

#10 | February 2010

Value-Added Tax on Transportation and Related Services: 0% or 18%?

New Unified Position of the Russian Supreme Arbitration Court

Analysis of the Russian Tax Code provisions regulating the Value-Added Tax (VAT) taxation of transportation and related works and services (loading, reloading, storage, escort etc.) with respect to goods imported into the Russian Federation or exported from the Russian territory reveals differing interpretations of legal norms. In particular, the Tax Code does not indicate exactly which VAT rate – general (18%) or “preferential” (0%) – should apply to these works and services. This uncertainty may give rise to risks for contractors operating in this sphere and, consequently, in the absence of clear legal principles, the position of the competent authorities (both tax and judicial) on this matter becomes crucial.

Legal context

According to Russian tax regulations in force (art. 146 (1) of the Russian Tax Code (Part II dated 5 August 2000 No. 17-FZ)) VAT is chargeable on works and services performed on the territory of the Russian Federation.

Services of freight transportation as well as related works and services (except for services rendered with respect to goods under the customs regime of international customs transit) are deemed to be rendered on the territory of Russia if (i) the executor (transporter, forwarder, etc.) is a Russian company; and (ii) departure point and/or destination point of transportation are located in Russia. Thus, *transportation and related services rendered by Russian companies outside of the Russian territory as well as such services rendered by foreign companies on the territory of Russia are not subject to Russian VAT.*

As for the applicable VAT rate, art. 164 (1.1) of the Russian Tax Code stipulates that a 0% VAT rate applies to operations related to *goods exported under the export customs regime as well as of goods under the free customs zone customs regime*. Moreover, this rate applies to the performance of works and services connected directly with the production and realisation of such goods.

In addition, the second paragraph of art. 164 (1.2) of the Tax Code establishes that the above rules extend to the following works and services:

- transportation;
- organisation and escort of transportation;
- organisation, escort, loading and reloading; and
- other similar works and services.

Such works and services must relate to goods exported outside the territory of Russia or imported into the Russian territory and must be performed by Russian companies (excluding railway transporters) or individual entrepreneurs.

In practice these two main provisions regulated by the one art. 164 of the Russian Tax Code and representing a complex legal norm create controversies in their interpretation. Two explanations are possible:

1. Based on a literal interpretation, we can conclude that the 0% VAT rate applies only to works and services of transportation, organisation, escort, loading and reloading of goods exported outside the territory of Russia *under the export customs regime* or exported/imported *under the free customs zone customs regime*.
2. Based on a broader interpretation we may assume that the 0% rate applies to works and services of organisation, escort, loading and reloading of *all kinds of goods exported outside the Russian territory or imported to Russia*.

Obviously, both interpretations may be advantageous depending on the category of company. This contradiction has provoked numerous disputes between taxpayers and tax authorities and has brought about inconsistencies in the positions of the Russian courts and the Ministry of Finance, as follows.

Existing practice of Russian courts and authorities

Russian federal arbitration courts in several decisions¹ have acknowledged the right of taxpayers to apply a 0% VAT rate to the services of organisation and escort of transportations and other similar services rendered directly in respect of goods imported into the Russian territory or exported from the Russian territory regardless of the customs regime applicable to such goods. According to their position, the 0% rate may be applied by a taxpayer when filing (i) the relevant services agreement; (ii) statements of banks confirming the receipt of payment under the agreement; and (iii) copies of transport, shipping and other documentation confirming export/import of goods. These are filed with the relevant tax authorities within 180 calendar days from the date of export/import.

Such interpretation was upheld by the Presidium of the Russian Supreme Arbitration Court².

Moreover, the Ministry of Finance has equally supported this position and has supplemented it by indicating that the application of such 0% VAT rate should constitute the obligation (and not the right) of the taxpayer³.

On the other hand, according to the opposite interpretation (supported, however, only by court practice⁴ and not by the Ministry of Finance⁵ and the tax authorities), as the two paragraphs of art. 164 of the Russian Tax Code must be regarded as a unique legal construction regulating a complex of legal relationships, the provisions in question apply only to transportation and related services rendered in respect of goods under the export and the free customs zone customs regimes. Consequently, a general 18% VAT rate should apply to services with respect to goods which are not subject to the indicated customs regimes.

