supporting documentation – acts of acceptance of services, tangible evidence (planograms, photos, merchandising reports, etc), marketing budgets and plans, etc
- Review of rationale for change in scope of Retail services and level of the fees – reflect in marketing policy
- Propose changes to Trade Law and Tax Code – e.g. allow logistic bonus under supply agreement; introduce specific provision on deductibility of Retail services, etc?
- Other ideas?

## Contacts

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# Business practice

- We have collected information on retail practice of the UK and a number of European countries, including Germany, France, Sweden, Finland, Denmark, Czech Republic and Poland.
- All incentive payments common for European and UK business practices are represented by:

Payments related to initial sale and included into supply contracts

- volume rebates;
- payments for correct placement (incl. fees for preferential display / maintaining a given mix or level of product / listing of new or special products);
- contingent discounts (e.g. payments for prompt payment).

Payments for various services arranged under separate service contracts

- various marketing/advertising (incl. campaigns, linked promotions);
- logistics/ delivering of goods;
- POS;
- training of sellers.



# Legislative provisions

- Generally there are no statutory set limits of maximum bonus amounts in the analyzed countries. Usually the payments are subject to agreement between the parties.
- Incentive payments are legally regulated by:
  - 1) Trade laws or laws on competition, e.g.:
    - “Competition Act” in Denmark;
    - “Marketing Practices Act” in Denmark regulating relationships between traders, suppliers and consumers;
    - “Unfair Contract Terms Act” in the UK.
  - 2) Anti-bribery legislation, e.g.:
    - in Germany and Sweden “entrance payments” are likely to be treated as bribes;
    - in the UK “entrance payments” may be prohibited.



# Tax implications

- Payments are deductible for profits tax purposes of the supplier
- Also, payments are subject to VAT, however, the mechanism may differ depending on type of payments:

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## Payments related to initial sale and included into supply contracts

-payments decrease the price of supply with the respective VAT base adjustment;  
-arranged mostly as discounts via credit-note;  
-some limits for types of bonuses and timing/format of credit note are provided in legislation of Germany, Czech Republic and Poland;

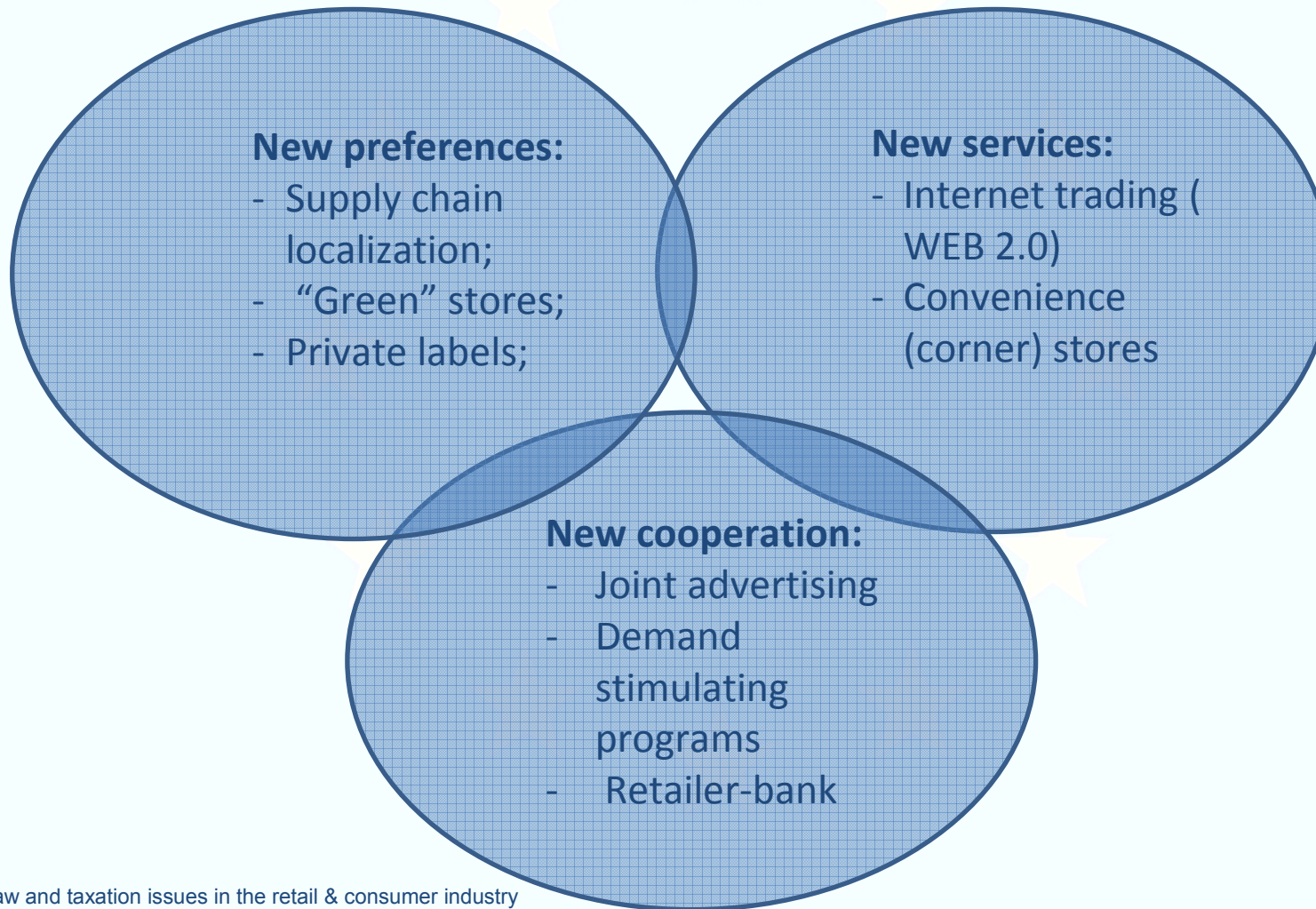
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## Payments for various services arranged under separate service contracts

