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B2B: The Importance of the Right Commercial Policy

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Does your organization have a written commercial policy? Does it set clear and equitable rules and drivers for your business partners? Do your managers clearly understand and consistently apply them? Does your policy fully meet the commercial objectives of the business? Is it overly conservative or flexible enough to encourage more proactive sales strategies by accepting a reasonable level of risk. To what extent is the policy open to your business partners? Does it comply with the applicable tax, competition and anti-bribery legislation? These are just some of the questions that executives periodically address to drive up sales and profitability. Let's take a closer look at certain practical and legal aspects of how organizations perform with and without a proper commercial policy.

Optimizing VAT treatment of discounts, bonuses and service-type fees

There are many instances when companies incentivize their business partners with retroactive or prospective discounts and bonuses, which are VAT neutral if they do not change the price of goods sold. Most such incentive payments are well known, such as turnover and floor sample discounts, sell-in / sell-out bonuses, bonuses for timely payment, etc. They are most commonly used by major suppliers in the FMCG industry, but gradually will become more widespread, especially in the e-commerce sector and by companies seeking to expand.

Bonuses to cascading levels of the supply chain, e.g. in the absence of direct contractual relationships with sub-dealers, are used less frequently due to the associated tax risks. The same applies to bonuses for marketing of already sold products in third-party retail stores. Some payments, e.g. for provision of financial statistics, conducting marketing campaigns, training sales personnel, are service fees and attract VAT. Retroactivity should be minimized to avoid reissuing VAT invoices and amending earlier tax records and returns.

Mitigating the risk of losing tax deductions

Analyzing existing court practice, we find multiple cases when the Russian tax authorities challenged the deductibility of certain payments — which companies clearly made for business reasons to unrelated parties — either on the premise that they lacked documentation supporting the rationale for payment or as being economically unjustified (i.e. not aimed at generating profits), or if they violated applicable laws.

In many cases, taxpayers ultimately won, sometimes only at the federal circuit level. However, the mere fact that businesses encounter unplanned expenses litigating over matters that in many developed tax jurisdictions are barely challenged is an unnecessary burden. This is especially relevant in the current economic environment, coupled with budget deficits and a clear trend towards more sophisticated tax audit practice and a greater level of unpredictability in tax disputes.

We already live in a world where the Russian courts have developed concepts and doctrines going far beyond a literal reading of the statutory rules. Corporations need to be proactive and try to remove unnecessary tax risks. One easy means to achieve this is to prepare an appropriate commercial policy that provides formal guidance for the business and explains the economic rationale for underlying payments, especially for new business techniques developed overseas and imported into Russia.

Upsides of greater compliance

If a particular payment contradicts applicable competition laws, the tax authorities may attempt to challenge its deduction for tax purposes. This is especially true for payments aimed at coordinating the market, at linking dealers with particular distributors, at maintaining suppliers' price policies at various levels of the supply chain, and at having sales managers give a particular brand preferred treatment over competing ones when offering products to customers.

There is plenty of risky creativity in the market regarding disguised payments. Some arrangements may contravene Russian competition law.

However, if the desired goals are not unlawful in substance, it is possible to achieve them through adjusted, but legitimate, means. The same applies to questionable payments under applicable anti-corruption laws.

Benefits of thinking in the long term

Developing a new commercial policy (or revising an existing one) is normally accompanied by an in-depth analysis of the drivers an organization sets for its managers and business partners.

Discussions over financial and operational considerations, working capital and inventory management, and related regulatory aspects help companies better understand their growth strategies and pave their unique way for products to reach customers in the desired manner.

In certain cases, businesses deliberately favor greater flexibility over complete, but restrictive, compliance policies, especially when the upsides of envisioned "freedom" of corporate behavior outweigh the potential penalties and cost of possible litigation. However, over time, organizations should benefit more if they can incorporate their vision of long-term corporate growth into a concise, flexible and user-friendly commercial policy that can be easily adjusted going forward.

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