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B2B: Tax Risks and Tax Opportunities

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Without a doubt, 2014 can be regarded as a turning point in the development of tax law relations: taxpayers moved from a conservative approach in matters of taxation to a moderately aggressive one, seeking out further opportunities to fund their activities from tax overpayments, and making use of tools to reduce tax risks. As such, 2014 is a year where tax risks have given rise to opportunities.

Even a cursory analysis of tax-related court decisions in 2014 shows that a significant number of tax disputes were initiated by taxpayers themselves, who sought refunds for overpaid taxes. Previously, taxpayers had preferred to ignore their rights for reimbursement for one reason or another.

The economic reasons for this behavior are not difficult to fathom. In particular, one cannot fail to recall August 2014, when the Supreme Commercial Court of the Russian Federation was eliminated. Thanks to its work, taxpayers had finally achieved a level of certainty in taxation matters and could comfortably plan their activities for several years ahead. The fairness and progressiveness that the court tried to uphold are another matter. Now, however, the Supreme Commercial Court has been replaced by the Russian Supreme Court —specifically its judicial collegium on economic disputes. In the four months of its operation, the Supreme Court heard five tax disputes (versus dozens of disputes handled over the same period in the Supreme Commercial Court). In four of those cases, it handed down decisions in favor of the tax authorities. Moreover, while the Supreme Commercial Court worked at developing the law, the Supreme Court's efforts for now are comparable to putting out brushfires without the prospect of improving the situation.

In addition, in October 2014 the Investigative Committee of Russia regained its powers to independently commence criminal proceedings for tax crimes without regard to taxpayer tax audits and their findings. In November 2014, a bill to toughen tax penalties for tax crimes

(for evasion of tax through the use of fly-by-night companies, with concealment or misstatement of information on controlled foreign companies or transfer pricing of controlled transactions) was adopted by the State Duma at its first reading.

Thus, the events of 2014 effectively prompted taxpayers to reconsider their relationship with the tax authorities.

Tax accounting of inventory losses in self-service stores for many years had been one of the most pressing issues for retail companies. Such companies were deprived of the ability to deduct these losses, because tax authorities required to provide them with decisions from Russian internal affairs authorities on suspension or termination of a criminal case, but taxpayers were unable to obtain such decisions.

Representing the interests of major retailers — Auchan, Atak, Dixy, Hyperglobus, and Stockmann — we were able to persuade the Supreme Commercial Court that this practice was a poor one, and taxpayers are entitled to recognize such expenses as a routine matter (Judgment No. VAS-13048/13 of December 4, 2013).

Late June 2014 saw the publication of Decision No. 33, May 30, 2014, in which the Plenum of the Supreme Commercial Court again addressed the documentation of inventory losses, this time in the context of determining what items are subject to VAT. In particular, the Plenum stated that a taxpayer is required to document the occurrence of a product disposal and the fact that it occurred specifically because of wastage, breakage, or pilferage (i.e., events not attributable to the taxpayer) without a transfer of the product to third parties. If the taxpayer fails to provide documentary proof of the circumstances of inventory losses, VAT is to be charged on them.

Because of the risk of additional VAT charges, taxpayers began to evaluate the state of their document management as accurately as possible, and then to make use of the opportunities provided by the Supreme Commercial Court in December 2013 to record inventory losses for purposes of the profits tax.

Reform of the system of assessing the property tax on real estate at its cadastral value continued in 2014. Cases involving this category of disputes were transferred from commercial courts to courts of general jurisdiction, whose approaches to dispute resolution are somewhat different. Those who were active and succeeded in challenging the cadastral value of their property in commercial courts gained an opportunity to pay reduced property tax. This does not mean, however, that nothing can be done in the present circumstances and the outcome of a potential dispute is predetermined. It is simply that greater efforts now are required.

In the last few years, the forefront of events has continued to be occupied by tax disputes regarding intragroup services — especially when foreign companies in a group play the role of service provider. The British American Tobacco series of cases is an illustrative example of what not to do, and of the consequences that can ensue if the approach to documenting transactions is not sufficiently meticulous. Thus, it is extremely important to develop a general concept for documenting intragroup expenses, for appropriately formulating a contract, for compiling a set of source documents, and for determining the logic and interrelationship of all documents.

In 2014, the Federal Tax Service began auditing taxpayers to verify compliance with the new transfer pricing rules. In the same year, courts were swamped with disputes concerning the application of previous rules, and the outcome does not inspire optimism. It turns out that the tax authorities have honed their approaches in this area, and have honed them very successfully. Automakers (Subaru, Mazda, and others) were especially hard hit. In this situation, it is important for taxpayers to look after the development, justification and documentation of their pricing policies, without waiting for the issue to be raised by tax authorities.

Finally, in November 2014 we received a "gift" of new rules for controlled foreign companies. The rules dictate that retained earnings of foreign structures that are not legal entities (trusts, some funds and partnerships, etc...) are automatically classified as taxable profits (income) of their Russian beneficiaries. Even now it is necessary to think about developing measures to eliminate or minimize the risks associated with the application of these rules, while there is still time to make adjustments.

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