-payments for various services prescribed by service contracts are subject to VAT at standard rate;  
- assistance in delivery of goods and advertising are usually treated as additional service



# Trends in distribution practices



## Contacts

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## 5 factors increasing importance of having a proper documented marketing policy



- Provide **additional layer of defense to the treatment of bonuses** vs discounts (within the framework of SAC Resolution No 11175/09 dated 22 December 2009 – «DirolCadbury case»); )
- Add **clarity to the treatment of “reclassified” services** vs bonuses - following conversion of many traditional bonuses to services in the foods industry after introduction of the Trade Law (may impact other industries – see eg Moscow District FAC Resolution No KA-A40/-16279-10 dated 19 January 2011 – «Leroy Merlin case»)
- Additional **proof that prices are in line with the market** (increased importance after SAC Ruling No 2087/11 dated 04 March 2011 – «Mechel case»; potential introduction of new transfer pricing rules)
- Help prove **standalone economic rationale for change in pricing** – additional layer of defense when defending against **antimonopoly challenge for concerted actions** (based on SAC Plenum Resolution No 52 dated 14 October 2010)
- Provide economic rationale arguments to help defend against **antimonopoly challenge of abuse of dominant position**



## 7 key elements of a good marketing policy



- **Distributor selection policy:** commercial reasons and approach for selecting distributors and determining the number of selected distributors, minimal requirements for appointing distributors
- **Pricing policy:** pricing by distribution channels; factors to consider when setting the prices and when raising or reducing prices; impact of government control prices (eg pharma)
- **Discounts:** discounts used, economic rationale for providing discounts; lack of discrimination when providing discounts
- **Bonuses:** stimulating nature of the payment, reinforcing conditional nature of the payment and that they do not represent payment for service or discounts; reinforcing existence of interest to promotion of products even after it is sold to the distributor
- **Services:** types of promotion-linked services the company may be willing to contract for; economic rationale for purchasing such services; acceptability of paying for a service as a percentage of value of supplied products
- **Payment terms:** principles for setting the credit terms, requiring prepayment, providing special discounts for prepayment
- **Transparency:** accessibility for distributors; actual compliance

## Examples of court cases where absence of marketing policy played a negative role

*“The Company lacked a systematic approach to granting discounts; prices were set without any logical marketing system”* (Moscow District FAC Resolution No KA-A40/14493-10-2 dated 01 December 2010)

*“The Company did not provide any evidence (documents) proving existence of a marketing policy in connection with promotion of the new product in the market, and, correspondingly, of economic justification of discounts, which were reaching 65%”* (North-Western District FAC Resolution No F26-4341/2008 dated 26 October 2009)

