

Discounts, bonuses, marketing and advertising events – typical tax issues

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Discounts, bonuses, marketing and advertising actions – key tax issues

1. Discounts and bonuses for dealers
2. Joint advertising campaigns
3. Marketing events: motor shows, events for journalists and business partners

1. Discounts and bonuses for dealers

Definition of discounts and bonuses

- Discounts and bonuses are not defined in the legislation
- In contracts – various types of incentives
- Tax treatment of discounts and bonuses by the buyer – the law is silent
- Remaining uncertainty in the tax treatment of discounts and bonuses by the seller
- No certainty – tax risks

1. Discounts and bonuses for dealers

Main types of incentives:

- Change of sales price retrospectively (retro-discounts)
- Change of current or future price (on-invoice discounts)
- Incentive payments (without change of sales prices) for meeting certain conditions set in contracts (volume of sales, early payment, etc) (bonuses)
- Service fees

1. Discounts and bonuses for dealers

Retro discounts:

- Legally – change of price for goods sold. If goods have been already paid – risk that the price can not be changed
- Least recommendable option from the tax point of view:
 - Credit-notes – not envisaged by the law
 - Period of accounting for a discount – not clear
 - If price cannot be changed – tax risks
 - Provision of discount should be justified

1. Discounts and bonuses for dealers

Retro discounts – practice (for the seller):

Claims of the tax authorities:

- Period of accounting for a discount, Articles 54, 81 of the Russian Tax Code (TC)
- Credit-notes
- Debt forgiveness
- Economic justification
- Market level of price (Article 40 of the TC)

Court practice:

- Provision of discount – stand-alone operation, should be supported by separate documents
- Discount should be accounted in the current period (no corrections in previous periods). Articles 54, 81 of the Russian Tax Code are not applicable.

Resolution of the Federal Arbitration Court of the Moscow Region of 25.06.08 №KA-A40/5284-08

Resolution of the Federal Arbitration Court of the North-West Region of 14.08.08 re №A56-1302/2006

1. Discounts and bonuses for dealers

Retro discounts – practice (for the buyer):

Position of the tax authorities:

- Expense related to previous periods

Court practice:

- No price change, this payment is income of the current period
- No grounds to apply Article 54 of the TC (no mistakes were made)
- First instance – followed position of the tax authorities, the Appeal instance and Cassation - supported position of the taxpayer

Resolution of the Federal Arbitrage Court of the North-West region of 20.02.09 №A13-792/2008

1. Discounts and bonuses for dealers

On-invoice discounts:

- Method of the price formation for current and future supplies
- Possibility to grant a discount should be provided in the contract (Article 424 of the Russian Civil Code)
- Transfer pricing
- Provision of discounts - does it always require an explanation?

1. Discounts and bonuses for dealers

On-invoice discounts - practice:

Claims of the tax authorities:

- Debt forgiveness
- Economic justification
- Market level of price (Article 40 of the TC)

Court practice:

- Courts consider arguments of the tax authorities, but support taxpayers
(Resolution of the Federal Code of Arbitrage of the Moscow Region of 11.09.08 №КА-А41/8495-08-П)

1. Discounts and bonuses for dealers

Bonuses:

- Incentive payments for meeting certain targets set in contract (no price change)
- Do not represent payment for services rendered
- Non-sales expense (sp.19.1 p.1 Article 265 of the TC)
- Bonus should be justified
- What if bonus is paid to a third party, ie not to the buyer?
- VAT treatment of bonuses (Letter of the Russian Ministry of Finance №03-07-15/112 of 26.07.07)

1. Discounts and bonuses for dealers

Bonuses – court practice

Claims of the tax authorities:

- Economic justification
- Documentary support
- Change of price? Period of recognition?
- Payment for services? VAT?
- Debt forgiveness? Free of charge transfer of property?

Court practice:

- Consignment notes and VAT invoices should not be corrected
- No free of charge transfer of property
- Documents confirming that bonus criteria are met are available

Resolution of the Federal Arbitrage Court of the Moscow Region of 20.06.08 №A52-5014/2007, Resolution of the Federal Arbitrage Court of the North-West region of 9.03.06 № A56-13538/2005, Resolution of the Federal Arbitrage Court of the North-West region of 2.05.06 №A56-30073/2005

1. Discounts and bonuses for dealers

Incentives - reasons for their provision

- Different grounds in practice
- Discount or bonus? – may depend on the type of the marketing campaign
- Certain grounds – tax risks
 - Bonuses to dealers, but for meeting criteria not directly related to our sales (for example, volume of retail sales)
 - Reimbursements
 - Bonuses for meeting criteria resembling services
 - Payment of bonuses to third parties (not our buyers)

Is there any possibility to avoid these risks?

