

360 Degrees of Your Pricing Policy: A Legal View

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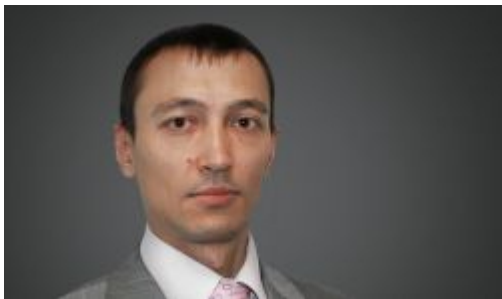


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Distribution cannot be a successful business in Russia without legal security for your pricing.

When elaborating its pricing policy, a company may focus on one or two pressing aspects, such as tax or customs risks. But make no mistake – a successful pricing policy can only result from a 360-degree legal audit. The Transfer Pricing Tax Law and the high profile of the Russian anti-monopoly watchdog highlight tax and anti-monopoly matters.

The best example to illustrate the interplay between anti-monopoly and tax aspects is, perhaps, the Trade Law. By prohibiting all bonuses other than ones based on volume, the Trade Law has actually confined the food business to invoice-based discounts and services. The Supreme Arbitration Court has fuelled the flames. Its position expressed in December 2009 on the Dirol Cadbury case, to the effect that bonuses, irrespective of their form, change the product price, has placed bonuses, together with price adjustments, within the tax risk zone. As a result, the Finance Ministry (Letter No. 03-07-11/436 of Nov. 13, 2010) combined the positions of the SAC and the Trade Law and concluded that bonuses paid with respect to food products do not change the product price, while those paid with respect to nonfood supplies do change the price, which appears odd to say the least.



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The reasoning behind the Trade Law was purely anti-monopoly reasoning: to restrict the market power of the retail chains, which used to levy big bonuses on suppliers at every opportunity. The focus of the law is foodstuffs. The result, however, is ambiguity over taxation of distributors in both the food and nonfood sectors.

Tax matters are important. Many practical issues remain unresolved at both the legislative and law enforcement levels. For instance, invoice-based discounts are not flexible enough to stimulate consumers at the end of a particular period. It is not economically feasible for either party to set a fixed service fee when the volume of operations is directly tied to turnover. Besides, there is a practical need for marketing discounts, which lose their economic value if classified as services for taxation purposes, because it is the end result and not the process that matters to market players.

The anti-monopoly risks are also important. The Federal Law on protection of competition prohibits dominant market players from discriminating against their customers in price without clear economic or technical justification. Because up to the five biggest players in the market could, under certain conditions, be considered collectively dominant, the ban on discrimination acquires importance for many distributors. The prohibition on concerted practices, namely parallel price increases that can only be explained by tacit collusion among

competitors, obliges a company always to have an economic justification for its price moves. Last, but not least, are the tricky rules governing resale price maintenance, which is permitted only under certain exceptional circumstances. This makes distributors think twice before launching price promo campaigns.

In this context, the uncertainty surrounding the legal regulations and the ambiguity of judicial practice entail tax and anti-monopoly risks threatening the distribution business in terms of applied prices, discounts, their re-qualification as services, challenges to the service calculation mechanism, documentary support for expenses, etc.

Even so, given the tools available in practice, it might be recommended that distributors emphasize their own pricing and marketing policy more in order to reduce the tax risks. This is quite a powerful instrument for resolving transfer pricing issues and justifying pricing from the anti-monopoly perspective. A pricing policy is used as a formal document by most companies and is usually supplemented by an internal control mechanism, such as tax or anti-monopoly audit. Many companies also include special "tax clauses" in their contracts to substantiate the business purposes of discounts, bonuses, acquisition of services, etc. and to form positive judicial precedents.

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