*“Refuting the arguments raised by the Company, the courts based their decision on the adopted Marketing Policy of the Company which does not appear to establish any difference between ...”*  
Moscow District FAC Resolution No KA-A40/14493-10-2 dated 01 December 2010)



## Contacts

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**ASSOCIATION OF EUROPEAN BUSINESSES  
IN THE RUSSIAN FEDERATION**

# **Lease and leasehold improvements – disputable points**

**Elena Orlovskaya, Beiten Burkhardt**

April 27, 2011  
Marriott Grand Hotel

## Disputable points



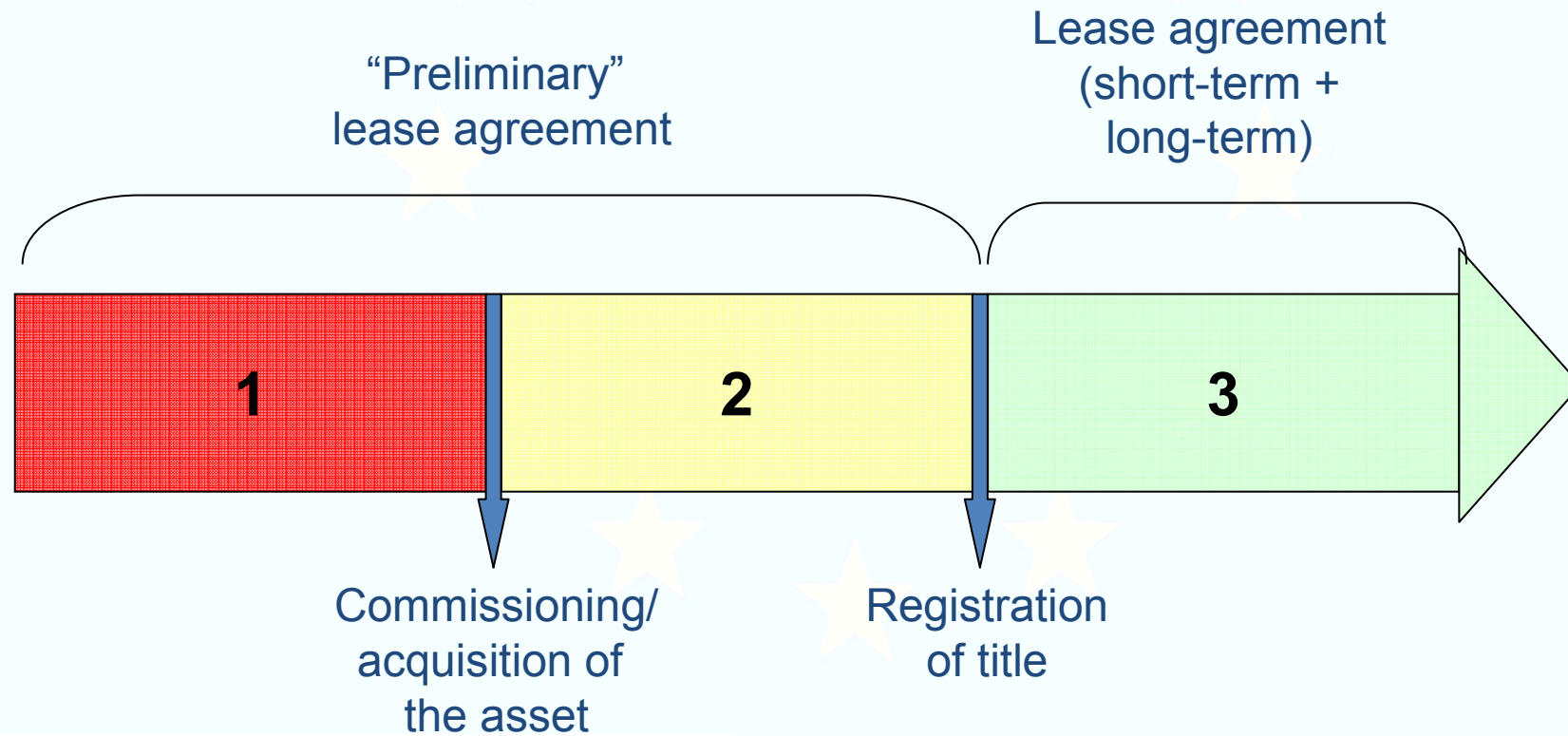
### Taxation of payments under a lease agreement