2. Joint advertising campaigns

Options for structuring:

- Agency agreement, OEM – dealer
- Advertising services agreement, OEM – dealer
- Multi-party agreement, OEM – dealer – advertising agency
- Increase of price of goods (OEM bears advertising expenses)
- Decrease of price of goods (dealer bears advertising expenses)
- Do nothing (no cost sharing)

2. Joint advertising campaigns

Agency agreement, OEM – dealer (OEM operates as an agent):

- Risk that a principal must compensate to an agent expenses in full (Civil Code)
- Significant amount of dealers - administrative burden (documentation)
- How to justify split of advertising costs (exact percentage)?

2. Joint advertising campaigns

Advertising service agreement, OEM – dealer:

- More often in practice
- No legal obstacles
- Significant amount of dealers - administrative burden (documentation)
- How to justify split of advertising costs (exact percentage)?

2. Joint advertising campaigns

Multi-party agreement, OEM – dealer – advertising agency:

- Solves the problem of justification of split of costs
- Solves the problem of administrative burden (documentation) – the problem is pushed to advertising agency
- Therefore, difficult to implement in practice

2. Joint advertising campaigns

Reduction / Increase of sales price:

- Hidden compensation of advertising costs
- Transfer pricing issues
- Not one-off payment; requires administering

2. Joint advertising campaigns

Do nothing (no cost sharing)

- Commonly used in practice
- The majority of tax authorities' challenges is associated with this option

“+” Resolution of the Federal Arbitrage Court of the North Caucasian Region of 17.01.08 №Ф08-8934/07-353А,
Resolution of the Federal Arbitrage Court of the North Caucasian Region of 06.12.07 № Ф08-8070/07-3001А

2. Joint advertising campaigns

Practice:

Challenges of tax authorities:

- Advertising of another taxpayer's activity
 - Extensive court practice – both positive and negative
- No rights to use advertised brand
 - Ministry of Finance Letter of 26.03.08 № 03-03-06/2/28
 - Courts support position of taxpayers
 - It is important to prove that taxpayer's activity was advertised

2. Joint advertising campaigns

Court practice (1 of 2):

Advertising of another taxpayer's activity

- «+» Resolution of the Federal Arbitrage Court of the North-West Region of 04.06.2008 № Ф04-3448/2008(6074-A03-40), Resolution of the Federal Arbitrage Court of the North-West Region of 14.01.2008 № Ф04-15/2008(378-A45-40), Resolution of the Federal Arbitrage Court of the Moscow Region of 12.02.2007 (15.02.2007) № KA-A40/249-07, Resolution of the Federal Arbitrage Court of the Moscow Region of 24.11.2006 (01.12.2006) № KA-A40/11515-06, Resolution of the Federal Arbitrage Court of the North-West Region of 02.11.2006 № A56-27732/2005, Resolution of the Federal Arbitrage Court of the East-Siberian Region of 05.05.2006 № A33-32109/04-C3-Ф02-2023/06-C1, Resolution of the Federal Arbitrage Court of the North-West Region of 17.08.2004 № A56-43525/03
- «-» Resolution of the Federal Arbitrage Court of the North-West Region of 04.03.2009 № Ф04-3014/2008 (1784-A46-37), Resolution of the Federal Arbitrage Court of the Moscow Region of 08.02.2008 № KA-A40/14488-07-2 (Definition of High Arbitrage Court of 23.06.2008 № 7268/08), Resolution of the Federal Arbitrage Court of the Moscow Region of 19.12.2007 № KA-A40/13055-07-П, Resolution of the Federal Arbitrage Court of the North-West Region of 01.06.2007 № A42-3310/2006, Resolution of the Federal Arbitrage Court of the North-West Region of 13.04.2007 № A56-4088/2006, Resolution of the Federal Arbitrage Court of the North-West Region of 11.04.2007 № A56-27762/2004, Resolution of the Federal Arbitrage Court of Volgo-Vyatsky Region of 15.09.2004 № A31-6609/7, Resolution of the Federal Arbitrage Court of Volgo-Vyatsky Region 13.10.2004 № A31-6851/7, Resolution of the Federal Arbitrage Court of the East-Siberian Region of 11.09.2003 № A33-18259/02-C3H-Ф02-2827/03-C1, Point 22 of Informational Letter of Presidium of High Arbitrage Court of 25.12.1998 № 37 «Overview of court practice related to application of advertising law»
- «//» Resolution of the Federal Arbitrage Court of the Moscow Region of 20.12.2007 № A40-65570/06-90-379, Resolution of the Federal Arbitrage Court of the Moscow Region of 15.06.2007 № KA-A40/5046-07-2 (Definition of High Arbitrage Court of 03.04.2008 № 3874/08)

