



RUSSIAN DESK

TAX LAW

New Legal Positions of the Supreme Courts of the Russian Federation. Overview for the Second Quarter of 2020

The Federal Tax Service of Russia publishes on a regular basis highlights from new legal positions on tax issues which have been adopted by the Constitutional and Supreme Courts of the Russian Federation. This publication covers the second quarter of 2020.¹

We would like to draw your attention to the following important approaches of the highest Russian Courts.

1. A VAT DEDUCTION IS LEGAL EVEN IF THE COUNTERPARTY DIDN'T PAY THE TAX TO THE BUDGET. IN THIS INSTANCE A VAT DEDUCTION IS ONLY REFUSED FOR A TAXPAYER PARTICIPATING IN TAX EVASION SCHEME.

All at once two cases considered by the Supreme Court in the second quarter of 2020 concerned issues of the legitimacy of VAT deductions for the buyer when the seller itself had not paid the tax to the budget.²

In general, the circumstances in both cases were very similar. The buyer acquired from a seller specific products which were actually supplied and paid in full, and then filed for a deduction of the amount of "input" VAT. Subsequently, the tax authorities filed claims against the buyer on the grounds that the seller for its part had not paid VAT to the budget and had indicia of a shell company. For this reason the tax authorities disallowed the deductibility of the amount of "input" VAT for the buyer.

The Supreme Court disagreed with the decisions of the courts which had ruled in favour of the tax authorities. It stated that the

non-payment of VAT to the budget by the counterparty-seller (resulting in "no economic source for the deduction (refund) of the tax") constitutes an essential, but insufficient criterion to deny the buyer's deduction of VAT.

Such a refusal is legitimate if it has been proved that the buyer had been pursuing the goal of tax evasion as a result of actions agreed on with other parties (counterparties), and in the absence of such a goal – knew or should have known about the violations committed by these parties, acting on the basis of behaviour to be expected from a reasonable participant in business (due diligence criterion). If the opposite were true, this would mean that the tax authorities **held the buyer liable for the tax offences committed by the seller.**

At the same time, the Supreme Court stressed that when examining the facts in such cases, the court must take account of both the results of the tax control measures, and also the materials and arguments of taxpayers.

2. WHEN ASSESSING A SPECIFIC TRANSACTION FROM THE PERSPECTIVE OF VAT, DUE ATTENTION SHOULD BE PAID TO THE ECONOMIC SUBSTANCE OF THE TRANSACTION, AND NOT ONLY FORMAL CRITERIA

The Constitutional Court of the Russian Federation has also taken an interest in VAT issues. In Judgment No. 31-P dated 30 June 2020, it assessed the legitimacy of applying a zero "export" rate to chartering services for the sea carriage of goods in the Russian Federation in a situation when such carriage represented only part of the chain of transactions involved in the export of the products.

A company chartered a tanker to export petroleum products from Russia to the Netherlands. Such charter services are subject to

¹ https://www.nalog.ru/rn77/taxation/jud_settlement/.

² See: Ruling No. 307-ES19-27597 of the Supreme Court of the Russian Federation dated 14 May 2020 in case No. A42-7695/2017; Ruling No. 305-ES19-16064 of the Supreme Court of the Russian Federation dated 28 May 2020 in case No. A40-23565/2018.

the 0% VAT rate. However, on one of the trips the tanker struck an underwater obstacle, and the cargo had to be transferred to another vessel in Murmansk. The cargo was delivered from Murmansk to its intended destination. The company paid the owner of the tanker for the charter, based on the zero rate of VAT. However, the owner of the vessel held that the VAT rate should be the basic rate (at the time – 18%), as the tanker had not left Russia.

The Constitutional Court held that the tanker chartering services in this case should in actual fact be subject to VAT at the zero rate, even though the carriage was only performed in Russia. The economic substance of the transactions, their link with the export of petroleum products, has prevailing legal significance for this conclusion, in other words, the general intent of the actions to export goods outside Russia. This is confirmed in the case under consideration by virtue of unforeseen circumstances beyond the control of the parties.

At the same time, the Constitutional Court stated that the zero rate of VAT on export transactions is established, *inter alia*, to support exports and reinforce the competitiveness of goods being exported from Russia, while the refusal of this rate violates not only the taxpayer's interests, but also the state's interests, as it discourages the economic activity of exporters and in the final analysis leads to a decrease in remittances to the Russian budget.

Even though the case concerned a dispute between private companies regarding the compensation of VAT to the owner of the vessel under the agreement, it would appear that the conclusion of the Constitutional Court on the need to adhere to the economic substance of the transaction may also be used in disputes with the tax authorities.

3. PROCEDURAL TAX ISSUES

The Courts have also paid attention to some interesting procedural issues concerning interaction with tax inspectorates.

■ A taxpayer must file an application to recover interest for the late refund of VAT from the budget

In one case the Constitutional Court expressed the position that interest for the late refund of the amount of VAT from the budget by the tax authority is only paid to the taxpayer if the latter had submitted an application for a tax refund (offset) before the adoption of the decision to refund the amount of VAT. If the tax authority initially refused to refund VAT, while the taxpayer successfully contested this refusal in court and only filed a respective application after the entry into legal force of the court's decision, no interest accrues on the refundable tax.³

■ A taxpayer must file an application to recover interest for the late refund of VAT from the budget

In another case the Supreme Court concluded that legislation does not establish a mandatory pre-trial procedure for the settlement of disputes regarding the claims of taxpayers for the recovery of amounts of taxes, late payment interest and fines collected in excess. Such a procedure is only established in cases where a taxpayer files a claim in court for the invalidation of non-regulatory acts, the actions (inaction) of the tax authorities (for example, decisions issued based on the results of tax audits).⁴



Anna Lesova

Lawyer | LL.M. | Of Counsel
BEITEN BURKHARDT Moscow
E-mail: Anna.Lesova@bblaw.com



Egor Repin

Lawyer | Associate
BEITEN BURKHARDT Moscow
E-mail: Egor.Repin@bblaw.com

³ See: Ruling No. 543-O of the Constitutional Court of the Russian Federation dated 26 March 2020.

⁴ See: Ruling No. 307-ES19-23989 of the Supreme Court of the Russian Federation dated 16 June 2020 in case No. A56-60671/2019.

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EDITOR IN CHARGE

Anna Lesova
Egor Repin

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YOUR CONTACTS

MOSCOW

Turchaninov Per. 6/2 | 119034 Moscow
Falk Tischendorf
Tel.: +7 495 2329635 | Fax: +7 495 2329633
Falk.Tischendorf@bblaw.com

ST. PETERSBURG

Marata Str. 47-49 | Lit. A | Office 402 | 191002 St. Petersburg
Natalia Wilke
Tel.: +7 812 4496000 | Fax: +7 812 4496001
Natalia.Wilke@bblaw.com