- **Lease payment** – other expenses of the lessee and income of the lessor
- **Non-recoverable expenses on improvements (repairs) to the premises** – an expense of the lessee; does not constitute income for the lessor
  - **Repairs** - one-time
  - **Reconstruction, modernization** – through depreciation
    - **Separable improvements**
    - **Non-separable improvements**

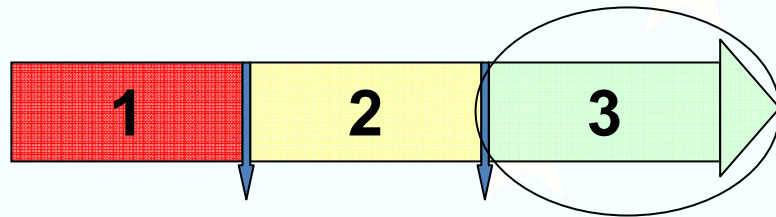
# Disputable points



## Contractual relations of the parties



## Disputable points For Lessee

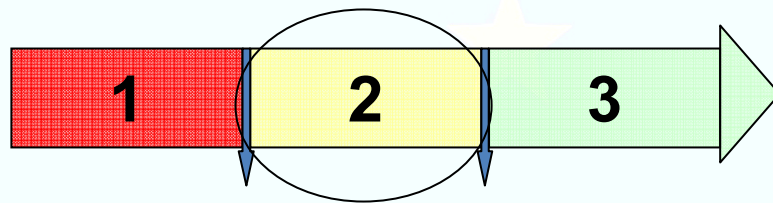


- Lack of state registration of a long-term lease agreement
  - does not prevent the deductibility of lease payments and does not affect the tax treatment of expenses on improvements (courts)
  - does not prevent this, subject to compliance with the following conditions (Letter No. 03-03-06/4/18 of the Ministry of Finance dated 5 March 2011):
    - the effect of the agreement extends to relations before its registration
    - documents have been submitted for registration

## Disputable points For Lessee



### Fee for the use of premises



- To be recognized as a deductible expense, it must be proved that the premises were actually used for business purposes\*
- The Ministry of Finance takes a different approach depending on whether the asset was acquired (A) or built (B) by the lessor:
  - A – expenses are not recognized until the lessor registers title (Letter No. 03-03-06/1/728 of the Ministry of Finance dated 16 November 2010)
  - B – expenses are recognized (Letter No. 03-03-05/193 of the Ministry of Finance dated 30 August 2010)

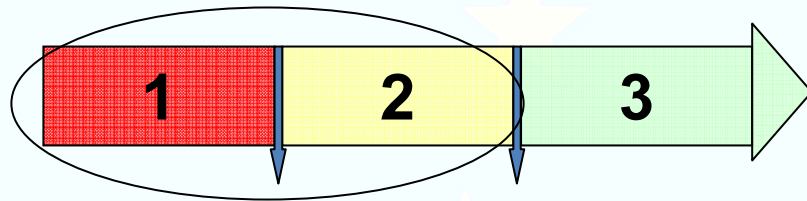
\* The ASHAN case (FAS, 2011); the Amway case (FAS, 2010); the ZAO Sberkarta case (FAS, 2010)



## Disputable points For Lessee



### Non-recoverable expenses on improvements (non-separable)



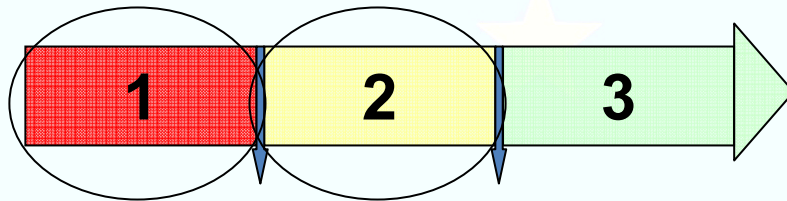
- Expenses may only be deducted after the conclusion of a lease agreement (Letter No. 03-03-06/1/230 of the Ministry of Finance dated 10 April 2009)
- Expenses are conditioned by commercial interests and confirmed by supporting documents prepared by contractors (the courts\*)
- Means of expense recognition
  - Pursuant to the procedure stipulated for leasehold improvements