2. Joint advertising campaigns

Court practice (2 of 2):

- **No rights to use advertised brand**

«+» Resolution of the Federal Arbitrage Court of the North-West Region of 27.12.2006 № A56-52006/2005,
Resolution of the Federal Arbitrage Court of the Moscow Region of 18.11.2003 г. № KA-A40/9281-03

«-» Resolution of the Federal Arbitrage Court of the Moscow Region of 26.06.2007 (28.06.2007) № KA-A40/5989-07

3. Marketing events

Participation of journalists and business partners in marketing events – related costs

Possible classification of expenses:

- Business entertainment expenses
- Advertising expenses
- Other expenses
- Non-deductible expenses

3. Marketing events

Participation of journalists and business partners in marketing events – related costs

- No extensive court practice and clarifications
- Court practice - deductible as business entertainment expenses (mainly transportation costs and accommodation of journalists), participation of business partners
- Articles written by journalists – not advertising
- Positive clarifications of Ministry of Finance (press conferences) – deductible as advertising costs or as other expenses
- Entertainment – low chances to sustain

3. Marketing events

Participation of journalists and business partners in marketing events – related costs

Court practice:

- **Transportation costs and accomodation of journalists = business entertainment**

«+» Resolution of the Federal Arbitrage Court of the Central Region of 12.01.2006 № A62-817/2005, Resolution of the Federal Arbitrage Court of the Povolzhsky Region of 16.03.06 № A72-5629/05-6/435, Resolution of the Federal Arbitrage Court of the North-West Region of 28.11.05 № A42-7239/04-28

- **Events for business partners – justified**

«+» Resolution of the Federal Arbitrage Court of the Moscow Region of 13.03.2009 № KA-A40/1354-09, Resolution of the Federal Arbitrage Court of the North-Caucasian Region of 02.07.03 № Ф08-2313/2003-860А, Resolution of the Federal Arbitrage Court of the Moscow Region of 23.12.2004 № KA-A40/12097-04, Resolution of the Federal Arbitrage Court of the Moscow Region of 20.02.2008 № KA-A40/707-08-П

- **Articles written by journalists – not advertising**

Resolution of the Federal Arbitrage Court of the Moscow Region of 04.12.2006 № KA-A40/10794-06-П, Resolution of the Federal Arbitrage Court of the Moscow Region of 04.10.07 по делу N KA-A40/10197-07-П-1,2

- **Entertainment – low chances to sustain**

Resolution of the Arbitrage Court of Moscow of 13.10.2008 № A40-45314/08-117-151

3. Marketing events

Marketing events held abroad (motor shows, exhibitions)

- Usually represent HQ charges – extensive documentation support is necessary – proof of economic justification
- Connection with Russian business – proof is required
- Entertainment – low chances to sustain
- Participation of employees – may be deducted as business trip expenses

3. Marketing events

Marketing events held abroad (motor shows, exhibitions)

- Participation of employees – may be deducted as business trip expenses

«+» Resolution of the Federal Arbitrage Court of the Central Region of 16.02.09 № A54-1345/2008-C8

«-» Resolution of the Federal Arbitrage Court of the Moscow Region of 07.07.08 № A40-32260/07-75-17, Decision of Moscow Arbitrage Court of 03.10.08 №A40-42258/08-111-127, confirmed by Resolution of 9th Arbitrage Appeal Court of 16.12.08 № 09АП-15688/2008-AK, Decision of Moscow Arbitrage Court of 02.10.07 №A40-19454/07-80-68, Resolution of the Federal Arbitrage Court of the Moscow Region of 29.02.08 № A40-19454/07-80-68

- Participation of business partners, journalists

«+» Decision of Moscow Arbitrage Court of 07.05.08 №A40-12749/08-142-37, confirmed by Resolution of 9th Arbitrage Appeal Court of 31.07.08 №09АП-7885/2008-AK

Thank you!

Questions?

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