Interestingly, this position has also been supported by the Russian Supreme Arbitration Court⁶.

Obviously, such discrepancies of the courts' rulings (including the Supreme Arbitration Court) have adversely affected the consistency and uniformity of judgments and ultimately attracted the attention of the Supreme Arbitration Court in August 2009⁷. As a result, the **Presidium of the Supreme Arbitration Court** has adopted a **Decree dated 8 December 2009 No. 8133/09** (hereinafter – the “**Decree**”) which summarised the existing positions and set out a unified approach to the issue in question.

Newly defined position of the Russian Supreme Arbitration Court

In the particular case examined by the Presidium of the Supreme Arbitration Court, the tax authorities had refused the recovery from the state budget of VAT paid by the client to its contracting party with respect to services of unloading, storage and transportation of goods imported into Russia and had indicated that a 0% VAT rate should apply to such services according to the art. 164 (1.2) of the Russian Tax Code.

The Presidium overturned the relevant decision of the tax authorities explaining in the Decree that the services in question are VAT chargeable *at the 18% rate since they are not related to goods under the export and the free customs zone customs regimes*.

In conclusion, transportation and related services may be subject to the 0% rate only if they are related to goods exported outside the Russian territory under the export customs regime or exported/imported under the free customs zone regime and, as such, a literal interpretation of art. 146 of the Russian Tax Code must be used in practice according to the Decree. A general 18% VAT rate must be applied to all other works and services of this kind.

¹ Rulings of the Federal Arbitration Court of Moscow region dated 14 July 2008 No. KA-A40/5756-08, dated 7 June 2008 No. KA-A40/4868-08, Ruling of the Federal Arbitration Court of Povolzhskiy region dated 20 January 2009 No. A55-5304/2008, etc.

² Decrees of the Presidium of Russian Supreme Arbitration Court dated 20 June 2006 No. 14555/05, dated 4 April 2006 No. 14240/05.

³ Letters of the Russian Ministry of Finance dated 25 July 2008 No. 03-07-08/187, dated 12 April 2007 No. 03-07-08/76.

⁴ See, for example, Rulings of the Federal Arbitration Court of North-West region dated 21 October 2008 No. A56-49125/2007, dated 9 June 2008 No. A56-10390/2007, etc.

⁵ See, for example, Letters of the Russian Ministry of Finance dated 15 December 2009 No. 03-07-08/251, dated 3 December 2009 No. 03-07-08/246, dated 30 October 2009 No. 03-07-08/220.

⁶ Decisions of the Supreme Arbitration Court dated 28 May 2008 No. 6635/08, dated 7 May 2008 No. 5828/08.

⁷ Decision of the Supreme Arbitration Court dated 18 August 2009 No. VAS-8133/09.

We hope that in the context of the formation of a quasi-precedent system in Russia the Decree will represent a step to systematisation of the Russian courts' positions. According to Russian legislation, the interpretations of Russian laws by the Presidium of the Supreme Arbitration Court are not considered to be legally binding rules. They are, though, deemed *obligatory for all courts of the Russian Federation*. Consequently, even if the tax authorities continue in future to refuse the VAT recovery for companies working with Russian transporters, exporters etc. due to the reasons explained above the possibility for positive court rulings for taxpayers challenging such decisions of the tax authority is now greatly increased.

CMS can offer you the following assistance:

- Audit of your current contractual strategy with transporters, forwarders and others as well as advice on choosing the most suitable and efficient contractual instruments
- Pre-deal and transaction structuring services
- Draft and/or review of your agreements (for transportation and related services and other) and assistance in negotiations to achieve more favourable terms
- Audit of existing or contemplated expenses in view of tax planning
- Representation of your company in disputes with tax authorities and/or contracting parties

If you have any questions on the matters referred to in this RUSSIA TAX OUTLOOK, please do not hesitate to contact Dominique Tissot, Partner, and Anastasia Prozor, Associate, or your regular contact at CMS, Russia.

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