\* The ASHAN case (FAS, 2011); the Aurus case (FAS, 2010); the Stockmann case (SAC, 2008)

## Disputable points For Lessor



- **Non-recoverable expenses on improvements (non-separable)**



- The lessor receives income, as it commissions the asset and receives corresponding title once the improvements have been made\*
- The income of the lessor is determined proceeding from the value of work performed by the contractors on the orders of the lessee\*
- Expenses form part of the historical cost of the asset and should be taken into account by the lessor when calculating property tax\*

\* The IKEA case (Court of Appeal, 2011)

## Contacts

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**BEITEN BURKHARDT**

# Shortages and losses of goods – issues and prospects



# Shortages and losses of goods

## The current situation

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- **Natural waste:** losses due to shortage and/or impairment during storage and transportation within the limits of the laws on natural loss (art. 254.7.2 of the Tax Code)
- **Technological losses** in the course of production and transportation processes due to technological features of production and/or transportation, and physicochemical properties of used raw materials (art. 254.7.3 of the Tax Code)
- **Inventory losses and theft:** deductibility is subject to confirmation of the absence of guilty party, obtained from a competent state authority (art. 265.2.5 of the Tax Code)
- **Spoilage and expiration of shelf life:** no special rules; possible qualification as “other expenses” associated with production and/or sales? (art. 264.1.49 of the Tax Code)



## Shortages and losses of goods what has been expected...

### Tax policy guidance for 2010 and planning period of 2011 and 2012

(approved by the Russian Government on 25 May 2009):

- **For retail and small wholesale businesses:** aggregate limit of inventory losses (in particular, losses due to spoilage, breakage, scrapping of goods, loss of marketable appearance). Losses on certain groups of goods – within the limits set out by the Russian Government.
- **For self-service stores:** recognition of inventory losses due to unknown-cause shortages identified as a result of stocktaking. Aggregate limit of losses as a percentage of retail revenues. Losses on certain groups of goods – within the limits set out by the Russian Government.

### Tax policy guidance for 2011 and planning period of 2012 and 2013

(approved by the Russian Government on 20 May 2010):

- Matters to be considered: restoring of previously deducted VAT where goods, including fixed assets, have been disposed of other than by way of sales transactions; no requirement to restore VAT to the extent that fixed assets have been disposed of as a result of emergency and natural disasters.



# Shortages and losses of goods ...should have been done?

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## Draft laws introduced to the State Duma

### VAT (Draft Law No. 488640-5)

- Supplement Article 265.2 with sub-clause 5.1:  
«losses due to the theft of goods sold in trading areas of self-service stores. Losses are deducted based on orders of the head of the company in accordance with the procedure established by the federal executive authority in charge of domestic trade.».
- Commented on by the Russian Government

### Profit tax (Draft Law No. 482215-5, passed in the first reading, dated 25.03.2011)

#### Supplement Article 170.3 with sub-clause 4:

Previously deducted VAT amounts should be restored in the following cases:  
disposal of goods, including fixed assets, as a result of theft and/or shortages identified through taking stock. The restored VAT amounts should not be included in deductible expenses for profit tax purposes

Commented on by the Budget and Tax Committee of the State Duma



# Shortages and losses of goods

## Recent court decisions

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### Spoilage and expiration of shelf life

- **Nestle Food:** Federal Arbitration Court of Moscow circuit N KA-A40/14839-07-2 of 01.02.2008
- **Nestle Food:** Federal Arbitration Court of Moscow circuit N KA-A40/5815-10 of 11.06.2010
- **Perekrestok:** Federal Arbitration Court of Moscow circuit N KA-A40/2561-10 of 22.04.2010 + Supreme Court N VAS-7524/10 of 31/08/2010,
- **Perekrestok:** Ninth Arbitration court of appeal N 09AP-31991/2010-AK of 24.01.2011
- **Top-Kniga:** Federal Arbitration Court of West-Siberian circuit N 45-7702/2010 of 13.12.2010

### Theft

- **Pallada Torg:** Federal Arbitration Court of the Central circuit N A48-4388/2009 of 11.06.2010 + Supreme Court N KA-A40/13938-07-2 of 11.11.2010 N VAS-13572/10

### VAT recovery:

- Federal Arbitration Court of Moscow circuit N KA-A40/13770-10 of 16.11.2010 (Supreme Court N 10652/06 of 23.10.2006)



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